


CR 2016/10 - Income tax: Octagonal Resources Limited - scheme of arrangement and selective capital reduction

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Class Ruling

Income tax: Octagonal Resources Limited – scheme of arrangement and selective capital reduction

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📌 This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936, and
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All subsequent legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies are the ordinary shareholders of Octagonal Resources Limited (Octagonal) other than those shares held by Abbotsleigh and its associated shareholders (Gandel shareholders) who:

- are registered on the Octagonal share register on 15 February 2016 (Record Date) and were entitled to participate in the arrangement described in paragraphs 9 to 26 of this Ruling
- held their Octagonal shares on capital account at the time of cancellation of those shares
- were residents of Australia within the meaning of that expression in subsection 6(1) at the time of cancellation of their Octagonal shares, and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Octagonal shares.

(Note: Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them).

4. In this Ruling, a person belonging to this class of entities is referred to as 'participating Octagonal shareholders'.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 26 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- this Ruling may be withdrawn or modified.

Date of effect

8. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Background

10. Octagonal is a publicly listed Australian company, limited by shares.

11. As at 30 September 2015 Octagonal had a single class share capital structure consisting of 248,331,672 fully paid ordinary shares.

12. Prior to the scheme Abbotsleigh and its associated shareholders (Gandel shareholders) owned 41.24% of total ordinary shares on issue. Following completion of the scheme, all ordinary shares held by non-Gandel shareholders were cancelled and the Gandel shareholders owned 100% of the ordinary shares in Octagonal.

13. Prior to the scheme Octagonal owned 169,672,726 ordinary shares in A1 Consolidated Gold Limited (A1 Gold) which were acquired as part of the sale of Octagonal subsidiaries to A1 Gold that was completed in June 2015.

Cancellation of shares

14. Under a scheme of arrangement, Octagonal took steps to privatise the company by cancelling all ordinary shares other than those held by Gandel shareholders (Selective Capital Reduction).

15. The scheme was effected by the following steps:

- (a) A Supreme Court of Victoria hearing was held on 18 December 2015 to approve convening of shareholder meetings. A second Supreme Court of Victoria hearing was held on 5 February 2016 to approve the proposed scheme.

- (b) A Scheme Meeting of the ordinary shareholders of Octagonal, other than Gandel shareholders was held on 29 January 2016 at 10.04 am at which:
- a special resolution was passed in accordance with section 411 of the *Corporations Act 2001* to approve the scheme of arrangement between Octagonal and the Gandel shareholders.
- (c) A Non-Gandel Meeting of the ordinary shareholders of Octagonal, other than Gandel shareholders was held on 29 January 2016 at 10.41am at which:
- a special resolution was passed pursuant to sections 256B and 256C(2)(a) of the *Corporations Act 2001* to reduce the capital of Octagonal by cancelling all fully paid ordinary Octagonal shares held by participating Octagonal shareholders. A payment (Cancellation Payment) was approved to participating Octagonal shareholders.
- (d) A General Meeting of the ordinary shareholders of Octagonal was held on 29 January 2016 at 11am at which:
- a special resolution was passed pursuant to sections 256B and 256C(2)(a) of the *Corporations Act 2001* to reduce the capital of Octagonal by cancelling all fully paid ordinary Octagonal shares held by participating Octagonal shareholders for the Cancellation Payment.
 - an ordinary resolution was passed for the purposes of Chapter 2E of the *Corporations Act 2001* granting shareholder approval for Octagonal to facilitate the scheme transaction for the benefit of Gandel shareholders.

Cancellation Payment

16. The ordinary shares held by the non-Gandel shareholders were cancelled on 22 February 2016 (the Implementation Date).

17. Implementation of the court approved scheme included the Cancellation Payment being paid to the non-Gandel shareholders on 22 February 2016.

18. The Cancellation Payment comprised a cash payment of \$0.0055 per Octagonal share and an in-specie distribution of two A1 Gold shares for every five Octagonal shares held on the Record Date.

19. The market value of each A1 Gold share distributed to Octagonal shareholders pursuant to the scheme of arrangement was \$0.028 being the ASX listed price at close of business on the Implementation Date.

20. The Record Date for determining the entitlement to the Cancellation Payment was 15 February 2016.

21. The accounting entries to reflect the cash payment and in specie distribution by Octagonal were:

- \$2,611,779.71 debited to Octagonal's share capital account
- \$802,502.10 credited to cash, and
- \$1,809,277.61 credited to Investment in A1 Gold.

22. The purpose of the Selective Capital Reduction was to achieve a more efficient capital structure. Prior to the scheme, corporate costs of reporting and compliance were excessive. An unsustainable proportion of funds remained for the company's core business activities of in-ground exploration, and this situation needed to be urgently addressed.

Other matters

23. Octagonal confirms that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997, from any of its other accounts. The share capital account of Octagonal is not tainted within the meaning of section 197-50 of the ITAA 1997.

24. All Octagonal shareholders acquired their Octagonal shares on or after 20 September 1985.

25. The Cancellation Payment was debited against Octagonal's share capital account.

26. Octagonal has not historically declared or paid a dividend to shareholders, and does not anticipate paying a dividend to its shareholders in the foreseeable future based on its future financial projections.

Ruling

Cancellation Payment is not a dividend

27. The amount of \$0.0055 per share debited to share capital under the scheme is not considered a 'dividend' as defined by subsection 6(1).

28. The in-specie distribution of A1 Gold shares debited to share capital under the scheme is not considered a 'dividend' as defined by subsection 6(1).

The application of sections 45A, 45B and 45C

29. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the Selective Capital Reduction.

Capital gains tax

CGT event C2 – section 104-25 of the ITAA 1997

30. CGT event C2, in section 104-25 of the ITAA 1997, happened upon the cancellation of the Octagonal ordinary shares.

31. The participating Octagonal shareholders will make a capital gain when CGT event C2 happened if the capital proceeds for each Octagonal ordinary share are more than its cost base. They will make a capital loss if the capital proceeds are less than the share's reduced cost base (subsection 104-25(3) of the ITAA 1997).

Commissioner of Taxation

2 March 2016

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Cancellation Payment is not a dividend

32. The term 'dividend' is defined in subsection 6(1) and includes a distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution that is debited against an amount standing to the credit of the share capital account of the company.

33. As the Cancellation Payment was recorded as being wholly debited to Octagonal's share capital account, and the account is not tainted, the amount of \$0.0055 per share and in-specie distribution of A1 Gold shares will not be a dividend.

Anti-avoidance provisions will not apply

34. Section 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfranked dividend.

Section 45A

35. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the capital benefits than other shareholders (the Disadvantaged Shareholders) and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

36. Although there has been a 'provision of capital benefit' (as defined in subsection 45A(3)) to participating Octagonal shareholders under the Selective Capital Reduction, the capital benefit will be provided to all participating Octagonal shareholders in the same proportion as their shareholding. Furthermore, no amount of the Cancellation Payment is a dividend.

37. Therefore, the circumstances of the Selective Capital Reduction indicate that there will be no streaming of capital benefits to some shareholders and of dividends to other shareholders.

38. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies.

Section 45B

39. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, section 45B applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a))
- (b) under the scheme, a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)), and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose), of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

40. In the case of the Cancellation Payment, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, the requisite purpose of enabling the participating Octagonal shareholder to obtain a tax benefit – by way of a capital distribution – is not present.

41. Having regard to the relevant circumstances of the scheme, as listed under subsection 45B(8), it cannot be concluded that Octagonal entered into or carried out the scheme for a more than incidental purpose of enabling the Octagonal shareholders to obtain a tax benefit.

42. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies.

Section 45C

43. As the Commissioner will not make a determination under section 45A or 45B in relation to the scheme as described, section 45C will not apply to treat any part of the capital benefit as an unfranked dividend for the purposes of the ITAA 1936 or the ITAA 1997.

CGT consequences

CGT event C2 – section 104-25 of the ITAA 1997

44. Under paragraph 104-25(1)(a) of the ITAA 1997 CGT event C2 happens if a taxpayer's ownership of an intangible CGT asset ends because it is redeemed or cancelled. CGT event C2 happens upon the cancellation of the Octagonal shares (subsection 104-25(2) of the ITAA 1997).

45. A taxpayer will make a capital gain when CGT event C2 happens if the capital proceeds received are more than the cost base of the share. A taxpayer will make a capital loss if the capital proceeds are less than the asset's reduced cost base (subsection 104-25(3) of the ITAA 1997).

46. If the Octagonal share was originally acquired by a participating Octagonal shareholder at least 12 months before the Implementation Date, a capital gain from CGT event C2 happening to the share may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

47. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds are the cash payment of \$0.0055 plus the market value of the A1 Gold shares received under the scheme of arrangement at the time of the Cancellation Payment (subsection 116-20(1) of the ITAA 1997).

Cost base and time of acquisition of A1 Gold shares

48. The first element of the cost base and reduced cost base of the A1 Gold shares acquired by a participating Octagonal shareholder is the market value of the A1 Gold shares at the time of the Cancellation Payment (subsection 112-20(1) of the ITAA 1997).

49. Under section 109-5 of the ITAA 1997, the participating Octagonal shareholder acquired their A1 Gold shares at the time of the Cancellation Payment.

Examples

Capital Gain

50. A participating Octagonal shareholder who invested \$20,000 by purchasing 2,000,000 Octagonal shares at \$0.01 per share has their Octagonal shares cancelled on the Implementation Date.

51. The shareholder's cost base and reduced cost base is \$20,000 (2,000,000 ORS shares at \$0.01 per share).

52. On the Implementation Date, the market value of each A1 Gold share was \$0.028. On the Implementation Date, the shareholder received cash of \$11,000 and 800,000 A1 Gold shares (two A1 Gold shares for every five Octagonal shares held) in respect of the cancellation of their 2,000,000 Octagonal shares. The total market value of the 800,000 A1 Gold shares was \$22,400.

53. The shareholder will make a capital gain of \$13,400, being equal to the aggregate of the cash received (\$11,000) and market value of 800,000 A1 Gold shares (\$22,400) less the total cost base (\$20,000).

54. The capital gain may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Capital Loss

55. A participating Octagonal shareholder who invested \$25,000 by purchasing 500,000 Octagonal shares at \$0.05 per share has their Octagonal shares cancelled on the Implementation Date.

56. The shareholder's cost base and reduced cost base is \$25,000 (500,000 ORS shares at \$0.05 per share).

57. On the Implementation Date, the market value of each A1 Gold share was \$0.028. On the Implementation Date, the shareholder received cash of \$2,750 and 200,000 A1 Gold shares (two A1 Gold shares for every five Octagonal shares held) in respect of the cancellation of their 500,000 Octagonal shares. The total market value of the 200,000 A1 Gold shares was \$5,600.

58. The shareholder will make a capital loss of \$16,650, being equal to the aggregate of the cash received (\$2,750) and market value of 200,000 A1 Gold shares (\$5,600) less the total reduced cost base (\$25,000).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(8)
 - ITAA 1936 45C
 - ITAA 1997
 - ITAA 1997 104-25
 - ITAA 1997 104-25(1)(a)
 - ITAA 1997 104-25(2)
 - ITAA 1997 104-25(3)
 - ITAA 1997 109-5
 - ITAA 1997 112-20(1)
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25(1)
 - ITAA 1997 116-20(1)
 - ITAA 1997 197-50
 - ITAA 1997 Div 230
 - ITAA 1997 975-300
 - Corporations Act 2001
 - Corporations Act 2001 256B
 - Corporations Act 2001 256C(2)(a)
 - Corporations Act 2001 411
 - Corporations Act 2001 Ch 2E
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ATO references

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