


CR 2018/34 - Income tax: IPE Limited: return of share capital

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Class Ruling

Income tax: IPE Limited: return of share capital

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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*. (TAA 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)
 - Section 45A of the ITAA 1936
 - Section 45B of the ITAA 1936
 - Section 45C of the ITAA 1936
 - Section 47 of the ITAA 1936
 - Section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997)
 - Section 104-135 of the ITAA 1997
 - Subdivision 115-A 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 indicated.

Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares in IPE Limited (IPE) who:
- a) were listed on the IPE share register on the relevant date (**Record Date**) for determining entitlements to receive the return of share capital made on 9 April 2018
 - b) held their IPE share on capital account (that is, shareholders who do not hold their IPE shares as 'revenue assets' or as 'trading stock' (as defined in sections 977-50 and 995-1(1) of the ITAA 1997 respectively), and
 - c) were not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their IPE 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 an 'IPE 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 22 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 this 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

8. The following description of the scheme is based on the class ruling application and other correspondence 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. IPE is an Australian resident company established on 3 February 2004 and listed on Australian Securities Exchange (ASX) on 25 November 2004.

10. IPE's primary business activity is investing in private equity funds which usually have an investment period of five or six years from the initial commitment date.

11. IPE's board of directors determined in 2008 that IPE would cease making new investments and would be wound down over time.

12. IPE keeps accounts and portfolio records of its investments such that it is able to identify all of its receipts as one of the following:

- a return of capital invested
- a capital gain on capital invested, or
- income generated by capital invested.

Status of the IPE portfolio – capital now excess to requirements

13. Previously, IPE had been able to pay dividends to its shareholders purely out of profits (being income and capital gains arising from its investments in private equity funds). It had used the capital returns from the private equity funds to satisfy calls from other private equity funds in respect of its commitments.

14. IPE's position changed in 2014 with the completion of the investment phases of the funds in which IPE invests. Capital returns received by IPE were then (and now) surplus to its needs. With the undrawn commitments amount at a low level, IPE started to deliver cash back to its shareholders. Part of that cash is not income generated by capital invested or capital gains on capital invested; it has the character of capital, in the sense that it flows from returns of capital invested in private equity funds, arising from the disposal of assets by those funds.

Return of share capital

15. IPE paid a return of share capital of 3.25 cents per share on 9 April 2018 (**Payment Date**) amounting to \$4,408,368 (return of share capital). The return of capital was approved by IPE's shareholders and was paid equally to each shareholder listed on IPE's share register on 22 March 2018 being the Record Date for the return of share capital.

16. The Record Date and the Payment Date for each return of share capital occurred during the year ended 30 June 2018.

17. IPE debited the entire amount of the return of share capital against the company's share capital account. There was no change in either the number of IPE shares on issue or the proportionate interest of each shareholder in IPE. The return of share capital was paid from IPE's existing net cash reserves.

Other matters

18. The IPE half-yearly report for the half-year ended 31 December 2017 disclosed:

- a net loss after tax of \$453,000
- issued capital of \$41.436 million
- accumulated losses of \$27.449 million, and
- total equity of \$13.987 million.

19. IPE has consistently paid unfranked and franked dividends in the last four financial years with the most recent two distributions paid on 12 April 2017 and 9 April 2018 being paid as unfranked dividends.

20. During the 2016 financial year IPE initiated an on-market buy-back of shares which is still ongoing. As at 9 March 2018, IPE had bought back 929,103 shares which was 0.68% of the shares on issue at the commencement of the buy-back.

21. As at 28 February 2018, IPE had 1,770 shareholders on its share register. The top 20 shareholders held 64.63% of the shares on issue and a minority group of non-residents held 1.21% of the shares on issue.

22. IPE's share capital account (as defined in section 975-300 of the ITAA 1997) was not tainted within the meaning of Division 197 of the ITAA 1997.

Ruling

Return of share capital not a dividend

23. No part of the return of share capital paid to the IPE shareholders is a dividend as defined in subsection 6(1).

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

24. The Commissioner will not make a determination under section 45A or section 45B that section 45C applies to any part of the return of share capital paid to the IPE shareholders.

Capital gains tax (CGT) consequences

25. CGT event G1 (section 104-135 of the ITAA 1997) happened to a resident IPE shareholder when IPE paid them the return of share capital in respect of the IPE shares that they owned at the relevant Record Date and continued to own at the relevant Payment Date.

26. CGT event C2 (section 104-25 of the ITAA 1997) happened when IPE paid the return of share capital to an IPE shareholder in respect of an IPE share that they owned at the relevant Record Date but ceased to own before the relevant Payment Date.

Foreign resident shareholders

27. An IPE shareholder who was a foreign resident just before CGT event G1 happened disregards any capital gain made when CGT event G1 happened if their IPE shares were not 'taxable Australian property' (section 855-10 of the ITAA 1997).

28. An IPE shareholder who was a foreign resident just before CGT event C2 happened disregards any capital gain or capital loss made when CGT event C2 happened if their right to receive each return of share capital was not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

15 August 2018

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.*

Return of share capital not a dividend

29. 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.

30. The term '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 on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

31. Subsection 975-300(3) of the ITAA 1997 provides that an account is generally taken not to be a share capital account if it is tainted. IPE has confirmed that its share capital account was not tainted within the meaning of Division 197 of the ITAA 1997.

32. The return of share capital was recorded as a debit to IPE's share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) applies and neither distribution of share capital is a dividend as defined in subsection 6(1).

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

33. 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 IPE shareholders as an unfranked dividend paid by the company out of profits.

Section 45A – streaming of dividends and capital benefits

34. 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 (**Disadvantaged Shareholders**) and the Disadvantaged Shareholders receive, or are likely to receive, dividends.

35. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) to include the distribution to the shareholder of share capital.

36. Although a 'capital benefit' was provided to IPE shareholders, the circumstances of the return of share capital indicate that there was no streaming of capital benefits to some IPE shareholders and dividends to the other IPE shareholders.

37. 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 return of share capital.

Section 45B – scheme to provide capital benefits

38. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, subsection 45B(2) applies where:

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

39. Each return of share capital satisfies the conditions in paragraphs 45B(2)(a) and 45B(2)(b). However, having regard to the relevant circumstances of each scheme (comprising each distribution of share capital paid), it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling IPE shareholders to obtain a tax benefit.

40. 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 the return of share capital.

Capital gains tax (CGT) consequences

CGT event G1 – section 104-135 of the ITAA 1997

41. CGT event G1 happens if 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 of the ITAA 1997).

42. CGT event G1 happened to a resident IPE shareholder when IPE made the return of share capital to them in respect of IPE shares that they owned at the relevant Record Date and continued to own at the relevant Payment Date (section 104-135 of the ITAA 1997). The non-assessable part in respect of the share capital return is 3.25 cents per share.

43. A resident IPE shareholder will make a capital gain under CGT event G1 if the non-assessable part is more than the cost base of the shareholder's IPE share. The amount of the capital gain is equal to the excess (subsection 104-135(3) of the ITAA 1997).

44. If a resident IPE shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of their IPE share is reduced to nil. An IPE shareholder cannot make a capital loss when CGT event G1 happens (Note 1 to subsection 104-135(3) of the ITAA 1997).

45. A capital gain made when CGT event G1 happens is eligible to be treated as a discount capital gain under Division 115 of the ITAA 1997 provided that the IPE shareholder acquired their IPE share at least 12 months before the Payment Date (subsection 115-25(1) of the ITAA 1997) and the other conditions of Division 115 are satisfied.

46. If the non-assessable part is not more than the cost base of the resident shareholder's IPE 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) of the ITAA 1997).

47. An IPE shareholder that is either a foreign resident whose IPE shares are taxable Australian property, or who is a temporary resident, must meet further conditions to be eligible to treat the capital gain as a discount capital gain under Division 115 of the ITAA 1997.

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

48. If, after the Record Date but before the Payment Date, an IPE shareholder ceased to own an IPE share in respect of which the return of share capital was payable, the right to receive the return of share capital in respect of that share is retained by the IPE shareholder and is a separate CGT asset from the IPE share.

49. CGT event C2 happened when the return of share capital was made. The right to receive the return of share capital (being an intangible asset) ended by the right being discharged or satisfied when the return of share capital was made (section 104-25 of the ITAA 1997).

50. An IPE shareholder will make 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. An IPE shareholder 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) of the ITAA 1997).

51. In working out the capital gain or capital loss when CGT event C2 happens, the capital proceeds is equal to the amount of the return of share capital (that is, 3.25 cents per share) (subsection 116-20(1) of the ITAA 1997).

52. The cost base of the IPE shareholder's right to receive each return of share 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 an IPE shareholder that was applied in working out a capital gain or capital loss made when a CGT event happened to the share, for example, when the IPE shareholder disposed of the share after the relevant Record Date. Therefore, the right to receive the return of share capital will have a nil cost base. As a result, an IPE shareholder will make a capital gain equal to the capital proceeds, being 3.25 cents per IPE share it owned at the Record Date.

53. The right to receive the in specie distribution was acquired at the time when the right was created (section 109-5 of the ITAA 1997). This would be no earlier than when the IPE shareholders approved the return of share capital by IPE.

54. As the right to receive the return of share capital was not acquired by an IPE shareholder at least 12 months before the distribution was made, any capital gain made from CGT event C2 happening on the ending of the corresponding right will not satisfy subsection 115-25(1) of the ITAA 1997. Such a capital gain will not be eligible to be treated as a discount capital gain.

55. An IPE shareholder that is either a foreign resident whose IPE shares are 'taxable Australian property', or who is a temporary resident, must meet further conditions to be eligible to treat any capital gain as a discount capital gain under Division 115 of the ITAA 1997.

Foreign resident shareholders

56. 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'.

57. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out five categories of CGT assets:

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 items 1, 2 or 5
Item 4	an option or right to acquire a CGT asset covered by items 1, 2 or 3
Item 5	a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a gain or loss on ceasing to be an Australian resident)

58. An IPE shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event G1 happened to their IPE share under subsection 855-10(1) of the ITAA 1997 if:

- a) their IPE share was an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997), or
- b) their IPE share 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
- c) their IPE share was covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

59. An IPE shareholder, being a foreign resident, or the trustee of a foreign resident trust for CGT purposes, cannot disregard a capital gain or capital loss made when CGT event C2 happened to their right to receive a return of share capital if:

- a) the 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
- b) the right 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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10; CR 2014/50;
CR 2015/42; CR 2016/46;
CR 2017/45

Legislative references:

- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)(b)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45C
 - ITAA 1936 47
 - ITAA 1997
 - ITAA 1997 104-25
 - ITAA 1997 104-25(3)
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-135(4)
 - ITAA 1997 104-165(3)
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 - ITAA 1997 Div 112
 - ITAA 1997 Div 115
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 - ITAA 1997 115-25(1)
 - ITAA 1997 116-20(1)
 - ITAA 1997 Div 197
 - ITAA 1997 Div 230
 - ITAA 1997 855-10
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 - ITAA 1997 975-300
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ATO references

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