

# ***CR 2006/106 - Income tax: return of capital: Ausron Limited***

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2006*



## Class Ruling

### Income tax: return of capital: Ausron Limited

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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, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

#### **Relevant provision(s)**

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997; and
- section 136-10 of the ITAA 1997.

All references are to the ITAA 1936 unless otherwise stated.

## Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Ausron Limited (Ausron) who are registered on the Ausron Share Register on the date the proposed capital return is declared (Record Date). This class of persons is referred to as 'Participating Shareholders'.

## Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in the 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 13 to 25 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.

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## Date of effect

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8. This Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) in which the return of capital is paid to the Participating Shareholder by Ausron. The scheme, as described in paragraphs 13 to 25 of this Ruling, will be completed within that income year. For a Participating Shareholder that does not have a substituted accounting period, this will be the income year ending 30 June 2007. However, the Ruling does not apply to a Participating Shareholder to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or

- the relevant provisions are not amended.

9. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

## Withdrawal

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12. This Ruling is withdrawn and ceases to have effect after 30 June 2007. However, the Ruling continues to apply after its withdrawal in respect of the relevant provisions ruled upon, to all entities within the specified class who entered into the specific scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

## Scheme

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13. The scheme that is the subject of the Ruling is described below. This description is based on, and includes reference to:

- The application for the Class Ruling from Pitcher Partners dated 6 July 2006; and
- Correspondence providing further particulars dated 28 September 2006 from Pitcher Partners.

**Note:** Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

14. Ausron is an Australian public company listed on the Australian Stock Exchange and is the ultimate parent of the Ausron Group.

15. Through Ausron's subsidiaries, its primary business originally consisted of the manufacture and wholesale of garden and horticultural products and managed investment forestry. The attachment to the Class Ruling application, 'Appendix 4E Preliminary final report of the financial year ended 30 June 2005' contains a section 'Discontinuing Operations'. The report states:

During the previous year Ausron sold the trading assets of various businesses comprising the whole of the Company's manufacture and wholesale of garden and products segment.

Prior to these sales this business segment had traded unprofitably. Additionally the drought impacted severely on the businesses. With a high level of debt associated with these businesses the directors were unable to assure shareholders of the long-term viability of the company, and a decision was made to dispose of the assets.

16. These businesses have been, or are being, sold off, and in anticipation of winding down the group's activities, the group is returning significant portions of its share capital from any proceeds made from those sales.

17. On 23 June 2005, Ausron signed an agreement with Integrated Tree Cropping for the sale of its remaining forestry assets, with partial settlement proceeds received on 5 September 2005.

18. On 15 August 2005, Ausron received a settlement payment of \$10 million in respect of a long running Supreme Court and Court of Appeal litigation.

19. As a result of the sale of Ausron's forestry assets and finalisation of the litigation, Ausron resolved to pay a fully franked dividend of \$0.03 per share (approximately \$10.08 million) on 13 October 2005 out of 2005/2006 profits, with a further dividend to be paid if and to the extent additional profits are available once the 2005/2006 year results are finalised.

20. The amount of this dividend is based on estimated after tax current year accounting profits. Ausron has distributed the maximum amount of estimated profits calculated at October 2005, with a further dividend to be paid if and to the extent that additional profits are available by law at this time. Surplus accounting profits available for distribution at the time of the dividend payment, represent a retention of liquidity in the company to ensure any future contingent liability arising is met.

21. As a result of Ausron selling its businesses it has excess capital that was originally invested in those businesses that have been sold. Ausron no longer holds any material assets for which unrealised gains exist.

22. Ausron proposes to pay a capital return of \$0.03 per ordinary share. The return of capital will amount to approximately \$10 million.

23. The proposed return of capital will be an equal distribution to all ordinary shareholders of the company.

24. Ausron confirms it will debit the entire return of capital against its share capital account.

25. At 30 June 2002 Ausron had a tainted share capital account due to the transfer of an amount from the option premium reserve in relation to lapsed options. In accordance with current legislation Ausron intends to untaint its share capital account by paying untainting tax prior to the proposed capital return.

## **Ruling**

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### **Dividends**

26. The return of capital of \$0.03 per share under the Scheme is not a 'dividend' as defined by subsection 6(1).

### **Anti-avoidance provisions**

27. The Commissioner will not make a determination (under sections 45A or 45B) that section 45C applies to the whole, or any part, of the return of capital received by the holders of Ausron ordinary shares.

### **Capital gains tax consequences**

28. CGT event G1 will happen to an Ausron shareholder when the return of capital is paid (section 104-135 of the ITAA 1997).

29. CGT event C2 will happen to an Ausron shareholder receiving the return of capital, who ceases to own their Ausron share after the Record Date but before the payment of the return of capital (section 104-25 of the ITAA 1997).

30. A foreign resident shareholder will only make a capital gain as a result of the return of capital if the relevant asset has the necessary connection with Australia (section 136-10 of the ITAA 1997).

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**Commissioner of Taxation**

18 October 2006

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## Appendix 1 – Explanation

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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.*

### Dividends

31. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

32. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, later paragraphs in this subsection exclude certain items from being a dividend for income tax purposes.

33. Relevantly, paragraph (d) specifically excludes from the definition of dividend in subsection 6(1):

money 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 6(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 the 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.

34. The return of capital will be debited against Ausron's share capital account. At 30 June 2002 Ausron had a tainted share capital account due to the transfer of an amount from the option premium reserve in relation to lapsed options. Based on the rewritten share capital tainting rules contained within Division 197 of the ITAA 1997 Ausron's share capital account at 26 May 2006 will be tainted to the same extent as at 30 June 2002. In accordance with section 197-55 Ausron intends to untaint its share capital account by paying untainting tax prior to the proposed capital return. Therefore paragraph (d) of the definition of 'dividend' in subsection 6(1) applies and the return of capital would not constitute a dividend.

### Anti-avoidance provisions

35. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfrankable dividend that is paid by the company out of profits to the shareholder.

**Streaming of dividends and capital benefit: section 45A**

36. Section 45A applies in circumstances where capital benefits are streamed to advantaged shareholders who would, in the year of income in which the capital benefits are provided, derive a greater capital benefit than the other shareholders (the disadvantaged shareholders) who would receive dividends.

37. Ausron will provide all of its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), and the capital benefit is to be provided to all shareholders in direct proportion to their individual shareholding. As all shareholders benefit equally from the return of capital, there is no indication of 'streaming' of capital benefits to some shareholders and not to other shareholders. Accordingly, section 45A will not apply to the return of capital, and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to return of capital.

**Schemes to provide capital benefits in substitution for dividends: section 45B**

38. Section 45B applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

39. Subsection 45B(2) sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) that section 45C applies. These conditions are that:

- there is a scheme under which a person is provided with a capital benefit by a company;
- under the scheme a person (the relevant taxpayer), who may or may not be the person provided with the capital benefit, obtains a tax benefit; and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into 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.

Each of these conditions are considered below.

40. The return of capital is a 'scheme' within the broad meaning of that term.

41. The phrase 'provided with a capital benefit' is defined at subsection 45B(5). Relevantly, it includes a distribution to a person of share capital. As Ausron proposes to debit the return of capital against its share capital account, its shareholders will be provided with a capital benefit.



42. A shareholder 'obtains' a 'tax benefit', as defined in subsection 45B(9), where:

- the amount of tax payable; or
- any other amount payable under the ITAA 1936 or the ITAA 1997,

by the taxpayer would, apart from the operation of section 45B:

- be less than the amount that would have been payable; or
- be payable at a later time than it would have been payable,

if the capital benefit had instead been a dividend.

### Relevant circumstances

43. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the 'relevant circumstances' set out in subsection 45B(8) to determine whether any part of the scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit. However, the list of relevant circumstances in subsection 45B(8) is not exhaustive and regard may be had to other circumstances on the basis of their relevance.

44. The test of purpose is an objective one. The question is whether it would be concluded that a person who entered into or carried out the scheme did so for the purpose of obtaining a tax benefit for the relevant taxpayer in respect of the capital benefit. The requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

45. The purpose which causes section 45B to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is concerned only with the purpose of Ausron. The Commissioner cannot at this stage ascertain the purposes of Ausron's numerous shareholders, all of whom are eligible to vote on the return of capital under section 256C of the *Corporations Act 2001* and all of whom would participate in the return of capital should the proposal be approved. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company should, generally speaking, not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who vote in favour of the proposal.

46. The relevant circumstances under subsection 45B(8) cover the circumstances of the company and the tax profile of the shareholders. In this instance, as the return of capital is made to all shareholders of Ausron regardless of individual shareholder circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(i) and (j) pertaining to the provision of ownership interests and a demerger respectively are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

47. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital or profits (realised and unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, the capital return is referable to capital contributions by shareholders either from direct share issues or upon exercise of options to acquire shares in the company. In recent years, the Ausron group has incurred significant losses such that the company does not have any retained earnings. Ausron has distributed by way of a dividend paid on 13 October 2005 the maximum amount of estimated profits calculated at October 2005, and will make a further dividend payment to the extent additional profits are available once the 2005/2006 year results are finalised. The Taxpayer is returning capital to shareholders that were originally invested in businesses which have since been sold. Further, Ausron no longer holds any material assets for which unrealised gains exist. In these circumstances, the capital benefit is attributable to capital not profits.

48. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate of the company. There has only been one dividend payment by Ausron since March 2001 which was made on 13 October 2005 of 3 cents per share made to all shareholders. Prior to the events which occurred in June to October 2005, there have been no profits or retained earnings out of which to pay dividends. Ausron has announced it will pay a further dividend to ordinary shareholders in the amount of the surplus profit for the 2005/2006 year if any.

49. Ausron has previously announced and paid on 29 November 2004 a \$0.015 per share return of capital to shareholders totalling \$5,039 million. This was in the context of a sale of land by the group for \$11,550 million, from which a loss was made. Due to the group incurring significant prior year losses there were no amounts available from which to pay a dividend. Accordingly, funds were returned to shareholders as a capital return, returning money to shareholders following the asset sale and in the context of winding down the businesses.

50. On 24 March 2006, Ausron released an Appendix 3C form officially announcing the details of an on market share buy back agreement. Ausron intended to buy back a maximum of 33,500,000 ordinary shares. As at 3 May 2006, Ausron had bought back 161,262 ordinary shares. All ordinary shareholders were entitled to participate in the on market share buy back and the purchase price of the on market will effectively be the market value of the taxpayer's shares at the time of offering the buy back to the shareholders. Due to the sale of significant business assets and the winding down of the taxpayers business, the on market buy back arrangement was undertaken by Ausron to effectively return amounts to ordinary shareholders that were originally invested by the shareholders. Due to a dividend being paid on 13 October 2005 to the maximum amount permissible, there was no option available to Ausron to pay a further dividend to ordinary shareholders.

51. Accordingly the company's pattern of distribution does not suggest that the capital benefit arising from the capital return is made in substitution for a dividend.

52. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (viii). These are matters by reference to which a scheme is able to be examined from a practical perspective in order to identify and compare its tax and non-tax objectives. The matters include the manner in which the scheme is carried out, its form and substance, and its financial and other implications for the parties involved. In this case, the practical implications of the scheme for Ausron and its shareholders are consistent with its being, in form and in substance, a distribution of share capital.

### **Deeming dividends to be paid where a determination is made: section 45C**

53. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) in relation to the scheme as described, section 45C will not apply.

### **CGT event G1: section 104-135 of the ITAA 1997**

54. CGT event G1 (section 104-135 of the ITAA 1997) will happen if a company makes a payment to a shareholder in respect of a share they own in the company and some or all of the payment (non-assessable part) is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, or an amount that is taken to be a dividend under section 47.

55. The cost base and reduced cost base of each Ausron share will be reduced (but not below nil) by the non-assessable part, in this case being the amount of the return of capital (subsections 104-135(3) and (4) of the ITAA 1997).

56. An Ausron shareholder may make a capital gain if the return of capital by the company in relation to each Ausron share exceeds the cost base of the share (subsection 104-135(3) of the ITAA 1997). If the Ausron share was acquired by the shareholder at least 12 months before the date of payment, a capital gain from the share may qualify as a discount capital gain (subsection 115-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

### **CGT event C2: section 104-25 of the ITAA 1997**

57. A person who is a registered ordinary shareholder of Ausron on the Record Date for the return of capital acquires the right to receive the return of capital on that date. A shareholder continues to have the right to the return of capital even if the shareholder ceases to own the shares before the payment is made. The right is a CGT asset separate from the Ausron share.

58. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the return of capital is paid and the right to receive that payment ends.

59. A capital gain will result if the capital proceeds for the event are more than the cost base of the right. The capital proceeds will be the amount of the payment from Ausron. As no amount will have been paid for the right, its cost base is likely to be nil. Therefore, a capital gain equal to the payment of the return of capital will likely arise.

60. The right to payment from Ausron was inherent in the Ausron share during the time that it was owned. Therefore, for the purposes of Subdivision 109-A of the ITAA 1997 the right is considered to have been acquired at the time when the Ausron share was acquired. Consequently, if the Ausron share was originally acquired by the former shareholder at least 12 months before the payment, a capital gain from the right may qualify as a discount capital gain (subsection 112-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

#### **Foreign resident shareholders: Division 136 of the ITAA 1997**

61. If the Ausron shareholder is not an Australian resident for income tax purposes, a CGT event G1 capital gain cannot be made unless the shares have the necessary connection with Australia (section 136-25 of the ITAA 1997). Broadly, shares in public companies will not have the necessary connection with Australia, and a capital gain or a capital loss will not be made, where the foreign resident shareholder and their associates beneficially own less than 10% by value of the shares in the company during the 5 years before the CGT event happens.

62. As rights to receive a return of capital cannot have a necessary connection with Australia (section 136-25 of the ITAA 1997) there will be no CGT event C2 gain or loss for a foreign resident shareholder.

## **Appendix 2 – Detailed contents list**

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Subject references:*

- capital reduction
- reduction of share capital
- return of share capital
- share capital

*Legislative references:*

- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(5)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(c)
- ITAA 1936 45B(8)(d)
- ITAA 1936 45B(8)(e)
- ITAA 1936 45B(8)(f)
- ITAA 1936 45B(8)(g)
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(i)

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- ITAA 1936 47
- ITAA 1936 177D(b)(i)
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- ITAA 1936 177D(b)(v)
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- ITAA 1997 Subdiv 109-A
- ITAA 1997 112-25(1)
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- ITAA 1997 136-25
- ITAA 1997 Div 197
- ITAA 1997 197-55
- ITAA 1997 995-1(1)
- Copyright Act 1968
- Corporations Act 2001

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