

CR 2018/51 - Income tax: Folkestone Limited - Scheme of Arrangement and Special Dividend



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Class Ruling

Income tax: Folkestone Limited - Scheme of Arrangement and Special Dividend

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① 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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provisions

2. The relevant provisions dealt with in this Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
 - subsection 44(1) of the ITAA 1936
 - section 128B of the ITAA 1936
 - section 128D of the ITAA 1936
 - Division 1A of former Part IIIAA of the ITAA 1936
 - former section 160APHN of the ITAA 1936
 - former section 160APHO of the ITAA 1936
 - paragraph 177EA(5)(b) of the ITAA 1936
 - section 67-25 of the *Income Tax Assessment Act 1997* (ITAA 1997)

- subsection 67-25(1DA) of the ITAA 1997
- section 104-10 of the ITAA 1997
- Division 115 of the ITAA 1997
- subsection 116-20(1) of the ITAA 1997
- section 202-40 of the ITAA 1997
- paragraph 204-30(3)(c) of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-35 of the ITAA 1997
- subsection 207-35(1) of the ITAA 1997
- section 207-145 of the ITAA 1997
- section 208-195 of the ITAA 1997.

All legislative reference in this Ruling are to provisions of the ITAA 1997 unless otherwise specified.

Class of entities

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

- are residents of Australia as defined in subsection 6(1) of the ITAA 1936
- are non-residents of Australia (other than non-residents who carry on a business at or through a permanent establishment in Australia)
- held their Folkestone shares on capital account, that is, did not hold their shares in Folkestone as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1))
- disposed of their Folkestone shares under the scheme described in paragraphs 9 to 22 of this Ruling and received Scheme Consideration (as described in paragraph 16 of this Ruling) for that disposal
- did not acquire their shares under an employee share plan (including any shares issued under the vesting of the Executive Incentive Plan)
- are not subject to the investment manager regime in Subdivision 842-I in relation to their Folkestone shares, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Folkestone shares.

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

4. In this Ruling, an entity belonging to this class of entities is referred to as a Scheme Shareholder.

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 22 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 2018 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 *Public Rulings*).

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.

Capitalised terms referred to in this Ruling are as defined in the ruling application and supporting documents.

Folkestone

10. Folkestone is an Australian incorporated company that was listed on the Australian Securities Exchange (ASX) from 14 June 2000 to 8 November 2018.

11. As at 13 September 2018 (the date of the Scheme Booklet), Folkestone had 148,368,964 ordinary shares on issue. Folkestone had no other classes of shares on issue.

12. As at 7 September 2018, Australian residents held approximately 99.6% of Folkestone ordinary shares.

Charter Hall Limited

13. Charter Hall Limited (Charter Hall) is an Australian incorporated company and a member of the Charter Hall Group. Charter Hall Group has been listed on the ASX since 10 June 2005.

Scheme of Arrangement

14. On 7 November 2018 (Implementation Date), a Scheme of Arrangement (Scheme) between Folkestone and its shareholders was implemented. The Scheme was approved by the Folkestone shareholders and approved by the Federal Court under section 411 of the *Corporations Act 2001*.

15. The Scheme resulted in Charter Hall acquiring all of the shares in Folkestone from the Scheme Shareholders who held their Folkestone shares as at 31 October 2018 (Scheme Record Date).

16. Scheme Shareholders received Scheme Consideration of \$1.39 per share comprising of:

- Scheme Cash Consideration of \$1.354 which was paid on 7 November 2018 (Implementation Date), and
- a fully franked Special Dividend of \$0.036 that was paid on 7 November 2018.

17. On 8 November 2018, shares in Folkestone were delisted from the ASX.

Special Dividend

18. On 21 August 2018, the Board of Directors of Folkestone determined a fully franked Special Dividend of \$0.036 per share held at 26 October 2018 (Special Dividend Record Date).

19. The payment of the Special Dividend was conditional on approval of the Scheme by Folkestone shareholders. On approval of the Scheme, the Special Dividend must be paid by Folkestone on or before the Implementation Date.

20. Folkestone funded the Special Dividend entirely from existing cash reserves and debited the amount against its retained earnings account. Charter Hall did not finance or facilitate financing for the payment of the Special Dividend.

21. The share capital account of Folkestone is untainted for the purposes of Division 197.

22. The Special Dividend complied with the requirements of the *Corporations Act 2001*, including section 254T of the *Corporations Act 2001*.

Ruling

Special Dividend

23. The Special Dividend paid to a Scheme Shareholder is a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

Assessability of the Special Dividend

Residents

24. A resident Scheme Shareholder includes the Special Dividend in their assessable income (subparagraph 44(1)(a)(i) of the ITAA 1936).

Non-residents not carrying on a business at or through a permanent establishment

25. A non-resident Scheme Shareholder (other than those carrying on business in Australia at or through a permanent establishment in Australia) does not include the Special Dividend in their assessable income under subparagraph 44(1)(b)(i) of the ITAA 1936 (section 128D of the ITAA 1936) and will not be liable for withholding tax (subparagraph 128B(3)(ga)(i) of the ITAA 1936).

Gross up and tax offset

26. The Special Dividend is a frankable distribution under section 202-40.

27. A Scheme Shareholder who received the Special Dividend directly and satisfies the residency requirements in section 207-75:

- includes the amount of the franking credit attached to the Special Dividend in their assessable income, and
- is entitled to a tax offset equal to the franking credit attached to the Special Dividend

in the income year the Special Dividend is paid (section 207-20) subject to being a 'qualified person' in relation to the Special Dividend.

28. A Scheme Shareholder (not being a corporate tax entity), who received the Special Dividend as a trustee of a trust (not being a complying superannuation entity) or as a partnership, subject to the trustee or the partnership being a qualified person, includes an amount equal to the franking credit attached to the Special Dividend in its assessable income (subsection 207-35(1)).

29. The relevant members of a partnership or trust to whom a distribution flows indirectly through the partnership or trust, are entitled to a tax offset under section 207-45, equal to their share of the franking credit attached to the distribution included in the assessable income of the partnership or trust under subsection 207-35(1).

Qualified persons

30. The payment of the Special Dividend constitutes a 'related payment' for the purposes of former section 160APHN of the ITAA 1936 (paragraph 207-145(1)(a)).

31. For the purposes of Division 1A of former Part IIIAA of the ITAA 1936, to be a 'qualified person' in relation to the Special Dividend, each Scheme Shareholder must have held their Folkestone shares 'at risk' for a continuous period of at least 45 days in the secondary qualification period (former section 160APHO of the ITAA 1936).

32. A Scheme Shareholder, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, will be a qualified person in relation to the Special Dividend, if during the period from 12 September 2018 to 30 October 2018 (inclusive), they held their Folkestone shares for a continuous period of at least 45 days (not counting the day on which the share was acquired or the day of the disposal of the share and not counting days they had, if any, a 'materially diminished risk of loss or opportunities for gain' (as defined under former section 160APHM of the ITAA 1936) in respect of their Folkestone shares).

Refundable tax offset

33. The franking credit tax offset a Scheme Shareholder is entitled to under Division 207 in relation to the Special Dividend is subject to the refundable tax offset rules in Division 67. Certain trustees and corporate tax entities are excluded from the refundable tax offset rules under section 67-25.

Exempting entity

34. Folkestone was not an 'exempting entity' when the Special Dividend was paid, nor was it a 'former exempting entity' at the time as less than 95% of accountable membership interests or accountable partial interests (broadly direct and indirect ownership interests) held in Folkestone were held by non-residents (Division 208).

35. Therefore, section 208-195 will not apply to deny the gross up of the assessable income of a Scheme Shareholder by the amount of the franking credits attached to the Special Dividend received by the Scheme Shareholders, nor to deny the tax offset to which the Scheme Shareholder is otherwise entitled under Division 207 at the time when the Special Dividend was paid.

The anti-avoidance provisions***Section 177EA***

36. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit in relation to the Special Dividend.

Section 204-30

37. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit received in relation to the Special Dividend.

Capital gains tax (CGT) consequences***CGT event A1***

38. CGT event A1 happened on 7 November 2018 (Scheme Implementation Date) when a Scheme Shareholder disposed of their Folkestone shares to Charter Hall in accordance with the Scheme (subsection 104-10).

Capital proceeds

39. The Scheme Consideration of \$1.39 for each Folkestone share is the capital proceeds from CGT event A1 happening to the share (subsection 116-20(1)).

40. The capital proceeds include the Special Dividend of \$0.036 as the Special Dividend was paid in respect of the CGT event happening.

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Capital gain or capital loss

41. A Scheme Shareholder will make a capital gain if the capital proceeds from the disposal of a Folkestone share exceed its cost base (subsection 104-10(4)). The capital gain is the amount of the excess.

42. A Scheme Shareholder will make a capital loss if the capital proceeds from the disposal of a Folkestone share are less than the reduced cost base of the Folkestone share (subsection 104-10(4)). The capital loss is the amount of the difference.

CGT anti-overlap provisions

43. A capital gain made by a Scheme Shareholder from CGT event A1 that happened to their Folkestone shares is reduced by the amount of the Special Dividend that is included in their assessable income under section 44 of the ITAA 1936 (section 118-20). This has the effect of reducing the capital gain (but not below zero) by the amount that is assessable under another provision.

44. A capital gain is not reduced by the amount of the franking credit (attached to the Special Dividend) that is included in their assessable income under section 207-20 (paragraph 118-20(1B)(b)).

Discount capital gain

45. If a Scheme Shareholder makes a capital gain from the disposal of a Folkestone share, they will be eligible to treat the capital gain as a 'discount capital gain' provided that they satisfy the requirements of Division 115.

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.*

Special Dividend

46. The term 'dividend' includes any distribution made by a company to any of its shareholders, whether in money or other property (subsection 6(1) of the ITAA 1936).

47. The payment of the Special Dividend was a distribution in money made by Folkestone to its shareholders.

48. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 excludes from the definition of 'dividend' any:

... moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

49. Folkestone sourced the Special Dividend from its retained earnings and Folkestone did not debit the Special Dividend against its share capital account. Therefore, in this case, the exclusion in paragraph (d) will not apply and the Special Dividend constitutes a 'dividend' for the purposes of subsection 6(1) of the ITAA 1936.

Assessability of the Special Dividend

Resident Scheme Shareholder

50. Subparagraph 44(1)(a)(i) of the ITAA 1936 includes in the assessable income of an Australian resident shareholder in a company:

...dividends (other than non-share dividends) that are paid to the shareholder by the company out of profits derived by it from any source;

51. Folkestone paid the Special Dividend to its shareholders out of profits derived by Folkestone. Accordingly, a Scheme Shareholder who is a resident of Australia is required to include the Special Dividend in their assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

Non-residents not carrying on business at or through a permanent establishment

52. Subparagraph 44(1)(b)(i) of the ITAA 1936 includes in the assessable income of a non-resident shareholder in a company:

...dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia;

53. Subsection 128B(1) of the ITAA 1936 imposes Australian withholding tax on income which:

- is derived, on or after 1 January 1968, by a non-resident, and
- consists of a dividend paid by a company that is a resident.

54. However, subparagraph 128B(3)(ga)(i) of the ITAA 1936 excludes from subsection 128B(1) income derived by a non-resident that consists of the franked part of a dividend. As the Special Dividend was fully franked, it will not be subject to Australian withholding tax when derived by a non-resident Scheme Shareholder.

55. In addition, section 128D of the ITAA 1936 operates to treat the Special Dividend as non-assessable non-exempt income.

56. Accordingly, non-resident Scheme Shareholders who received the fully franked Special Dividend (other than those carrying on business in Australia at or through a permanent establishment in Australia) are not required to include the dividend as assessable income under subparagraph 44(1)(b)(i) of the ITAA 1936 (section 128D of the ITAA 1936) and are not liable to Australian withholding tax in relation to the dividend (subparagraph 128B(3)(ga)(i) of the ITAA 1936).

Gross up and tax offset

57. A distribution is a frankable distribution to the extent it is not unfrankable (section 202-40). Section 202-45 sets out the circumstances under which an amount or distribution is taken to be unfrankable.

58. None of the circumstances in section 202-45 apply to the Special Dividend. Accordingly, the Special Dividend is a frankable distribution under section 202-40.

59. Subject to satisfying the qualified person rule, where the Special Dividends are received directly by a Scheme Shareholder and the shareholder satisfies the residency requirements in section 207-75, the Scheme Shareholder:

- is required to include the amount of the franking credits attached to the Special Dividend in their assessable income, and

- is entitled to a tax offset equal to the amount of the franking credits

in the income year in which the Scheme of Arrangement happened.

60. Subject to satisfying the 'qualified person' rule, a Scheme Shareholder (not being an entity taxed as a corporate tax entity) that is a trustee of a trust (not being a complying superannuation fund) or a partnership, is required to include the amount of the franking credit attached to the Special Dividend in their assessable income under subsection 207-35(1).

Qualified person, related payment rule and holding period requirement

Qualified person

61. An entity must be a 'qualified person' in relation to a dividend in order to be entitled to a tax offset in respect of the franking credit on a dividend (subsection 207-145(1)).

62. A partner in a partnership or a beneficiary of a trust cannot be a qualified person in relation to a dividend unless the partnership or the trustee of the trust is also a qualified person in relation to the dividend (former section 160APHU of the ITAA 1936).

63. Former Division 1A of Part IIIAA of the ITAA 1936 provides the statutory tests that must be satisfied for a taxpayer to be a 'qualified person' in relation to a franked distribution they have received and thus be entitled to a tax offset for the franking credit on the distribution.

64. The test of what constitutes a 'qualified person' is provided in former subsection 160APHO(1) of the ITAA 1936 as follows:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a qualified person in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, or is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of a taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

65. Broadly, if the Scheme Shareholders are not under an obligation to make a related payment in relation to a dividend or distribution, they will have to satisfy the holding period requirement within the primary qualification period. If the Scheme Shareholders are under an obligation to make a related payment in relation to a

dividend or distribution, they will have to satisfy the holding period requirements within the secondary qualification period.

Related payment rule

66. In order to determine what the relevant qualification period is, it is necessary to determine whether, under the present arrangement, a Scheme Shareholder has made, or is under an obligation to make, or is likely to make, a related payment in respect of any of the dividends they receive.

67. Former section 160APHN of the ITAA 1936 gives examples of, but does not limit, what constitutes the making of a related payment for the purposes of Division 1A of former Part IIIA of the ITAA 1936.

68. Former subsection 160APHN(2) of the ITAA 1936 states:

The taxpayer or associate is taken, for the purposes of this Division, to have made, to be under an obligation to make, or to be likely to make, a related payment in respect of the dividend or distribution if, under an arrangement, the taxpayer or associate has done, is under an obligation to do, or may reasonably be expected to do, as the case may be, anything having the effect of passing the benefit of the dividend or distribution to one or more other persons.

69. Former subsection 160APHN(3) of the ITAA 1936 states:

Without limiting subsection (2), the doing of any of the following by the taxpayer or an associate of the taxpayer in the circumstances mentioned in subsection (4) may have the effect of passing the benefit of the dividend or distribution to one or more other persons:

- (a) causing a payment or payments to be made to, or in accordance with the directions of, the other person or other persons; or
- (b) causing an amount or amounts to be credited to, or applied for the benefit of, the other person or the other persons; or
- (c) causing services to be provided to, or in accordance with the directions of, the other person or other persons; or
- (d) causing property to be transferred to, or in accordance with directions of, the other person or other persons; or
- (e) allowing any property or money to be used by the other person or other persons or by someone nominated by the other person or other persons; or
- (f) causing an amount or amounts to be set off against, or to be otherwise applied in reduction of, a debt or debts owed by the other person or other persons; or
- (g) agreeing to treat an amount or amounts owed to the other person or other persons by the taxpayer or associate as having been increased.

70. Former subsection 160APHN(4) of the ITAA 1936 states:

The circumstances referred to in subsection (3), are where:

- (a) the amount or the sum of the amounts paid, credited or applied; or
- (b) the value or the sum of the values of the services provided, of the property transferred or of the use of the property or money; or
- (c) the amount or the sum of the amounts of the set-offs, reductions or increases;

as the case may be:

- (d) is, or may reasonably be expected to be, equal to; or
- (e) approximates or may reasonably be expected to approximate; or
- (f) is calculated by reference to;

the amount of the dividend or distribution.

71. Under the terms of the Scheme, the Scheme Cash Consideration (paid by Charter Hall) is defined as the Scheme Consideration less the amount of the Special Dividend paid by Folkestone to the Scheme Shareholders. It is considered that the payment of the Special Dividend is an integral part of the Scheme.

72. The reduction of the Scheme Cash Consideration payable by Charter Hall has the effect of passing the benefit of the Special Dividend from a Folkestone Shareholder to Charter Hall. Therefore, a Scheme Shareholder, or a partner in a partnership or a beneficiary of a trust that has an interest in Folkestone shares, is taken to have made a related payment in respect of the Special Dividend.

Holding period requirement

73. Former paragraph 160APHO(2)(a) of the ITAA 1936 provides that:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid satisfies this subsection in relation to a qualification period in relation to the shares or interest if, during the period:

- (a) where the taxpayer held the shares – the taxpayer held the shares for a continuous period (not counting the day on which the taxpayer acquired the shares or, if the taxpayer has disposed of the share, the day on which the disposal occurred) of not less than:
 - (i) if the shares are not preference shares – 45 days; or
 - (ii) if the shares are preference shares – 90 days.

74. As the Folkestone shares are not preference shares, Scheme Shareholders are required to hold their shares for at least 45 days

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during the relevant qualification period (former paragraph 160APHO(2)(a) of the ITAA 1936).

75. As Scheme Shareholders are taken, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, to have made, or be likely to make, a related payment in respect of the Special Dividend, the relevant qualification period is the secondary qualification period under former paragraph 160APHO(1)(b) of the ITAA 1936.

76. Former section 160APHD of the ITAA 1936 defines the 'secondary qualification period' as follows:

...in relation to a taxpayer in relation to shares or an interest in shares, means:

- (a) if the shares are not preference shares – the period beginning on the 45th day before, and ending on the 45th day after, the day on which the shares or interest became ex dividend...

77. The concept of 'ex dividend' for this purpose is defined by former section 160APHE(1) of the ITAA 1936 as follows:

A share in respect of which a dividend is to be paid, or an interest (other than an interest as a beneficiary of a widely held trust) in such a share, becomes ex dividend on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

78. The eligibility for the Special Dividend was determined on the Special Dividend Record Date of 26 October 2018, being the last day on which acquisition by a person of a Folkestone share entitled the person to receive the Special Dividend as per former section 160APHE of the ITAA 1936. Accordingly, the ex-dividend date of a Folkestone share for the purposes of former subsection 160APHE(1) of the ITAA 1936 is 27 October 2018.

79. The secondary qualification period runs from 45 days before and ends on 45 days after the ex-dividend date of 27 October 2018. This means that the secondary qualification period would ordinarily run from 12 September 2018 to 11 December 2018. However, under former subsection 160APHO(3) of the ITAA 1936, any days on which a Scheme Shareholder has materially diminished risks of loss or opportunities for gain in respect of the Folkestone share is to be excluded.

80. It is considered that once a Folkestone shareholder is identified as a Scheme Shareholder on the Scheme Record Date (31 October 2018), that Scheme Shareholder would no longer be considered to hold their shares 'at risk' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936 because, at that time, the Scheme Shareholder is committed to disposing their Folkestone shares and receiving the Scheme Consideration. This means that as at and from 31 October 2018, Scheme Shareholders no longer held their Folkestone shares 'at risk'. The days from

31 October 2018 and onwards are not counted towards the 45 day holding period.

81. Accordingly, a Scheme Shareholder who received the Special Dividend would need to have held their Folkestone shares at risk for a continuous period of not less than 45 days during the period 12 September 2018 to 30 October 2018 in order to be a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936. Under former paragraph 160APHO(2)(a) of the ITAA 1936, the dates of acquisition and disposal of a Folkestone share are not included in the relevant 45 day period.

82. Each shareholder will need to determine whether they satisfy this holding period requirement having regard to their personal circumstances (which will require them to take into account any positions they may have entered into that has diminished their risk of loss or opportunity for gain in respect of their shares) and is outside the scope of this Ruling.

Refundable tax offset

83. An entity entitled to a tax offset in respect of the franking credit received (subsection 207-20(2)) will also be subject to the refundable tax offset rules in Division 67, unless specifically excluded under section 67-25.

84. There are a range of taxpayers specifically excluded from the operation of the refundable tax offset rules (section 67-25). These excluded entities include:

- non-complying superannuation funds or non-complying approved deposit funds (subsection 67-25(1A))
- trustees of a trust who is liable to be assessed under section 98 or 99A of ITAA 1936 (subsection 67-25(1B))
- corporate tax entities, unless the entity is an exempt institution that is eligible for a refund, or a life insurance company that has received distributions on membership interests which were not held by the company on behalf of its shareholders (subsection 67-25(1C) and 67-25(1D)), and
- non-resident entities carrying on business in Australia at or through a permanent establishment (subsection 67-25(1DA)).

85. Accordingly, unless specifically listed as an excluded entity under section 67-25, a Scheme Shareholder who received the fully franked Special Dividend is subject to the refundable tax offset rules.

86. Generally, excluded entities from the operation of the refundable tax offset rules are corporate tax entities (including companies, corporate limited partnerships, corporate unit trusts and public trading trusts).

Exempting entity

87. Division 207 does not apply to a distribution by an exempting entity unless it is expressly stated to apply under Subdivision 208-G (section 208-195).

88. A corporate tax entity is an exempting entity at a particular time if, at that time, the entity is effectively owned by prescribed persons (section 208-20). In broad terms, an entity is effectively owned by prescribed persons if not less than 95% of accountable membership interests or accountable partial interests (broadly direct and indirect ownership interests) are held by or on behalf of prescribed persons (subsection 208-25(1)).

89. The definition of a prescribed person in relation to another corporate tax entity includes companies, trustees, partnerships or individuals that are a foreign resident or if they were to receive a distribution by the corporate tax entity, the distribution would be exempt income or non-assessable non-exempt income of the company, trust estate, partnership or individual (sections 208-40 and 208-45).

90. Folkestone was not an exempting entity at the time the Special Dividend was paid to Scheme Shareholders, nor was it a former exempting entity at that time, as less than 95% of the accountable membership interests or accountable partial interests held in Folkestone were held by foreign residents (Division 208).

91. Therefore, section 208-195 does not apply to deny the gross up of the assessable income of a Scheme Shareholder by the amount of the franking credit attached to the Special Dividend received by that shareholder, nor to deny the tax offset to which the Scheme Shareholder is otherwise entitled pursuant to Division 207 at the time when the Special Dividend was paid.

Imputation benefits anti-avoidance provisions

Section 177EA

92. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes seeking to obtain a tax advantage in relation to imputation benefits. In essence, it applies to schemes for the disposition of shares, or an interest in shares, where a franked distribution is paid or payable in respect of a share or an interest in a share.

93. If section 177EA of the ITAA 1936 applies, the Commissioner may make a determination, under subsection 177EA(5) of the ITAA 1936, that either:

- a franking debit arises to the company in respect of each distribution paid to the relevant taxpayer (paragraph 177EA(5)(a) of the ITAA 1936), or

- alternatively, that no imputation benefits arises in respect of a distribution paid to the relevant taxpayer (paragraph 177EA(5)(b) of the ITAA 1936).

94. Subsection 177EA(3) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies if:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the person (the **relevant taxpayer**) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) 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 the relevant taxpayer to obtain an imputation benefit.

95. Folkestone is a corporate tax entity. The transfer of the shares in Folkestone under the Scheme is a scheme for the disposition of membership interests. The fully franked Special Dividend is a frankable distribution that was paid to Scheme Shareholders (the relevant taxpayers) as part of this scheme and who could, therefore, reasonably be expected to receive imputation benefits.

96. In this case, it is considered that the conditions of paragraphs 177EA(3)(a) to 177EA(3)(d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme (as provided in subsection 177EA(17)), it would be concluded that, on the part of Folkestone, its shareholders or any other relevant party, there is a purpose, more than merely an incidental purpose, of conferring an imputation benefit under the scheme.

97. To arrive at a conclusion, you must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed in subsection 177EA(17) of the ITAA 1936 encompass a range of diverse matters which, taken individually or in conjunction with other

matters, listed or not, could indicate the requisite purpose, that is, that the delivery of the imputation benefit is more than an incidental purpose of the scheme.

98. The relevant circumstances are that the disposition of the Folkestone shares was made as part of a takeover by Charter Hall by way of a scheme of arrangement under the *Corporations Act 2001* which was voted on by Folkestone shareholders who were entitled to vote.

99. Folkestone's scheme of arrangement is a normal commercial transaction regarding the acquisition of Folkestone shares.

100. The fully franked Special Dividend was paid to all Scheme Shareholders, which included a mix of residents and non-residents, in proportion to the number of shares that each of these shareholders held on the Special Dividend Record Date irrespective of their ability to utilise the relevant franking credits.

101. In considering the manner, form and substance of the Scheme, it is considered that the scheme is not being entered into by Folkestone or the Scheme Shareholders for more than an incidental purpose of enabling the Scheme Shareholders to obtain imputation benefits. The provision of imputation benefits to Scheme Shareholders remains incidental, in the sense of being subservient to, the purpose of transferring their shares to Charter Hall.

102. Having regard to the relevant circumstances of the Scheme, it cannot be concluded that Folkestone or the Scheme Shareholders entered into or carried out the Scheme for the purpose of enabling the Scheme Shareholders to obtain an imputation benefit.

103. Therefore, the Commissioner considers that the requisite purpose is not present and accordingly the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit to be received in relation to the Special Dividend.

Section 204-30

104. Section 204-30 applies where a corporate tax entity streams the payment of dividends (or the payment of dividends and the giving of other benefits) to its members in such a way that:

- (a) an *imputation benefit is, or apart from this section would be, received by a *member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a)), and
- (b) the member would *derive a *greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)), and
- (c) the other member of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c)).

105. Relevantly, if section 204-30 applies, the Commissioner has the discretionary power under subsection 204-30(3) to make a written determination.

106. Subsection 204-30(3) provides:

The Commissioner may make one or more of these determinations:

- (a) that a specified *franking debit arises in the *franking account of the entity, for a specified *distribution or other benefit to a disadvantaged member;
- (b) that a specified *exempting debit arises in the *exempting account of the entity, for a specified *distribution or other benefit to a disadvantaged member;
- (c) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination.

A determination must be in writing.

107. 'Streaming' is not defined for the purposes of section 204-30. However, paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002 provides that 'streaming is selectively directing the flow of franked distributions to those members who can benefit most from the imputation credits.'

108. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The phrase 'derive a greater benefit from franking credits' is defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

109. In this case, Scheme Shareholders that received the Special Dividend received an imputation benefit when the Special Dividend was paid. The imputation benefit for resident shareholders is in the form of a tax offset (paragraph 204-30(6)(a)) and for non-resident shareholders is in the form of not being liable to pay dividend withholding tax (paragraph 204-30(6)(e)). The resident shareholders may derive a greater benefit from franking credits than the non-resident shareholders.

110. However, Folkestone paid the Special Dividend equally to all Scheme Shareholders and the Special Dividend was fully franked regardless of the recipient's tax profile. Accordingly, it cannot be said that Folkestone selectively directed the flow of franked distributions to those members who could most benefit from the franking credits.

111. As the conditions in subsection 204-30(1) have not been met, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit received in relation to the Special Dividend.

Capital gains tax (CGT) consequences

CGT event A1

112. CGT event A1 happens if there is a change in the ownership of an asset from one entity to another (section 104-10). The time the event happens is either when a contract to dispose of the asset is entered into or, if there is no contract, when the change of ownership occurs (subsection 104-10(3)).

113. A court approved scheme of arrangement does not involve a disposal of shares under a contract (paragraph 9 of Taxation Determination TD 2002/4 *Income tax: capital gains: what is the first element of the cost base and reduced cost base of a share in a company you acquire in exchange for a share in another company in a takeover or merger?*).

114. Accordingly, the time when CGT event A1 happened was when a Scheme Shareholder disposed of a Folkestone share to Charter Hall on the Scheme Implementation Date of 7 November 2018 (paragraph 104-10(3)(b)).

115. The time when CGT event A1 happens determines the income year in which any capital gain or capital loss is made and whether the CGT discount applies to any capital gain.

116. A Scheme Shareholder makes a capital gain from CGT event A1 happening if the capital proceeds from the disposal of a Folkestone share is more than the cost base of that Folkestone share. A Scheme Shareholder makes a capital loss if those capital proceeds are less than the reduced cost base of the Folkestone share (subsection 104-10(4)). The cost base and reduced cost base of a Folkestone share depends on each Scheme Shareholder's circumstances.

Capital proceeds

117. The capital proceeds received by a person from a CGT event include the money and/or the market value of any property received or entitled to be received (worked out at the time of the event happening) in respect of the event happening (subsection 116-20(1)).

118. The capital proceeds that Scheme Shareholders received for the disposal of their Folkestone shares is the amount of Scheme Consideration received (\$1.39 per share).

119. The phrase 'in respect of the event happening' in subsection 116-20(1) requires the relationship between the event and the receipt of the money or property, or the entitlement to receive the money or property, to be more than coincidental. An amount is not capital proceeds received, or entitled to be received, in respect of a CGT event merely because it is received in association with the CGT event.

120. However, in this case, the determination of the Special Dividend did not occur independently of the Scheme. Payment of the

Special Dividend was contingent on the Folkestone shareholders approving the Scheme. Once the Scheme was approved, Folkestone was required to declare and pay the Special Dividend. In this way, the Special Dividend is part of the sum of money in return for which the Folkestone shareholders will have, by approving the Scheme of Arrangement, demonstrated their willingness to transfer their Folkestone shares (paragraph 11 of Taxation Ruling TR 2010/4 *Income tax: capital gains: when a dividend will be included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement*).

121. In this case, it is considered that the Special Dividend forms part of the capital proceeds which a Scheme Shareholder received in respect of CGT event A1 happening.

CGT anti-overlap provision

122. A capital gain made from CGT event A1 happening to their Folkestone shares is reduced by the amount of the Special Dividend that is included in their assessable income under section 44 of the ITAA 1936 (section 118-20). This has the effect of reducing the capital gain (but not below zero) by the amount that is assessable under another provision.

123. However, a capital gain is not reduced by the amount of the franking credit, which is attached to the Special Dividend, where it is included in the Scheme Shareholder's assessable income under section 207-20 (paragraph 118-20(1B)(b)).

Discount capital gain

124. If a Scheme Shareholder made a capital gain from the disposal of their Folkestone share, the Scheme Shareholder may be eligible to treat the capital gain as a discount capital gain provided that all relevant requirements of Division 115 are met.

125. One of those requirements is that the capital gain must result from a CGT event happening to a CGT asset that was acquired by the entity making the capital gain at least 12 months before the CGT event (subsection 115-25(1)).

126. This means that a capital gain made by a Scheme Shareholder when they disposed of their Folkestone share is a discount capital gain if the shareholder acquired the Folkestone share at least 12 months before the date of disposal under the Scheme, being the Scheme Implementation Date of 7 November 2018 and the other requirements in Division 115 are satisfied.

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NO: 1-G7F27A5
 ISSN: 2205-5517
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