

CR 2016/4 - Income tax: CMI Limited - return of share capital

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Class Ruling

Income tax: CMI Limited – return of share capital

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	7
Scheme	8
Ruling	37
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	42
Appendix 2:	
Detailed contents list	73

ⓘ 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
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-135 of the ITAA 1997, and
- section 855-10 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this ruling applies is the holders of ordinary shares in CMI Limited (CMI) who:

- Are registered on the CMI share register on 8 December 2015 (the Record Date)
- Are entitled to participate in the return of capital
- Hold their CMI shares on capital account, and
- Are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to the gains and losses on their CMI 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)

In this ruling, a person belonging to this class of entities is referred to as a 'CMI shareholder'.

Qualifications

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

5. 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 8 to 36 of this Ruling.

6. 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

7. 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 in 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

8. 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

9. CMI is an Australian resident company whose shares have been listed on the Australian Securities Exchange (ASX) since 22 April 1993.

10. CMI Operations Pty Ltd (CMI Electrical) is a wholly owned subsidiary of CMI.

11. CMI carries on operations through CMI Electrical which include design, manufacture, marketing and distribution of specialist electrical cables and components for industrial and mining applications.

Purchase of TJM

12. On 20 September 1999, CMI raised \$13m of capital.

13. On 30 September 1999 CMI used \$7.822 million of the \$13m of capital raised to acquire 100% of the shares in TJM Products Pty Ltd (TJM).

14. CMI funded the acquisition of TJM via cash of \$5.447m and the issue of ordinary shares in CMI with a value of \$2.375 million.

15. CMI carried on operations which included manufacture, marketing and distribution of accessories and parts for the 4WD, SUV and Trade market segments through TJM from 30 September 1999 to 2 March 2015.

16. In the year ended 30 June 2002, CMI raised capital of \$15.356m and advanced loans to TJM.

17. In the year ended 30 June 2005, CMI raised capital of \$13.895m and advanced loans to TJM.

18. Over the years, TJM repaid some loans to CMI. At the time of the sale of TJM loan/s were owing to CMI.

Sale of TJM

19. TJM had a loss of \$2.3m for the 2013 income year and a loss of \$3.8m for the 2014 income year. At the time of the sale of all of TJM's ordinary shares TJM also had a loss of \$0.365m for the 2015 income year.

20. In October to December 2014, CMI conducted a strategic review of the loss-making TJM business.

21. On 19 December 2014, following the strategic review, CMI announced they would be divesting TJM. CMI announced that the funds could be used to finance profitable acquisitions which would have better synergies with CMI Electrical.
22. On 24 February 2015, CMI announced that it had entered into a binding Share Sale Agreement (SSA) for the sale and purchase of 100% of the issued shares in TJM. The sale of TJM was subsequently completed on 2 March 2015.
23. A condition of the sale under the SSA was that to the extent the amount outstanding under the loan/s from CMI to TJM was not repaid CMI was obligated to immediately forgive the loan/s before completion of the sale. TJM repaid an amount of the loan/s immediately prior to completion.
24. Notwithstanding the loan repayment by TJM, the amount outstanding under the loan/s remained payable to CMI. This was forgiven by CMI in February 2015, immediately prior to the sale of shares in TJM.
25. TJM's net assets on 2 March 2015 were \$21 million. The sale price was \$21.7m after balance sheet adjustments.

Return of capital

26. As of 16 September 2015, CMI had 34,852,634 ordinary shares on issue. 85,676 of those ordinary shares were held by non-residents.
27. More than 50% of the market value of CMI's assets do not relate to real property situated in Australia.
28. The CMI Board notified shareholders in the notice of AGM on 26 October 2015 that they would return \$10.5 million of capital to CMI shareholders.
29. The return of capital was ratified by the AGM on 25 November 2015 and will be paid equally to each CMI shareholder who is registered on the CMI share register on the record date.
30. Each CMI shareholder received \$0.30 per share and no shares were cancelled. There was no change in either the number of CMI Limited shares on issue or the number of shares held by each CMI shareholder.
31. CMI has not previously returned capital to shareholders.
32. The CMI share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.
33. There are no CMI shareholders who hold pre-CGT shares in CMI.
34. The return of capital will be debited in full against CMI's share capital account and funded entirely by the cash proceeds of the sale of TJM. The journal entries to record the return of capital are:

DR Fully Paid Ordinary Shares	\$10,500,000	
CR Cash at Bank		\$10,500,000

Other

35. CMI regularly pays franked dividends bi-annually.
36. CMI paid dividends of \$0.03 per share and \$0.06 per share on 23 March 2015 and 18 September 2015 for the year ended 30 June 2015, which included 57% of the profit from the sale of TJM.

Ruling

Return of capital is not a dividend

37. The Return of capital that will be paid to CMI Shareholders will not be a dividend, as defined in subsection 6(1).

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

38. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies in relation to the return of capital received by CMI.

Capital gains tax (CGT) consequences***CGT event G1***

39. CGT event G1 (section 104-135 of the ITAA 1997) will happen when CMI pays the return of capital to a CMI Shareholder in respect of a CMI ordinary share they own at 8 December 2015 (Record Date) and continue to own at 22 December 2015 (Payment Date).

CGT event C2

40. CGT event C2 (section 104-25 of the ITAA 1997) will happen when CMI pays the return of capital to a CMI Shareholder in respect of a CMI ordinary share they own at the Record Date, but cease to own before the Payment Date.

Foreign resident shareholders

41. Foreign resident CMI shareholders disregard any capital gain or capital loss made from CGT event G1 and CGT event C2, if their CMI ordinary shares or right to receive the relevant return of capital is not 'taxable Australian property' under section 855-10 of the ITAA 1997.

Commissioner of Taxation13 January 2016

Appendix 1 – Explanation

ⓘ *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.*

Return of capital is not a dividend

42. 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.

43. 'Share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

44. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account, except for certain purposes, if it is tainted.

45. The return of capital will be recorded as being wholly debited to CMI's share capital account. As CMI's share capital account is not tainted within the meaning of section 197-50 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies. Accordingly, the return of capital of \$0.30 per share will not be a dividend as defined in subsection 6(1).

Application of sections 45A, 45B and 45C

46. Section 45A and 45B are two anti-avoidance provisions which, if they apply, allows the Commissioner to make a determination that section 45C applies to treat all or part of the return of capital amount received by CMI Shareholders as an unfranked dividend paid by the company out of profits.

Section 45A – streaming of dividends and capital benefits

47. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders (the Advantaged Shareholders) who derive a greater benefit from the receipt of capital than other shareholders (the Disadvantaged Shareholders) and it is reasonable to assume that the Disadvantaged Shareholders have received, or will receive, dividends.

48. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) is provided to CMI Shareholders, the circumstances of the return of capital indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders.

49. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the capital return.

Section 45B – scheme to provide capital benefits

50. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. Specifically, the provision applies where:

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

51. The arrangement involving the return of capital to CMI shareholders will constitute a scheme for the purposes of section 45B.

52. The return of capital will be recorded as a debit to CMI's share capital account and CMI shareholders will receive a distribution of share capital to the value of \$0.30 per share. Therefore, CMI shareholders will be provided with a capital benefit (paragraph 45B(5)(b)).

53. The meaning of 'obtaining a tax benefit' is defined in subsection 45B(9) as occurring where the amount of tax payable from the treatment of a return of capital distribution as a capital benefit under the CGT provisions would, apart from the operation of 45B, be less than the amount that would be payable if the distribution had instead been a dividend.

54. As a return of capital will generally result in a lesser amount of tax payable than a dividend, CMI shareholders will obtain a tax benefit.

55. Paragraph 45B(2)(c) sets out an objective purpose test for the Commissioner to consider having regard to the 'relevant circumstances' of the scheme as set out in subsection 45B(8).

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

57. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or a part, of the payment for the return of capital.

CGT Consequences

CGT event G1

58. CGT event G1 (section 104-135 of the ITAA 1997) happens when a company makes a payment to a shareholder in respect of a share they own and some or all of the payment (the non-assessable part) is not a dividend or an amount that is taken to be a dividend under section 47.

59. Accordingly, CGT event G1 will happen when CMI pays the return of capital to a CMI Shareholder in respect of a CMI share that they own at the Record Date (8 December 2015) and continue to own at the Payment Date (22 December 2015).

60. A CMI Shareholder will make a capital gain if the return of capital amount is more than the cost base of the shareholder's CMI share. The amount of the capital gain is equal to that excess (subsection 104-135(3) of the ITAA 1997).

61. If an Australian resident CMI Shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the CMI share is reduced to nil. An Australian resident shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(4) of the ITAA 1997).

62. If the return of capital amount is equal to or less than the cost base of the CMI share at the Payment Date, the cost base and reduced cost base of the ordinary share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

63. A capital gain made when CGT event G1 happens will be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided that the CMI share was acquired at least 12 months before the payment of the return of share capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Division are satisfied.

CGT event C2

64. CGT event C2 happens when the Distribution is paid to a CMI Shareholder that held the share at the Record Date but no longer owned the CMI share at the Payment Date (section 104-25 of the ITAA 1997).

65. The right to receive the Distribution is one of the rights inherent in a CMI share held at the Record Date. If, after the Record Date but before the Payment Date, a CMI Shareholder ceased to own a CMI share in respect of which the Distribution was payable, the right to receive the Distribution is retained by that shareholder and constitutes a separate CGT asset.

66. The right to receive the Distribution ended by the right being discharged or satisfied when the payment was made.

67. A CMI Shareholder makes a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right. The capital gain is equal to the amount of the excess. A CMI Shareholder makes a capital loss if the capital proceeds from the ending of the right are less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3) of the ITAA 1997).

68. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the return of capital paid by CMI (subsection 116-20(1) of the ITAA 1997).

69. The cost base of the CMI Shareholder's right to receive the return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by a CMI Shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happens to the share, for example, when the CMI Shareholder disposed of it after the Record Date.

70. Therefore, if the full cost base or reduced cost base of the CMI share was applied in working out a capital gain or capital loss made when a CGT event happens to that share, the right to receive the return of capital will generally have a nil cost base. As a result, the CMI Shareholder will generally make a capital gain equal to the amount of the return of capital.

71. As a right to receive the return of capital was inherent in the CMI share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997).

72. Accordingly, if the CMI share was acquired at least 12 months before the payment of the return of capital, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain may be eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997, provided other conditions of that Division are satisfied.

Foreign resident shareholders

73. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss made from a CGT event if:

- just before the CGT event happened, the entity is a foreign resident, or the trustee of a foreign trust for CGT purposes, and
- the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

74. Section 855-15 of the ITAA 1997 sets out when a CGT asset is 'taxable Australian property'.

Item 1	taxable Australian real property
Item 2	an indirect Australian real property interest not covered by item 5
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2, or 5
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3, and
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

75. Items 1 and 2 of the table in section 855-15 of the ITAA 1997 do not apply to CMI ordinary shares.

76. CMI ordinary shares held by a CMI shareholder who was a foreign resident are not an indirect Australian real property interest in CMI at the time the CGT event happened as the CMI ordinary shares do not pass the principal asset test (section 855-30 of the ITAA 1997).

77. Accordingly, a foreign resident, or the trustee of a foreign resident trust for CGT purposes, disregards a capital gain or capital loss made when CGT event G1 or CGT event C2 happened to their CMI ordinary share or right to receive the capital return under section 855-10 of the ITAA 1997 unless their share or right:

- had been used at any time by them in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997), or
- was covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Appendix 2 – Detailed contents list

78. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	7
Scheme	8
Background	9
Purchase of TJM	12
Sale of TJM	19
Return of capital	26
Other	35
Ruling	37
Return of capital is not a dividend	37
The application of sections 45A, 45B and 45C	38
Capital gains tax (CGT) consequences	39
<i>CGT event G1</i>	39
<i>CGT event C2</i>	40
<i>Foreign resident shareholders</i>	41
Appendix 1 – Explanation	42
Return of capital is not a dividend	42
Application of sections 45A, 45B and 45C	46
<i>Section 45A – streaming of dividends and capital benefits</i>	47
<i>Section 45B – scheme to provide capital benefits</i>	50
CGT Consequences	58
<i>CGT event G1</i>	58
<i>CGT event C2</i>	64
<i>Foreign resident shareholders</i>	73
Appendix 2 – Detailed contents list	78

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

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 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)(b)
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 - ITAA 1936 45B(2)(a)
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Income tax ~~ Capital management ~~ Assessability of distribution

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