

# ***CR 2020/72 - Hawthorn Resources Limited - return of share capital***



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## Class Ruling

### Hawthorn Resources Limited – return of share capital

#### **❶ Relying on this Ruling**

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

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#### **What this Ruling is about**

1. This Ruling sets out the income tax consequences for shareholders of Hawthorn Resources Limited (HRL) who received the return of share capital pursuant to the scheme detailed in this Ruling.
2. Full details of this scheme are set out in paragraphs 19 to 37 of this Ruling.
3. All legislative references in this Ruling are to provisions of the *Income Tax Assessment Act 1936* or the *Income Tax Assessment Act 1997* (as detailed in the table in Appendix 2 of this Ruling) unless otherwise indicated.

#### **Who this Ruling applies to**

4. This Ruling applies to you if you:
  - were registered on the HRL share register on 10 November 2020 (Record Date)
  - held your HRL shares on capital account, that is, you neither held your HRL shares as ‘revenue assets’ (as defined in section 977-50) nor as ‘trading stock’ (as defined in subsection 995-1(1)) on the Record Date, and
  - received the return of share capital of 2.469087 cents per HRL share.

5. This Ruling does not apply to you if you are subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 19 to 37 of this Ruling.

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

## When this Ruling applies

6. This Ruling applies from 1 July 2020 to 30 June 2021 (the income year in which the return of share capital to shareholders occurred).

## Ruling

### Return of share capital is not a dividend

7. No part of the return of share capital paid to you on 20 November 2020 (Payment Date) is a dividend as defined in subsection 6(1). This means you will not include any part of the return of share capital as assessable income under section 44.

### Sections 45A, 45B and 45C do not apply

8. The Commissioner will not make a determination under either subsection 45A(2) or paragraph 45B(3)(b) that section 45C applies to any part of the return of share capital HRL paid to you on the Payment Date.

### Capital gains tax (CGT) consequences

#### CGT event G1

9. CGT event G1 (section 104-135) happened to you when HRL paid you the return of share capital in respect of HRL shares you owned on the Record Date and you continued to own on the Payment Date.

10. You made a capital gain under CGT event G1 if the amount of the return of share capital is more than the cost base of your HRL share. The capital gain is equal to the amount of the excess and the cost base and reduced cost base of the HRL share are reduced to nil (subsection 104-135(3)). You cannot make a capital loss when CGT event G1 happens (Note 1 to subsection 104-135(3)).

11. If the amount of the return of share capital is not more than the cost base of your HRL share, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the return of share capital (subsection 104-135(4)).

12. You can treat a capital gain made when CGT event G1 happens as a 'discount capital gain' under Subdivision 115-A if you acquired your HRL shares at least 12 months before the Payment Date (subsection 115-25(1)) and the other conditions in that Subdivision are satisfied.

#### CGT event C2

13. CGT event C2 happened to you when HRL paid you the amount of the return of share capital in respect of HRL shares that you owned at the Record Date but ceased to own at the Payment Date (section 104-25).

14. You made a capital gain under CGT event C2 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. You made 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)).

15. The right to receive the return of share capital had a nil cost base. As a result, you made a capital gain equal to the capital proceeds, being 2.469087 cents per HRL share.

### ***Discount capital gain***

16. You can treat a capital gain made when CGT event C2 happened to your right to receive the return of share capital as a discount capital gain under Subdivision 115-A if you acquired your HRL share at least 12 months before the Payment Date (subsection 115-25(1)) provided the other conditions in Subdivision 115-A are satisfied.

### ***Foreign resident shareholders***

17. If you were a foreign resident or the trustee of a foreign trust that held HRL shares for CGT purposes on the Payment Date, you cannot disregard any capital gain when CGT event G1 happened in relation to your HRL share pursuant to section 855-10 if:

- your HRL share was an indirect Australian real property interest (table item 2 of section 855-15), having satisfied the non-portfolio test in section 960-195 at the Payment Date, or throughout a 12-month period that began no earlier than 24 months before the Payment Date and ended no later than that time
- you used your HRL share at any time in carrying on a business through a permanent establishment in Australia (table item 3 of section 855-15), or
- you held your HRL share as an individual and your share was covered by subsection 104-165(3) (table item 5 of section 855-15).

18. If you are a foreign resident shareholder, or the trustee of a foreign trust for CGT purposes, you also cannot disregard a capital gain made when CGT event C2 happened to your right to receive a return of share capital if the right:

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

### **Scheme**

19. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

### **Background**

20. HRL is a resident of Australia for income tax purposes.

21. HRL was incorporated on 27 November 1985 (with the name Mt. Kersey Mining N.L.) and listed on the Australian Securities Exchange on 3 July 1986.

22. HRL carries on the business of mineral exploration with tenement holdings throughout Western Australia.

## Share capital account

23. As at 30 June 2020, HRL had 333,515,613 fully-paid ordinary shares on issue. HRL has only ordinary shares on issue.

24. As at 30 June 2020, HRL's share capital balance was \$62,043,314.

25. HRL's share capital account is not tainted (within the meaning of Division 197).

## Sale of mining leases and exploration tenements

26. On 18 April 2019, HRL announced that it had entered into an Asset Sale and Purchase Agreement for the sale of HRL's interests in Box Well and Deep South mining leases and exploration tenements and leases (the Assets).

27. On 4 June 2019, HRL announced the completion and cash settlement of the sale for \$13.5 million.

## Return of share capital and special dividend

28. Proceeds of the sale of the Assets were used by HRL to make a return of share capital and a special dividend to HRL shareholders.

29. On 30 October 2020, HRL shareholders approved a return of share capital of 2.469087 cents per share pursuant to section 256C of the *Corporations Act 2001*.

30. On the same date, the directors of HRL resolved to distribute a special dividend of 1.578699 cents per share. The special dividend was not franked (that is, its franking percentage was 0%).

31. The Record Date for HRL shareholders to be entitled to receive the special dividend and return of share capital was 10 November 2020.

32. The special dividend was paid on 20 November 2020 to each HRL shareholder and was not debited against the share capital account of HRL. The special dividend was debited against its retained earnings.

33. The return of share capital was paid on the Payment Date and debited against the share capital account of HRL. After rounding, the total amount of share capital paid was \$8,234,809.24.

## Other matters

34. HRL has never declared a dividend.

35. HRL's franking account balance is nil.

36. HRL has never previously made any return of share capital.

37. On the Payment Date:

- some foreign residents, either alone or together with any associates, beneficially held 10% or more of the HRL shares, and
- the sum of the market values of HRL's assets that were taxable Australian real property exceeded the sum of the market values of its assets that were not taxable Australian real property.

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**Commissioner of Taxation**

25 November 2020

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**Appendix 1 – Explanation**

**❶** *This Explanation 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.*

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**Return of share capital not a dividend**

38. 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.

39. The term 'share capital account' is defined in section 975-300 as an account which the company keeps of 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.

40. Subsection 975-300(3) provides that an account is generally taken not to be a share capital account if it is tainted. HRL has confirmed that its share capital account was not tainted within the meaning of Division 197.

41. The return of share capital was recorded as a debit to HRL's share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) applies and the distribution of share capital is not a dividend as defined in subsection 6(1).

42. This means no part of the return of share capital will be included in your assessable income under section 44.

**Sections 45A, 45B and 45C do not apply**

43. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of the return of share capital received by HRL shareholders as an unfranked dividend paid by the company out of profits.

**Section 45A – streaming of dividends and capital benefits**

44. Section 45A applies where capital benefits are streamed to some shareholders (advantaged shareholders) who would derive a greater benefit from the receipt of capital than other shareholders (disadvantaged shareholders) and it is reasonable to assume that the disadvantaged shareholders received, or are likely to receive, dividends.

45. Paragraph 45A(3)(b) provides that a reference to the 'provision of a capital benefit to a shareholder in a company' includes the distribution to the shareholder of share capital.

46. A 'capital benefit' was provided to HRL shareholders. However, the circumstances of the return of share capital indicate that there was no streaming of capital benefits to some HRL shareholders and dividends to other HRL shareholders.

47. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to any part of the return of share capital.

**Section 45B – scheme to provide capital benefits**

48. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, subsection 45B(2) 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 (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 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 (relevant taxpayer) to obtain a tax benefit (paragraph 45B(2)(c)).

49. The return of share capital HRL made to you satisfies the conditions in paragraphs 45B(2)(a) and 45B(2)(b). However, having regard to the relevant circumstances of the scheme, the Commissioner concludes that the scheme was not entered into or carried out for a more than incidental purpose of enabling HRL shareholders to obtain a tax benefit.

50. 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 of a return of share capital. This means no part of the return of share capital will be treated as an unfranked dividend for tax purposes and will not be included in your assessable income under section 44.

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

51. CGT event G1 happens when a company makes a payment to a shareholder in respect of a share they own in the company, 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, and the payment is not included in the shareholder's assessable income (section 104-135).



52. If you are an Australian resident shareholder, CGT event G1 happened to you when HRL paid you the return of share capital in respect of HRL shares you owned on the Record Date and you continued to own on the Payment Date (subsection 104-135(1)). The non-assessable part in respect of the return of share capital is 2.469087 cents per HRL share.

53. If you are an Australian resident shareholder, you made a capital gain under CGT event G1 if the non-assessable part is more than the cost base of your HRL share. The capital gain is equal to the amount of the excess and the cost base and reduced cost base of the HRL share are reduced to nil (subsection 104-135(3)). You cannot make a capital loss when CGT event G1 happens (Note 1 to subsection 104-135(3)).

54. A capital gain made when CGT event G1 happens is eligible to be treated as a discount capital gain under Subdivision 115-A provided you acquired your HRL share at least 12 months before the Payment Date (subsection 115-25(1)) and the other conditions in that Subdivision are satisfied.

55. If you are an Australian resident shareholder and the amount of the return of share capital is not more than the cost base of your HRL share, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the non-assessable part (subsection 104-135(4)).

### **CGT event C2**

56. CGT event C2 happened to you if you received the return of share capital in respect of HRL shares that you owned on the Record Date but ceased to own on the Payment Date (section 104-25).

57. If you ceased to own a HRL share after the Record Date but before the Payment Date, you retained the right to receive the return of share capital (which is a separate CGT asset from the HRL share). When the return of share capital was paid, the right to receive the return of share capital (being an intangible CGT asset) ended by the right being discharged or satisfied.

58. You made a capital gain under CGT event C2 if the capital proceeds from the ending of the right were more than the cost base of the right. The capital gain is equal to the amount of the excess. You made a capital loss if the capital proceeds from the ending of the right were less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

59. In working out the capital gain or capital loss made from CGT event C2, the capital proceeds are the amount of the return of share capital of 2.469087 cents per HRL share (subsection 116-20(1)).

60. The cost base of your right to receive the return of share capital is worked out under Division 110 (modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the HRL share you previously owned that was applied in working out a capital gain or capital loss made when a CGT event happened to the share. Therefore, the right to receive the return of share capital had a nil cost base. As a result, you made a capital gain equal to the capital proceeds, being 2.469087 cents per HRL share.

61. For the purposes of Subdivision 109-A, you are considered to have acquired the right at the time when you acquired your HRL share. Therefore, you can treat a capital gain made when CGT event C2 happened to your right to receive the return of share capital if you acquired your HRL share at least 12 months before the Payment Date (subsection 115-25(1)) provided the other conditions in Subdivision 115-A are satisfied.

**Foreign resident shareholders**

62. You disregard a capital gain or capital loss made from a CGT event if:
- just before the CGT event happened you are 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' (subsection 855-10(1)).
63. Your HRL share was 'taxable Australian property' on the Payment Date if the HRL share:
- was an indirect Australian real property interest within table item 2 of section 855-15; or
  - had been used at any time by you in carrying on a business through a permanent establishment in Australia within table item 3 of section 855-15; or
  - was covered by subsection 104-165(3) within table item 5 of section 855-15.
64. An indirect Australian real property interest is a membership interest held by an entity in another entity if the interest passes the principal asset test in section 855-30 and the non-portfolio interest test under section 960-195 (section 855-25).
65. A HRL share held by a foreign resident shareholder passes the principal asset test as the sum of the market values of HRL's assets that are taxable Australian real property exceeds the sum of the market values of its assets that are not taxable Australian real property (subsection 855-30(2)).
66. The non-portfolio interest test is passed if the sum of the HRL shares held by the foreign resident shareholder and its associates is 10% or more of the total HRL shares.
67. Therefore, if you are a foreign resident shareholder or the trustee of a foreign resident trust for CGT purposes with at least 10% shareholding in HRL on Payment Date or throughout a 12-month period that began no earlier than 24 months before the Payment Date and ended no later than that time, you cannot disregard a capital gain made when CGT event G1 happened to your HRL share under subsection 855-10(1).
68. You also cannot disregard any capital gain when CGT event G1 or C2 happened in relation to a HRL share or the right to receive return of share capital respectively (section 855-10) if your HRL share or the right:
- had been used at any time by you in carrying on a business through a permanent establishment in Australia within table item 3 of section 855-15, or
  - was covered by subsection 104-165(3) within table item 5 of section 855-15.

**Appendix 2 – Legislative provisions**

69. This paragraph sets out the details of the provisions ruled upon or referenced in this Ruling.

<i>Income Tax Assessment Act 1936</i>	subsection 6(1)
<i>Income Tax Assessment Act 1936</i>	section 44
<i>Income Tax Assessment Act 1936</i>	section 45A
<i>Income Tax Assessment Act 1936</i>	subsection 45A(2)
<i>Income Tax Assessment Act 1936</i>	paragraph 45A(3)(b)
<i>Income Tax Assessment Act 1936</i>	section 45B
<i>Income Tax Assessment Act 1936</i>	subsection 45B(2)
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(2)(a)
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(2)(b)
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(2)(c)
<i>Income Tax Assessment Act 1936</i>	subsection 45B(3)
<i>Income Tax Assessment Act 1936</i>	paragraph 45B(3)(b)
<i>Income Tax Assessment Act 1936</i>	section 45C
<i>Income Tax Assessment Act 1936</i>	section 47
<i>Income Tax Assessment Act 1997</i>	section 104-135
<i>Income Tax Assessment Act 1997</i>	subsection 104-135(1)
<i>Income Tax Assessment Act 1997</i>	subsection 104-135(3)
<i>Income Tax Assessment Act 1997</i>	subsection 104-135(4)
<i>Income Tax Assessment Act 1997</i>	section 104-25
<i>Income Tax Assessment Act 1997</i>	subsection 104-25(3)
<i>Income Tax Assessment Act 1997</i>	subsection 104-165(3)
<i>Income Tax Assessment Act 1997</i>	Division 110
<i>Income Tax Assessment Act 1997</i>	Division 112
<i>Income Tax Assessment Act 1997</i>	Subdivision 115-A
<i>Income Tax Assessment Act 1997</i>	subsection 115-25(1)
<i>Income Tax Assessment Act 1997</i>	subsection 116-20(1)
<i>Income Tax Assessment Act 1997</i>	Division 197
<i>Income Tax Assessment Act 1997</i>	Division 230
<i>Income Tax Assessment Act 1997</i>	section 855-10

<i>Income Tax Assessment Act 1997</i>	subsection 855-10(1)
<i>Income Tax Assessment Act 1997</i>	section 855-15
<i>Income Tax Assessment Act 1997</i>	section 855-25
<i>Income Tax Assessment Act 1997</i>	section 855-30
<i>Income Tax Assessment Act 1997</i>	section 855-30(2)
<i>Income Tax Assessment Act 1997</i>	section 960-195
<i>Income Tax Assessment Act 1997</i>	section 975-300
<i>Income Tax Assessment Act 1997</i>	subsection 975-300(3)
<i>Income Tax Assessment Act 1997</i>	section 977-50
<i>Income Tax Assessment Act 1997</i>	subsection 995-1(1)

## References

*Previous draft:*

Not previously issued as a draft

*Legislative references:*

- Corporations Act 2001 256C

*Related Rulings/Determinations:*

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