


CR 2008/34 - Income tax: return of capital: Hansen Technologies Ltd

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Class Ruling

Income tax: return of capital: Hansen Technologies Ltd

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	9
Scheme	14
Ruling	30
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	32
Appendix 2:	
<i>Detailed contents list</i>	58

ⓘ 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 (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided 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

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; and
 - section 45C of the ITAA 1936.

All references are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies are those shareholders who hold ordinary shares in Hansen Technologies Limited and who participate in the scheme described in paragraphs 14 to 29 of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme 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 14 to 29 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.
7. This Ruling does not provide guidance on any further income taxation implications that may arise for the shareholders as a consequence of any of the relevant provisions applying.
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Date of effect

9. This Ruling applies from 1 July 2007 to 30 June 2008.
10. The Ruling does not apply to taxpayers 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.
11. If this 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)).

12. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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.

13. 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).

Scheme

14. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them, form part of and are to be read with the description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- Class Ruling application, dated 25 September 2007; and
- additional information provided by the applicant between 12 October 2007 and 17 April 2008.

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

Background

15. Hansen Technologies Limited (Hansen) is a public company listed on the Australian Securities Exchange.

16. Hansen is the parent company of a group of entities that comprise a tax consolidated group.

17. The principal activities of the Hansen accounting consolidated entity at all relevant times includes the development, integration and support of billing systems software for the telecommunications and utilities industries.

18. During and prior to 2005, Hansen experienced difficult trading conditions. By 30 September 2005, the company's cash position had deteriorated to such an extent that it had almost reached its bank overdraft limit.

19. On 5 October 2005, Hansen undertook a capital raising by issuing an additional 32,198,472 shares at 20 cents per share. This additional capital was raised pursuant to a Non-Renounceable rights issue. Under the terms of the rights issue, shareholders were offered two new shares for every five shares held at the record date of 19 September 2005. In total, the company raised \$6,439,694.40 of additional share capital from its existing shareholders.

20. Part of the money obtained from the capital raising was immediately applied to eliminate the bank overdraft. The remaining funds became cash reserves for use as working capital.

21. By 30 June 2006, Hansen's cash reserves had increased to approximately \$6.9 million notwithstanding the fact that it recorded an accounting loss of \$865,000 for the year ended 30 June 2006. On an accounting consolidated entity basis, the Hansen group recorded a profit of \$724,000 for the same year.

22. By 30 June 2007, the cash reserves had increased to approximately \$11.9 million on a consolidated entity basis.

23. Hansen did not declare or pay any dividends during the years ending 30 June 2006 and 2007.

24. Given the surplus nature of the cash reserves that exist in respect of the Hansen accounting consolidated entity, the directors of Hansen proposed a return of capital of \$3,026,016 (two cents per share) to shareholders.

25. Hansen, through its subsidiary Hansen Corporation Investments Pty Ltd (HCI), acquired Hansen Professional Services Pty Ltd (HPS) on 1 April 2002 for approximately \$8.8 million. On 30 August 2007, HPS was sold for a profit of \$1.2 million.

26. The projected franking account balance at 30 June 2008 is \$22,277.

27. Hansen has a stated policy of distributing by way of dividends approximately 50% of annual profits.

28. Hansen has declared unfranked dividends of four cents per share (approximately \$6,000,000 in total) in respect of profits attributable to the six months ended 31 December 2007. A dividend of three cents per share was paid in December 2007.

29. A subsequent dividend of one cent per share was paid in March 2008. Given that Hansen reported a half year (to 31 December 2007) profit after tax of approximately \$12 million (including the profit on the sale of Hansen Professional Services Pty Ltd), the payment of this unfranked dividend represents approximately 50% of its half year profit.

Ruling

Distribution is not a dividend for income tax purposes

30. The proposed return of capital to the ordinary shareholders of Hansen will not be a dividend, as defined in subsection 6(1).

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

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

Commissioner of Taxation

7 May 2008

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.*

Dividend

32. 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).

33. 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' of subsection 6(1) excludes a distribution from the meaning of 'dividend' if the amount of a distribution is debited against an amount standing to the credit of the company's share capital account.

34. 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.

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

36. The proposed return of capital will be recorded as a debit to Hansen's share capital account. As the share capital account of Hansen is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies. Accordingly, the proposed return of capital will not constitute a dividend.

Anti-avoidance provisions

37. 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 unfranked dividend that is paid by the company out of profits to the shareholder.

Section 45A

38. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the capital benefits than other shareholders (the Disadvantaged Shareholders) and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

39. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in section 45A(3) to include the distribution to the shareholder of share capital. The proposed return of share capital in the present case by Hansen to its shareholders will constitute the provision of a capital benefit. However, as Hansen will make a pro-rata return of capital to all of its shareholders in respect of their ordinary shares in Hansen, there will be no streaming of capital benefits to some shareholders and not to others. Therefore, section 45A will have no application in respect of the proposed return of capital. Accordingly, the Commissioner will not be entitled to make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the capital benefit.

Section 45B – schemes to provide capital benefits in substitution for dividends

40. Section 45B applies where certain payments are made to shareholders in substitution for dividends.

41. 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 (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, 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 the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Each of these conditions is considered below.

Scheme

42. A 'scheme' for the purposes of section 45B is taken to have the same meaning as provided in subsection 177A(1) of Part IVA. That definition is widely drawn and includes any agreement, arrangement, understanding, promise, undertaking, scheme plan or proposal.

43. A return of share capital would constitute a scheme for the purposes of paragraph 45B(2)(a), because the return of capital will provide shareholders with a capital benefit.

Tax benefit

44. A 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 a dividend.

45. Therefore, Hansen shareholders will obtain tax benefits from the return of capital.

Relevant circumstances

46. Under paragraph 45B(2)(c) the Commissioner is required to consider the 'relevant circumstances' set out under 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.

47. The test of purpose is an objective one. The question is whether, objectively, 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. This purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

48. The relevant circumstances under subsection 45B(8) cover both the circumstances of the company and the shareholders. In this instance, as the return of capital is to be made to all Hansen shareholders, regardless of their individual 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 demerger, are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

49. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, Hansen will make a pro-rata return of capital to its Shareholders in respect of their ordinary shares. The company proposes to return approximately \$3,026,016 (approximately \$0.02 per share) to shareholders as a return of capital. Hansen will fund the Capital Return from existing cash reserves.

50. Hansen has submitted that the Capital Return is not attributable to the profits of Hansen. In this regard, Hansen believes that the Capital Return represents a return of excess capital raised from existing shareholders in October 2005.

51. Prior to the time of the proposed Capital Return, Hansen declared unfranked dividends of four cents per share in respect of profits for the first half of the fiscal year ended 31 December 2007 which included the gain on the sale of HPS. This is consistent with its stated policy of paying 50% of profits to shareholders as dividends. Further, Hansen believes that the cash reserves of the company represent a part of the October 2005 capital raising that has not been utilised by the company, and that this amount is of a similar quantum to the proposed capital return. In this context, it is accepted that the Capital Return will be attributable to the capital raised by Hansen in October 2005.

52. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate (within the meaning of section 318) of the company. Hansen has a stated dividend policy of paying 50% of annual profits as a dividend.

53. Due to the ongoing losses of Hansen, it has not maintained a regular pattern of paying dividends to its shareholders.

54. With respect to the current year profit, including the profit generated on the sale of HPS, Hansen has declared a four cents per share dividend paid in two tranches. The first tranche had a record date of 12 December 2007 for the amount of three cents and the second tranche had a record date of 22 February 2008 for the amount of one cent. Hansen has also proposed a return of capital to shareholders for the amount of two cents per share.

55. Paragraph 45B(8)(k) refers to the matters in paragraphs 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 entered into or carried out, its form and substance and its financial and other implications for the persons involved. In this case the practical implications of the scheme for Hansen and its shareholders are consistent with it being, in form and substance, a return of capital.

56. Therefore, having regard to the relevant circumstances of the scheme to return capital to Hansen's ordinary shareholders as discussed in paragraphs 14 to 29 of this Ruling, it could not be concluded that Hansen will enter into or carry out the scheme for more than an incidental purpose of enabling the shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the return of capital.

Application of section 45C

57. 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 to deem any part of the proposed return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or of the ITAA 1997.

Appendix 2 – Detailed contents list

58. The following is a detailed contents list for this ruling:

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	9
Scheme	14
Background	15
Ruling	30
Distribution is not a dividend for income tax purposes	30
The application of sections 45A, 45B and 45C to the proposed return of capital	31
Appendix 1 – Explanation	32
Dividend	32
Anti-avoidance provision	37
Section 45A	38
Section 45B – schemes to provide capital benefits in substitution for dividends	40
Scheme	42
Tax benefit	44
Relevant circumstances	46
Application of section 45C	57
Appendix 2 – Detailed contents list	58

References

Previous draft:

Not previously issued as a draft

Subject references:

- Capital benefits
- Dividend income
- Dividend streaming arrangements
- Return of capital on shares

Legislative references:

- 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)
 - ITAA 1936 45B(8)(j)
 - ITAA 1936 45B(8)(k)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1936 Pt IVA
 - ITAA 1936 177A(1)
 - ITAA 1936 177D(b)(i)
 - ITAA 1936 177D(b)(ii)
 - ITAA 1936 177D(b)(iii)
 - ITAA 1936 177D(b)(iv)
 - ITAA 1936 177D(b)(v)
 - ITAA 1936 177D(b)(vi)
 - ITAA 1936 177D(b)(vii)
 - ITAA 1936 177D(b)(viii)
 - ITAA 1936 318
 - ITAA 1997
 - ITAA 1997 Div 197
 - ITAA 1997 975-300
 - ITAA 1997 975-300(3)
 - TAA 1953
 - TAA 1953 Sch 1 357-75(1)
 - Copyright Act 1968
 - ITAA 1936 6(1)
 - ITAA 1936 44(1)
 - ITAA 1936 45A
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 - ITAA 1936 45A(3)
 - 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 45B(8)
 - ITAA 1936 45B(8)(a)
 - ITAA 1936 45B(8)(b)
 - ITAA 1936 45B(8)(c)
 - ITAA 1936 45B(8)(d)
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ATO references

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