



CR 2005/86 - Income tax: Baycorp Advantage Limited: return of capital and on-market share buy-back

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Class Ruling

Income tax: Baycorp Advantage Limited: return of capital and on-market share buy-back

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Class Ruling are:
- section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 45B of the ITAA 1936;
 - section 45C of the ITAA 1936;
 - Division 16K of Part III of the ITAA 1936;
 - section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-25 of the ITAA 1997;
 - section 104-135 of the ITAA 1997; and
 - section 136-10 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the holders of ordinary shares in Baycorp Advantage Limited (Baycorp Advantage) who hold those shares on capital account and who are to receive a return of capital (the Proposed Capital Return), and/or participate in the on-market share Buy-back (the Proposed On-Market Buy-back) under the Arrangement described in paragraphs 11 to 19 of this Ruling. In this Ruling, this class of persons is referred to as 'Participating Shareholders'.

Qualifications

4. The Commissioner makes this ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 11 to 19.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

8. This Class Ruling applies to the income years (as defined in subsection 995-1(1) of the ITAA 1997) for a Participating Shareholder who receives the Proposed Capital Return and/or participates in the Proposed On-Market Buy-back. The arrangement, as described in paragraphs 11 to 19, will be completed within those income years.

9. For Participating Shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2006 for the Proposed Capital Return, and the income years ending 30 June 2006 and 2007 for the Proposed On-Market Buy-back. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2006 for the Proposed Capital Return and 30 June 2007 for the Proposed On-Market Buy-back. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling subject to there being no change in the arrangement or in the persons' involvement in the Arrangement.

Arrangement

11. The arrangement that is the subject of the Ruling is described below. The description is based on the following documents:

- the application letter from Baycorp Advantage requesting a Class Ruling dated 7 September 2005 and accompanying:
 - Baycorp Advantage 2005 Annual Result presentation dated 19 August 2005;
 - Baycorp Advantage Preliminary Final Report 30 June 2005;
 - Baycorp Advantage Target Statement 30 August 2005; and
 - Baycorp Advantage Media Release dated 19 August 2005; and

- further correspondence from PricewaterhouseCoopers dated 28 September 2005.

Note: Information received from Baycorp Advantage and PricewaterhouseCoopers has been provided on a commercial-in-confidence basis, and will not be disclosed or released under the Freedom of Information legislation.

12. Baycorp Advantage is an Australian resident public company listed on the Australian Stock Exchange.

13. On 19 August 2005, Baycorp Advantage announced an arrangement to return approximately \$150 million to its shareholders as part of its ongoing capital management program. The arrangement will consist of the Proposed Capital Return of \$0.50 per share on a pro-rata basis to all shareholders, and the Proposed On-Market Buy-back of up to 5% of issued share capital.

14. The amount of \$150 million will be funded by external borrowing.

15. The Proposed Capital Return will follow the Baycorp Advantage's 2005 final dividend of 8 cents per share.

16. Baycorp Advantage has \$378 million in share capital, with approximately 228 million shares on issue.

17. Both the Proposed Capital Return and the Proposed On-Market Buy-back should be wholly debited to Baycorp Advantage's share capital account.

18. Baycorp Advantage has a substantial number of non-resident shareholders.

19. Baycorp Advantage's share capital account is untainted.

Ruling

20. The Commissioner will not make a determination pursuant to subsections 45A(2) or 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the Proposed Capital Return or the Proposed On-Market Buy-back.

21. The Proposed On-Market Buy-back will be treated as an on-market share buy-back according to Division 16K of Part III of the ITAA 1936.

22. CGT event A1, in section 104-10 of the ITAA 1997, will happen to a Participating Shareholder who sells their shares to Baycorp Advantage in the Proposed On-Market Buy-back.

23. CGT event G1, in section 104-135 of the ITAA 1997, will happen when Baycorp Advantage pays the Proposed Capital Return to a Participating Shareholder in respect of a share they own at the Payment Date.

24. CGT event C2, in section 104-25 of the ITAA 1997, will happen when Baycorp Advantage pays the Proposed Capital Return to Participating Shareholders in respect of a share they own at the Record Date but have disposed of before the Payment Date.

25. A non-resident Participating Shareholder who either receives the Proposed Capital Return or sells their shares in the Proposed On-Market Buy-back will make a capital gain if their share has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Explanation

Anti-avoidance provisions

26. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C of the ITAA 1936 that all or part of the return of capital amount received by the shareholders is treated as an unfranked dividend.

Section 45A of the ITAA 1936

27. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or would receive dividends (the disadvantaged shareholders).

28. Baycorp Advantage will provide shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) under the Proposed Capital Return and the Proposed On-Market Buy-back. However, having considered the relevant circumstances of the Proposed Capital Return and the Proposed On-Market Buy-back, it cannot be concluded that capital benefits and dividends are being channelled by Baycorp Advantage to its shareholders, in a manner that enables advantaged shareholders to receive capital benefits whilst disadvantaged shareholders will receive dividends, as all shareholders of Baycorp Advantage would enjoy similar rights of access to both the Proposed Capital Return and the Proposed On-Market Buy-back with no option of receiving a dividend in place of the capital benefit.

29. Therefore, section 45A of the ITAA 1936 has no application to either the Proposed Capital Return or the Proposed On-Market Buyback.

Section 45B of the ITAA 1936

30. The purpose of section 45B of the ITAA 1936 is to ensure that the relevant amounts distributed to shareholders are treated as dividends for tax purposes if certain payments, allocations and distributions are made 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) of the ITAA 1936);
- under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b) of the ITAA 1936); 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, (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

31. Each of these conditions is considered below.

32. A scheme for the purposes of section 45B is defined in terms of subsection 177A(1) by section 160APA of Part IIIAA of the ITAA 1936.

33. A scheme is defined in subsection 177A(1) to include:

- any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- any scheme, plan, proposal, action, course of action or course of conduct.

34. The arrangement involving the Proposed Capital Return and the Proposed On-Market Buy-back will constitute a scheme for the purposes of section 45B.

35. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936 and includes a distribution to a person of share capital. As the Proposed Capital Return and the Proposed On-Market Buy-back will be recorded by means of a debit to Baycorp Advantage's untainted share capital account, its shareholders would be taken to have been provided with a capital benefit as defined in paragraph 45B(5)(b).

36. A taxpayer 'obtains a tax benefit', as defined in subsection 45B(9) of the ITAA 1936, where:

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

by the relevant 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.

37. As discussed in paragraph 35, the distributions shareholders will receive under the Proposed Capital Return and the Proposed On-Market Buy-back will both represent a return of capital and constitute a capital benefit. In the event that the relevant distribution did represent a dividend rather than a capital benefit, it is likely that some shareholders would have incurred a greater liability to tax. Consequently, the receipt of the capital benefit will represent a tax benefit to those shareholders.

38. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the relevant circumstances (as outlined in subsection 45B(8) of the ITAA 1936) of the scheme with a view to determine whether it could be concluded that persons that entered into or carried out the scheme or any part of the scheme did so for a purpose (other than an incidental purpose), of enabling the relevant taxpayer to obtain a tax benefit. Having considered all relevant circumstances, the Commissioner has formed the view that the capital benefits provided to the relevant taxpayers do not represent a payment in substitution for dividends.

39. Consequently section 45B of the ITAA 1936 will not apply to either the Proposed Capital Return or the On-Market Buyback.

Division 16K and CGT event A1 in respect of the Proposed On-Market Buy-back

40. Division 16K of Part III of the ITAA 1936 provides that no part of the amount of the purchase price of a share in an on-market purchase is taken to be a dividend (section 159GZZZR of ITAA 1936). The term 'on-market purchase' is defined in section 159GZZZJ of the ITAA 1936.

41. The total amount received on the share sale by a Participating Shareholder is, for both general income tax and the capital gains tax (CGT) purposes, treated as the consideration in respect of the disposal of the share (section 159GZZZS of the ITAA 1936).

42. As the proposed Buy-back would be conducted on-market, any payments received by the Participating Shareholders will therefore be treated as capital proceeds for CGT purposes provided they were holding the shares on capital account.

43. CGT event A1, in section 104-10 of the ITAA 1997 happens if there is a change in the ownership of an asset from one entity to another. The event happens when a contract to dispose of the asset is entered into or if there is no contract, when the change of ownership occurs.

44. The timing of the event is when you enter into the disposal contract, or if there is no contract, the time when change of ownership occurs (subsection 104-10(3) of the ITAA 1997).

45. The disposal of Baycorp Advantage shares under the Proposed On-Market Buy-back by the Participating Shareholders will trigger CGT event A1. Participation in the Proposed On-Market Buy-back is voluntary. Shareholders who participated in the Proposed On-Market Buy-back will not be entitled to any other distributions by Baycorp Advantage in respect of the disposed shares. Therefore, there will be a genuine share disposal by Participating Shareholders.

46. Where CGT event A1 happens, a Participating Shareholder will make on the disposal of each Baycorp Advantage share:

- a capital gain if the capital proceeds from the disposal are more than the share's cost base; or
- a capital loss if the capital proceeds are less than the share's reduced cost base (subsection 104-10(4) of ITAA 1997).

47. Furthermore, if the share was originally acquired by a Participating Shareholder at least 12 months before its sale under the Proposed On-Market Share Buy-back, a capital gain from CGT event A1 happening may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

The Proposed Capital Return and CGT event G1

48. CGT event G1 in section 104-135 of the ITAA 1997 will happen when Baycorp Advantage pays the Proposed Capital Return amount in respect of a share that a Participating Shareholder owned at the Record Date and continues to own at the payment time and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

49. Baycorp Advantage proposes to make the payment to its Participating Shareholders out of its share capital account. This payment will not be a dividend as defined. If the Proposed Capital Return amount (\$0.50 per share) is not more than the cost base of the Baycorp Advantage share at the time of the payment, the cost base and reduced cost base of the share are reduced by that amount (subsection 104-135(4) of the ITAA 1997).

50. A Participating Shareholder will make a capital gain if the return of capital amount is more than the cost base of their Baycorp Advantage share. The amount of the capital gain is equal to this excess.

51. If a Participating Shareholder makes a capital gain, the cost base and reduced cost base of the share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

52. A Participating Shareholder cannot make a capital loss under CGT event G1.

53. Consequently, if the share was originally acquired by a Participating Shareholder at least 12 months before the payment of the Proposed Capital Return amount, a capital gain from CGT event G1 happening to the share may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

CGT event C2

54. If between the Record Date and the time of the payment of the Proposed Capital Return a Participating Shareholder has ceased to own some, or all, of their shares in Baycorp Advantage the right to the payment is considered to be a separate CGT asset. This is because the right to the payment has been separated from the bundle of rights that once attached to the share.

55. A Participating Shareholder's right to receive the payment will be discharged or satisfied when the payment is made under the arrangement, causing CGT event C2 in section 104-25 of the ITAA 1997 to happen.

56. In working out the capital gain or capital loss made from CGT event C2 happening, the capital proceeds from the event will be the return of capital amount.

57. The cost base of the Participating Shareholder's right to receive a payment under the arrangement is worked out in accordance with Division 110 of the ITAA 1997. However, the cost base of the right will be nil if the full cost base (or reduced cost base) of the share previously held by the Participating Shareholder has been applied in working out a capital gain or loss made when a CGT event happened to the share – for example, when the Participating Shareholder disposed of the share. In these cases, the Participating Shareholder will generally make a capital gain equal to the amount paid under the Proposed Capital Return.

58. Because the right to a payment of the Proposed Capital Return was inherent in the share during the time it was owned then, for the purposes of Subdivision 109-A of the ITAA 1997, the right is considered to have been acquired at the time when the share was acquired.

59. Consequently, if the share to which the payment relates was originally acquired by a Participating Shareholder at least 12 months before the payment of the Proposed Capital Return amount, a capital gain from CGT event C2 happening to the right may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

Non-resident shareholders

60. Pursuant to section 136-10 of the ITAA 1997, a non-resident participating shareholder will make a capital gain from the Proposed Capital Return and/or Proposed On-Market Buy-back only if their Baycorp Advantage shares have the necessary connection with Australia. Under category 5 of the table in section 136-25 of the ITAA 1997, a Baycorp Advantage share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the Proposed Capital Return or the disposal of Baycorp Advantage shares under the Proposed On-Market Buy-back, the participating shareholder together with their associates owned 10% or more by value of the issued shares in Baycorp Advantage.

Detailed contents list

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Commissioner of Taxation

26 October 2005

<i>Previous draft:</i>	- ITAA 1936 45B(5)
Not previously issued as a draft	- ITAA 1936 45B(5)(b)
	- ITAA 1936 45B(8)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(9)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 45C
TR 97/16	- ITAA 1936 Pt III Div 16K
	- ITAA 1936 159GZZZJ
<i>Subject references:</i>	- ITAA 1936 159GZZZR
- capital reduction	- ITAA 1936 159GZZZS
- reduction of share capital	- ITAA 1936 160APA
- return of share capital	- ITAA 1936 177A(1)
	- ITAA 1997 104-10
<i>Legislative references:</i>	- ITAA 1997 104-10(3)
- Copyright Act 1968	- ITAA 1997 104-10(4)
- TAA 1953 Pt IVA	- ITAA 1997 104-25
- ITAA 1936 45A	- ITAA 1997 104-135
- ITAA 1936 45A(2)	- ITAA 1997 104-135(3)
- ITAA 1936 45A(3)	- ITAA 1997 104-135(4)
- ITAA 1936 45A(3)(b)	- ITAA 1997 Subdiv 109-A
- ITAA 1936 45B	- ITAA 1997 Div 110
- ITAA 1936 45B(2)	- ITAA 1997 Subdiv 115-A
- ITAA 1936 45B(2)(a)	- ITAA 1997 115-25(1)
- ITAA 1936 45B(2)(b)	- ITAA 1997 136-10
- ITAA 1936 45B(2)(c)	- ITAA 1997 136-25
- ITAA 1936 45B(3)	- ITAA 1997 995-1(1)

ATO references

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