



Class Ruling

Income tax: Return of capital: Wesfarmers 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, 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.

What this Ruling is about

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

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 44 of the 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;
 - section 112-25 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 stated.

Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares and/or partially protected ordinary shares in Wesfarmers Limited (Wesfarmers) who:

- are registered on the Wesfarmers share register on the date for determining entitlements to receive the return of capital (the Record Date);
- do not hold their fully paid ordinary shares and/or partially protected ordinary shares as revenue assets (as defined in section 977-50 of the ITAA 1997) nor as trading stock (as defined in subsection 995-1(1) of the ITAA 1997) – that is, the holders will hold their shares broadly on capital account; and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Wesfarmers shares.

(Note – Division 230 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 a 'Wesfarmers 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 30 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 2013 to 30 June 2014. The Ruling continues to apply after 30 June 2014 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

8. The following description of the scheme is based on information provided by the applicant.

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

9. Wesfarmers announced a proposed return of capital on 15 August 2013 with Wesfarmers returning to each shareholder \$0.50 per fully paid share.

10. At 30 June 2007, Wesfarmers' share capital was \$2,256 million, with retained earnings of \$1,131 million (effectively \$588 million after the final 2007 dividend of \$543 million). In November 2007, Coles Group Ltd (Coles Group) was acquired pursuant to a scheme of arrangement. Wesfarmers credited \$12,733 million to its share capital account on the issue of Wesfarmers ordinary shares and partially protected ordinary shares to Coles Group shareholders in part payment for the acquisition of all the issued shares in Coles Group.

11. Wesfarmers raised the following equity to reduce debt and provide balance sheet flexibility:

- In April 2008, Wesfarmers raised \$2.5 billion in equity via an entitlement offer.
- In February 2009, Wesfarmers undertook a second capital raising, issuing approximately \$4.6 billion of equity through a rights issue and placement.

12. Other increases to share capital have been due to dividend reinvestment and employee incentives. Wesfarmers share capital has increased from \$2.2 billion in July 2007, to \$23 billion in June 2012.

13. Since 2009, the dividend payout of Wesfarmers has been as follows:

- fully franked dividend of \$1,909 million paid in respect of the year ended 30 June 2012, representing 90% of the net profit after tax for the year (\$1.65 per share);

- fully franked dividend of \$1,735 million paid in respect of the year ended 30 June 2011, representing 90% of the net profit after tax for the year (\$1.50 per share);
- fully franked dividend of \$1,446 million paid in respect of the year ended 30 June 2010, representing 92% of the net profit after tax for the year (\$1.25 per share); and
- fully franked dividend of \$1,102 million paid in respect of the year ended 30 June 2009, representing 72% of the net profit after tax for the year (\$1.10 per share).

14. The high dividend payout policy is intended to be maintained following the return of capital to shareholders.

15. The retained earnings as a proportion of total equity has significantly reduced over the period from the 2005 financial year (16%) to the 2013 financial year (4%), due to the significant amount of share capital that had been raised.

16. Since 2009, Wesfarmers has reported the following retained earnings:

- retained earnings of \$2,103 million (\$1,004 million post final dividend) in the year ended 30 June 2012;
- retained earnings of \$1,774 million (\$791 million post final dividend) in the year ended 30 June 2011;
- retained earnings of \$1,414 million (\$604 million post final dividend) in the year ended 30 June 2010; and
- retained earnings of \$1,179 million (\$485 million post final dividend) in the year ended 30 June 2009.

Return of capital

17. Wesfarmers will reduce its share capital by returning \$0.50 per fully paid share (being ordinary shares and partially protected ordinary shares). This represents a total return of approximately \$579 million to Wesfarmers shareholders.

18. The return of capital will be affected by way of an equal reduction of capital under section 256B of the *Corporations Act 2001* (Corporations Act), and requires shareholder approval by ordinary resolution under section 256C of the Corporations Act. It is anticipated that shareholder approval will be sought at Wesfarmers' Annual General Meeting (AGM) which is scheduled for 7 November 2013.

19. The return of capital will be paid equally to each holder of a Wesfarmers share (being ordinary shares and partially protected ordinary shares) who is registered on the Wesfarmers share register on the Record Date.

20. The Record Date for the return of capital is expected to be on 15 November 2013. The Payment Date is anticipated to be late November to early December 2013.

21. The return of capital will be debited to Wesfarmers share capital account.

Share consolidation

22. In addition to the return of capital, Wesfarmers proposes to undertake a share consolidation of approximately 1 to 0.9876.

23. After the share consolidation, Wesfarmers shareholders will own fewer shares that are proportionately higher priced. It is anticipated that the share consolidation will have no effect on the value of each shareholder's shares relative to the total market value of Wesfarmers.

24. The share consolidation will occur after the return of capital to Wesfarmers shareholders, and will be applied to both the fully paid ordinary shares and the partially protected ordinary shares.

25. The share consolidation is conditional upon the approval by shareholders of an ordinary resolution. It is anticipated that shareholder approval will be sought at the AGM scheduled for 7 November 2013.

26. The share consolidation will be undertaken in accordance with section 254H of the Corporations Act such that:

- a shareholder's original shares will not be cancelled or redeemed,
- there will be no change in the total amount allocated to Wesfarmers share capital account, and
- the proportion of equity owned by each shareholder in the share capital account will be maintained.

Other matters

27. Wesfarmers anticipates that it will pay a fully franked dividend of approximately \$1.2 billion (\$1.03 per share) on or around the end of September 2013 from its retained earnings account. This will bring the total dividend for the year to \$2.1 billion.

28. For the year ended 30 June 2013, Wesfarmers' retained earnings will be \$2,375 million (\$1,160 million post final dividend).

29. Wesfarmers has confirmed that its share capital account (as defined in section 975-300 of the ITAA 1997) is not tainted (within the meaning of Division 197 of the ITAA 1997).

30. A Wesfarmers share is not an 'indirect Australian real property interest' as defined in section 855-25 of the ITAA 1997. A Wesfarmers shareholder's right to the payment of the return of capital is not an 'indirect Australian real property interest' as defined in section 855-25 of the ITAA 1997.

Ruling

Return of capital is not a dividend for income tax purposes

31. The payment of the return of capital to Wesfarmers shareholders will not be a dividend, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C to the return of capital

32. The Commissioner will not make a determination under section 45A or 45B that section 45C applies to the return of capital. Accordingly, no part of the return of capital will be taken to be a dividend for income tax purposes.

CGT consequences

33. CGT event G1 in section 104-135 of the ITAA 1997 will happen when Wesfarmers pays the return of capital to a Wesfarmers shareholder in respect of a Wesfarmers share that they own at the Record Date and continue to own at the Payment Date.

34. CGT event C2 in section 104-25 of the ITAA 1997 will happen when Wesfarmers pays the return of capital to a Wesfarmers shareholder in respect of a Wesfarmers share that they own at the Record Date but which they cease to own before the Payment Date.

Foreign resident shareholders

35. A Wesfarmers shareholder who is a foreign resident just before CGT event G1 happens, disregards any capital gain made when CGT event G1 happens if their shares in Wesfarmers are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

36. A Wesfarmers shareholder who is a foreign resident just before CGT event C2 happens, disregards any capital gain or capital loss made when CGT event C2 happens if their right to the return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Share consolidation

37. Under with section 112-25 of the ITAA 1997, the consolidation of Wesfarmers shares will not result in a CGT event happening where the company converts its shares in accordance with section 254H of the Corporations Act.

Commissioner of Taxation4 September 2013

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 capital is not a dividend

38. 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).

39. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However paragraph (d) of the definition of dividend specifically 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.

40. '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 after 1 July 1998 where the first amount credited to the account was an amount of share capital.

41. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted.

42. The return of capital will be debited against an amount standing to the credit of Wesfarmers' share capital account. As the share capital account of Wesfarmers is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) will apply and the return of capital will not constitute a dividend under subsection 6(1).

Anti-avoidance provisions

Sections 45A and 45B

43. Sections 45A and 45B are 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 capital to be received by Wesfarmers shareholders as an unfranked dividend.

Section 45A – streaming of dividends and capital benefits

44. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

45. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) will be provided to participating Wesfarmers shareholders under the return of capital, the circumstances of the return of capital indicate that there will be no streaming of capital benefits to some shareholders and dividends to other shareholders.

46. Accordingly, section 45A has no application to the return of capital.

Section 45B – schemes to provide capital benefits

47. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- under the scheme a taxpayer (the 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, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

48. Each of these conditions is considered in this Ruling.

The Scheme

49. A scheme for the purpose of section 45B is defined under subsection 995-1(1) of the ITAA 1997 to include:

- any agreement; or
- any scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise.

50. The arrangement involving Wesfarmers return of capital to the Wesfarmers shareholders will constitute a 'scheme' for the purposes of section 45B.

Capital benefit

51. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). It states that a person is provided with a capital benefit if:

- an ownership interest in a company is issued to the person;
- there is a distribution to the person of share capital; or
- the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest (which may or may not be the same interest) held by that person.

52. Wesfarmers' return of capital will be recorded as a debit to the share capital account and Wesfarmers shareholders will receive a distribution of share capital to the value of \$0.50 per share. Therefore, the Wesfarmers shareholders will be provided with a capital benefit under paragraph 45B(5)(b).

Tax benefit

53. A relevant taxpayer 'obtains a tax benefit' as defined in subsection 45B(9), if:

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

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 an assessable dividend.

54. As discussed in paragraph 52 of this Ruling, the payment of the return of capital to Wesfarmers shareholders will be a capital benefit. In the event that the return of capital did represent a dividend rather than a capital benefit, it is likely that a Wesfarmers shareholder would incur a greater tax liability. Consequently, receipt of the capital benefit by the Wesfarmers shareholders will be a tax benefit.

55. A return of capital would ordinarily be subject to the CGT provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the shares, there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). It is only to the extent (if any) that the distribution exceeds the cost base of the shares that a capital gain arises. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or in the case of a foreign resident, be subject to dividend withholding tax under section 128B. Therefore, Wesfarmers shareholders will obtain a tax benefit from the return of capital.

Relevant circumstances

56. 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.

57. 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.

58. The purpose which causes section 45B to apply may be the purpose of any party to the scheme.

59. Having regard to the relevant circumstances of the scheme, it cannot be concluded that the scheme is proposed to be entered into for a more than incidental purpose of enabling a taxpayer to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the return of capital.

CGT consequences

CGT event G1 – section 104-135

60. CGT event G1 (section 104-135 of the ITAA 1997) 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 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 of the ITAA 1936; and
- the payment is not included in the shareholder's assessable income.

61. No part of the return of capital to a Wesfarmers shareholder will be a dividend, nor included in a shareholder's assessable income.

62. Accordingly, CGT event G1 will happen when Wesfarmers pays the return of capital to a Wesfarmers shareholder in respect of a Wesfarmers share that they own at the Record Date and continue to own at the Payment Date.

63. If the return of capital (\$0.50 per fully paid share) is not more than the cost base of the Wesfarmers share at the Payment Date, the cost base and reduced cost base of the share will be reduced (but not below nil) by the amount of the return of capital (subsection 104-135(4) of the ITAA 1997).

64. A Wesfarmers shareholder will make a capital gain if the amount of the return of capital (\$0.50 per fully paid share) is more than the cost base of the Wesfarmers share (subsection 104-135(3) of the ITAA 1997). The amount of the capital gain is equal to that excess.

65. If a Wesfarmers shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the Wesfarmers share is reduced to nil. A Wesfarmers shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3) of the ITAA 1997).

66. If the Wesfarmers share to which the return of capital relates was acquired by a Wesfarmers shareholder at least 12 months before the payment, a capital gain from CGT event G1 happening may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions in Division 115 of the ITAA 1997 are satisfied.

CGT event C2 – section 104-25

67. The right to receive the payment of the return of capital is one of the rights inherent in a Wesfarmers share at the Record Date. If, after the Record Date but before the Payment Date, a Wesfarmers shareholder ceases to own some, or all, of their shares in Wesfarmers, the right to receive the payment of the return of capital in respect of each of the shares disposed of will be retained by the shareholder and is considered to be a separate CGT asset.

68. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the return of capital is paid. The right to receive the payment (being an intangible CGT asset) will end by the right being discharged or satisfied when the payment is made.

69. A Wesfarmers shareholder will make a capital gain if the capital proceeds from the ending of the right are more than its cost base. The capital gain is equal to the amount of the excess. A Wesfarmers shareholder will make 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) of the ITAA 1997).

70. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the return of capital (\$0.50 per fully paid share) (subsection 116-20(1) of the ITAA 1997).

71. The cost base of a Wesfarmers shareholder's right to receive the return of 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 the Wesfarmers shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share – for example, when the Wesfarmers shareholder disposed of the share after the Record Date.

72. Therefore, if the full cost base or reduced cost base of a Wesfarmers share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share, the right to receive the return of capital is likely to have a nil cost base.

73. As the right to receive the payment of the return of capital was inherent in the Wesfarmers share during the time it was owned, the right is considered to have been acquired at the time when the share was acquired (section 109-5 of the ITAA 1997).

74. Accordingly, if the Wesfarmers share was acquired by the Wesfarmers shareholder at least 12 months before the return of capital was paid, a capital gain from CGT event C2 happening on the ending of the corresponding right may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions in Division 115 of the ITAA 1997 are satisfied.

Foreign resident shareholders

75. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens, and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

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

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

77. Wesfarmers has advised that, at the time CGT event G1 happens for any foreign resident Wesfarmers shareholder who is entitled to the return of capital, a Wesfarmers share will not be an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997).

78. A Wesfarmers shareholder who is a foreign resident just before CGT event C2 happens, disregards any capital gain or capital loss made when CGT event C2 happens if their right to the return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Share consolidation

79. A CGT event will not happen if a company converts its shares into a larger or smaller number of shares (the converted shares) in accordance with section 254H of the Corporations Act in that:

- (a) the original shares are not cancelled or redeemed in terms of the Corporations Act;
- (b) there is no change in the total amount allocated to the share capital account of the company; and
- (c) the proportion of equity owned by each shareholder in the share capital account is maintained.

While there is a change in the form of the original shares, there is no change in their beneficial ownership.

80. The converted shares will have the same date of acquisition as the original shares to which they relate.

81. Where the original shares were acquired on or after 20 September 1985, subsection 112-25(4) of the ITAA 1997 provides that each element of the cost base and reduced cost base of the converted shares is the sum of the corresponding elements of each original share.

Appendix 2 – Detailed contents list

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

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| <i>Previous draft:</i> | - ITAA 1936 45B(8) |
| Not previously issued as a draft | - ITAA 1936 45B(9) |
| | - ITAA 1936 45C |
| <i>Related Rulings/Determinations:</i> | - ITAA 1936 45C(1) |
| TR 2006/10; TD 2000/10 | - ITAA 1936 45C(2) |
| | - ITAA 1936 47 |
| | - ITAA 1936 318 |
| <i>Subject references:</i> | - ITAA 1997 104-25 |
| - capital gains tax | - ITAA 1997 104-25(3) |
| - capital reductions | - ITAA 1997 104-135 |
| - CGT events C1-C3 – end of a CGT asset | - ITAA 1997 104-135(3) |
| | - ITAA 1997 104-135(4) |
| - CGT events G1-G3 – shares | - ITAA 1997 104-165(3) |
| - dividend income | - ITAA 1997 109-5 |
| - return of capital on shares | - ITAA 1997 Div 110 |
| - share capital | - ITAA 1997 Div 112 |
| | - ITAA 1997 Div 115 |
| <i>Legislative references:</i> | - ITAA 1997 115-25(1) |
| - ITAA 1936 6(1) | - ITAA 1997 116-20(1) |
| - ITAA 1936 44 | - ITAA 1997 Div 197 |
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| - ITAA 1936 45A | - ITAA 1997 855-10 |
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| - ITAA 1936 45B | - ITAA 1997 975-300 |
| - ITAA 1936 45B(2)(a) | - ITAA 1997 975-300(3) |
| - ITAA 1936 45B(2)(b) | - ITAA 1997 995-1(1) |
| - ITAA 1936 45B(2)(c) | - TAA 1953 |
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ATO references

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