


CR 2017/77 - Income tax: Dexus Funds Management Limited Capital Reallocation

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Class Ruling

Income tax: Dexu Funds Management Limited Capital Reallocation

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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.

Summary – 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 104-107A of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-107B of the ITAA 1997
- section 104-107C of the ITAA 1997
- section 104-107D of the ITAA 1997
- section 104-135 of the ITAA 1997

- section 110-25 of the ITAA 1997
- subsection 276-260(2) of the ITAA 1997
- Subdivision 276-C of the ITAA 1997
- Subdivision 276-D of the ITAA 1997
- Subdivision 713-C of the ITAA 1997
- section 855-10 of the ITAA 1997
- section 975-300 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the Unitholders who:

- (a) are registered on the DXS unit register on the Record Date for the return of capital
- (b) hold their units in Dexus Office Trust (DOT), Dexus Diversified Trust (DDF), Dexus Industrial Trust (DIT) and Dexus Operations Trust (DXO) on capital account, and
- (c) are not subject to the taxation of financial arrangement rules in Division 230 in relation to gains and losses on their DXS stapled securities.

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 28 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 2017 to 30 June 2018. The Ruling continues to apply after 30 June 2018 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

8. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for a Class Ruling received on 14 July 2017, and
- other correspondence, information and documents 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.

9. Dexus Funds Management Limited (DXFM) is the responsible entity of DIT, DDF, DOT and DXO.

10. DXS (which consists of four trusts (DOT, DDF, DIT and DXO)) trades on the Australian Securities Exchange as a single (quadruple) stapled security (ASX: DXS). DXS has been listed since 6 October 2004.

11. As at 31 December 2016, DXS had a market capitalisation of approximately \$8.5 billion. No single beneficial security holder held more than 10% of the voting rights in DXS. Approximately, 55% of DXS securities are held by non-residents (either directly or indirectly).

Previous capital reallocation

12. On 20 December 2011, DXS undertook a capital reallocation consisting of a return of trust capital by:

- DDF returning to all Unitholders \$0.0362 per unit (\$175 million in total), and
- DOT returning to all Unitholders \$0.0362 per unit (\$175 million in total).

13. These capital returns were compulsorily applied on behalf of each Unitholder as a further capital contribution in respect of existing units in:

- DIT, as to \$0.0362 per unit (\$175 million in total), and
- DXO, as to \$0.0362 per unit (\$175 million in total).

14. The capital raised by DIT and DXO in the 2011 Reallocation was used to repay debt owed to Dexus Finance Pty Limited (DXF).

The Transaction

15. On 24 October 2017, Unitholders approved the following transaction with the features set out below:

- (i) The capital reduction by DIT of approximately \$0.172 per unit. Consequently, the aggregate capital reduction would be \$175 million (**DIT Capital Distribution Amount**). The DIT Capital Distribution Amount will be debited to DIT's contributed equity account.
- (ii) The capital reduction of DXO of approximately \$0.172 per unit. Consequently, the aggregate capital reduction would be \$175 million (**DXO Capital Distribution Amount**). The DXO Capital Distribution will be debited to DXO's contributed equity account.
- (iii) DXO would increase their borrowing from DXF by \$175 million.
- (iv) DXF would repay \$175 million of the loan balance currently outstanding from DIT.
- (v) The DXO Capital Distribution Amount would be debited to the Contributed Equity of DXO.
- (vi) The subscription into DOT (**DOT Contribution**) of approximately \$0.344 per unit. Consequently, the aggregate capital contribution would be \$350 million (**DOT Contribution Amount**).
- (vii) The Capital Distribution Amounts would be set-off against the DOT Contribution Amount such that no cash would be received, or payable, by a DXS security holder, giving rise to **DOT Receivables**.
- (viii) The DOT Contribution Amount would be subscribed in respect of existing units in DOT. No new unit would be issued by DOT.
- (ix) DOT Receivables would not be re-lent to DXO immediately or shortly thereafter and would be transferred to DXF in repayment of amounts owed to DXF.

The effective date of this Transaction is 6 December 2017.

DXS

16. DXS's distribution policy is to distribute 70% of funds from operations. The distribution is allocated between DOT, DIT, DDF and DXO based on the relative size of each entity and the taxable income of each of the flow-through trusts in a given year of income.

DXO's financials

17. As at 31 December 2016, the equity accounts for DXO as per its consolidated statement of financial statement position were as follows:

Consolidated equity	\$237,985,000
Reserves	\$44,275,000
Retained profits	\$107,282,000

18. The net capital raised by DXO since the 2011 Capital Reallocation is \$39.1 million.

19. DXO's share capital account is not tainted for the purposes of the ITAA 1997.

20. At December 2016, DXO's gearing ratio was 33% and has decreased to approximately 23% in June 2017.

21. In respect of the year ended 30 June 2017, DXO paid a dividend of approximately \$50 million. DXO's franking account surplus after payment of this dividend is approximately \$23 million.

22. It is expected that DXO will pay dividends in the future, subject to the availability of franking credits and having regard to the taxable income of DIT, DOT and DDF.

Commercial rationale of the Transaction

23. The current and forecast gearing of DXO is less than many of its peers (being the 'corporate side' of stapled property trusts). This places DXO at a competitive disadvantage as DXO's competitors are able to report higher earnings as a result of greater deductible interest costs.

24. In parallel with the reduced requirements for capital in DIT and DXO, DOT requires additional capital for its business.

25. The Transaction would increase the gearing ratio for DXO and DIT and reduce the gearing ratio for DOT.

Other factors

26. DIT and DOT are both attribution management investment trusts for the purposes of section 276-10 of the ITAA 1997.

27. There is no expectation that DOT will make a capital return in the foreseeable future (other than regular tax deferred income distributions).

28. DIT and DXO both have a cash sweeping loan liability with DXF so that all income and proceeds of sales received by DIT or DXO are applied as a reduction in the loan balance; and purchases by DIT or DXO and interest charged by DXF are applied as an increase in the balance. It is not possible to state the proportion of debt and equity funding in each asset.

Ruling

DIT Capital Distribution Amount

29. There will be no determined member component in respect of the DIT Capital Distribution Amount for the purposes of Subdivision 276-C of the ITAA 1997.

30. The DIT Capital Distribution will be an AMIT cost base reduction amount for the purposes of section 104-107D of the ITAA 1997.

31. In the event that the AMIT cost base net amount exceeds the Unitholder's cost base in a DIT unit, CGT Event E10 in section 104-107A will be triggered such that a capital gain equal to that excess will arise. This capital gain will be disregarded pursuant to section 855-10 of the ITAA 1997 if the Unitholder is a non-resident and the DIT unit is not taxable Australian property.

DXO Capital Distribution Amount

32. The DXO Capital Distribution Amount will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

33. The cost base and reduced cost base in a DXO unit will be reduced by virtue of CGT event G1 in section 104-135 of the ITAA 1997 by the lesser of that cost base and the amount of the DXO Capital Distribution.

34. Pursuant to CGT event G1 in section 104-135, the Unitholder will make a capital gain if the amount of the DXO Capital Distribution exceeds the cost base of the unit, with the amount of the capital gain being equal to that excess. However, this capital gain will be disregarded pursuant to section 855-10 if the Unitholder is a non-resident and the DXO unit is not taxable Australian property.

DOT Contribution

35. The Unitholder's cost base and reduced cost base in a DOT unit will increase by the amount of the DOT Contribution pursuant to subsection 110-25(5) of the ITAA 1997.

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

36. The Commissioner will not make a determination under subsection 45A(2) or 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital return received by DXS Unitholders.

Commissioner of Taxation8 November 2017

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.*

DIT Capital Distribution Amount

37. The DIT Capital Distribution Amount, consisting of the aggregate of \$175 million, will be a return of capital debited to the contributed equity account of DIT. The return of capital will not form a part of the AMIT's trust component for an income year as defined in subsection 276-260(2) of ITAA 1997. No amount will be attributed to a Unitholder in respect of the DIT Capital Distribution. Accordingly, there will no determined member component in respect of the DIT Capital Distribution Amount for the purposes of Subdivision 276-D.

38. The term AMIT cost base reduction amount is defined in section 104-107D. Section 104-107D will be satisfied when the DIT Capital Distribution Amount is provided by the Trustee of DIT to the Unitholders and the criteria in CGT Event E10 are satisfied. The DIT Capital Distribution Amount will be an AMIT cost base reduction amount.

39. Where the AMIT cost base net amount of the income year exceeds the cost base or reduced cost base of the interest, the Unitholder will make a capital gain equal to the excess pursuant to CGT Event E10 in section 104-107A. However, section 855-10 has the effect that a capital gain made by a Unitholder from CGT Event E10 is disregarded if the Unitholder is a non-resident just before the CGT event and the DIT unit is not taxable Australian property.

DXO Capital Distribution Amount

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

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

42. Subsection 975-300(3) of the ITAA 1997 states that an account is generally taken not to be a share capital account if it is tainted. It is confirmed, in this case, that the share capital account is not tainted.

43. DXO, as the head company of a consolidated group, is deemed to be a company for all purposes of the Act by virtue of subdivision 713-C of the ITAA 1997. Accordingly, the contributed equity account in DXO is treated as DXO's share capital account for taxation purposes. In this case, the DXO Capital Distribution Amount will be debited to DXO's share capital account. As the share capital account of DXO is not tainted, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies. Accordingly, the DXO Capital Distribution Amount will not be a dividend as defined in subsection 6(1).

44. CGT event G1 in section 104-135 of the ITAA 1997 will happen in respect of the units in DXO at the time the DXO Capital Distribution Amount is provided to the Unitholders. Accordingly, pursuant to subsection 104-135(3), the DXO Capital Distribution Amount will have the following effect(s) on the Unitholders:

- the Unitholders will make a capital gain if the amount from the DXO Capital Distribution Amount is more than the cost base of the unit, with the amount of the capital gain being equal to that excess. The cost base and reduced cost base of the unit will be reduced to nil, or
- the amount from the DXO Capital Distribution is not more than the cost base of the unit, the cost base and the reduced cost base of the unit will be reduced by the amount.

45. However, any capital gain will be disregarded pursuant to section 855-10 if the Unitholder is a non-resident and the DXO unit is not taxable Australian property.

DOT Contribution

46. Subsection 110-25(5) provides:

The fourth element is capital expenditure you incurred:

- (a) The purpose or the expected effect of which is to increase or preserve the asset's value; or
- (b) That relates to installing or moving the asset.

The expenditure can include giving property: see 103-5

47. No new units in DOT will be issued. DOT will credit the DOT Contribution Amount to Contributed Equity in its accounts. In these circumstances, it is expected that the DOT Contribution Amount will increase the cost base and reduced cost base of each unit in DOT.

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

Section 45A

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

49. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 43A(3)(b) to include the distribution to the shareholder of share capital. In this case, DXO will provide its Unitholders with a 'capital benefit' when DXO makes the DXO Capital Distribution Amount to the Unitholders.

50. The capital benefit will be provided in the same proportion as each Unitholder's membership interests.

51. Accordingly, section 45A does not apply to the DXO Capital Distribution Amount and 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 DXO Capital Distribution Amount.

Section 45B

52. Section 45B of the ITAA 1936 applies where certain capital benefits are provided 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) of the ITAA 1936)
- 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) of the ITAA 1936), and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to 'obtain a tax benefit' (paragraph 45B(2)(c) of the ITAA 1936).

53. Under the scheme, a provision of capital benefit will be provided to the holders in the form of a DXO Distribution Amount in accordance with paragraph 45B(5)(b).

54. Pursuant to subsection 45B(9), it is likely that each Unitholder to which this ruling applies will obtain a tax benefit. The relevant tax benefit will be attributable to the return of capital being assessed under the capital gains tax (CGT) regime, rather than being assessed as a dividend under subsection 44(1).

55. Paragraph 45B(2)(c) requires the Commissioner to consider whether any part of the scheme was entered into for a purpose other than an incidental purpose, of enabling the Unitholders (the relevant taxpayers) to obtain a tax benefit. The conclusion as to purpose is to be obtained with regard to the 'relevant circumstances' of a scheme which includes the factors set out in subsection 45B(8).

56. Having regard to the relevant circumstances of the scheme, on balance, it is accepted that the return of capital will not be attributable to profits of DXO. The scheme has been carried out for genuine commercial reasons, being to increase DXO's gearing ratio to a level more comparable with its peers and to allow DOT to reduce its current gearing level whilst improving its ability to undertake further transactions. Having had regard to the relevant factors, it cannot be concluded that the Capital Reallocation scheme was entered into for a more than incidental purpose of enabling a taxpayer to obtain a tax benefit

57. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45 C applies to treat the whole, or any part of the return of capital as an unfranked dividend for the purposes of the ITAA 1936 or of the ITAA 1997.

Appendix 2 – Detailed contents list

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References

- Previous draft:*
- ITAA 1997 276-260(2)
 - ITAA 1997 104-107A
- Not previously issued as a draft
- ITAA 1997 104-107B
- Related Rulings/Determinations:*
- ITAA 1997 104-107C
 - ITAA 1997 104-107D
- TR 2006/10
- ITAA 1997 104-135
 - ITAA 1997 104-135(3)
- Legislative references:*
- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - 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(5)(b)
 - ITAA 1936 45B(8)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1936 177D
 - ITAA 1997
- ITAA 1997 110-25
 - ITAA 1997 110-25(2)
 - ITAA 1997 110-25(5)
 - ITAA 1997 276-C
 - ITAA 1997 276-D
 - ITAA 1997 276-10
 - ITAA 1997 276-260(2)
 - ITAA 1997 713-C
 - ITAA 1997 855-10
 - ITAA 1997 975-300
 - ITAA 1997 975-300(3)
 - TAA 1953
- Other references:*
- PS LA 2008/10
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ATO references

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- Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events G1 to G3 – shares
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