


***CR 2009/15 - Income tax: return of capital: DSF
International Holdings Limited (previously Deep Sea
Fisheries Limited)***

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Class Ruling

Income tax: return of capital: DSF International Holdings Limited (previously Deep Sea Fisheries Limited)

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① 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 provisions 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 855-10 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936 unless indicated otherwise.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of DSF International Holdings Limited (DSF) who:
- (a) were ordinary shareholders in DSF on the Record Date (being the date for determining entitlements to the return of capital) and who received distributions under the share capital reduction as described in paragraphs 10 to 22 of this Ruling; and
 - (b) held their DSF shares on capital account.

Qualifications

4. The Commissioner makes this ruling 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 10 to 22 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.
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Date of effect

8. This Ruling applies from 1 July 2008 to 30 June 2009. The Ruling continues to apply after 30 June 2009 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).

Previous Rulings

9. CR 2007/97 Income tax: return of capital: Deep Sea Fisheries Limited.

Scheme

10. 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 application for class ruling dated 18 September 2008;
- the documents received with the class ruling application dated 18 September 2008; and
- a letter dated 4 December 2008 received from 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.

11. On 31 January 1986 DSF was incorporated as Deep Sea Fisheries Limited as an Australian resident public company listed on the Australian Securities Exchange (ASX).

12. The DSF group owned and operated a fleet of fishing vessels in various Australian fisheries. The Group operated in two main fishing areas:

- the Northern Prawn Fishery (NPF), access to which is provided by ownership of access rights, known as Statutory Fishing Rights (SFRs); and
- the North West Slope Trawl Fishery (NWSTF).

13. In late 2005 the Government announced a \$220 million Structural Adjustment Package (SAP) aimed at reducing excess fishing effort to improve economic and biological sustainability in Australian fisheries. The SAP involved a 'buy-back' process whereby willing operators could tender their access rights and retire vessels from given fisheries.

14. As a result of the divestment of fishing access rights and vessels excess capital existed in DSF. In May 2007 a capital return of 11 cents per share totalling \$6,439,363 was made. That return of capital was the subject of Class Ruling CR 2007/97.

15. By July 2007 DSF had decided to pursue a different investment policy and settled the sale of its 2 remaining fishing vessels and the NWSTF permits. In November 2007 DSF paid a further special dividend from retained profits of \$0.01 per share, a total of \$585,397, to all ordinary shareholders.

16. As at 30 June 2008, the DSF group had

- \$998,496 issued capital;
- \$1,651,746 retained earnings; and
- \$2,790,791 in cash and cash equivalents.

17. As at 30 June 2008 there were 58,539,665 ordinary shares on issue. There was only one type of ownership interest on issue.

18. As at 4 September 2008 there were 358 ordinary shareholders, comprising 345 Australian residents and 13 foreign shareholders.

19. On 25 September 2008 DSF undertook

- a capital return of \$0.016 per fully paid ordinary share, totalling \$936,635; and
- a dividend payment of \$0.027 per share totalling \$1,580,571.

20. The return of capital of \$936,635 was funded from cash and cash equivalents and was debited against the untainted share capital account of DSF (as defined in section 975-300 of the ITAA 1997).

21. At a meeting on 7 November 2008, shareholders approved the proposal for a return of capital. Shareholders also approved a name change for the company to DSF International Holdings Limited, effective from 18 November 2008.

22. The Record Date for the return of capital was 18 November 2008 and the Payment Date was 25 November 2008.

Ruling

Distribution is not a dividend

23. The return of the share capital will not be a dividend, as defined in subsection 6(1).

Distribution will not be deemed a dividend under section 45C

24. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole, or any part, of the payment of the share capital received by the shareholders.

Capital gains tax

25. CGT event G1 happened when DSF paid the return of capital of \$0.016 per share to a DSF shareholder in respect of a DSF share that they owned at the time of payment (section 104-135 of the ITAA 1997).

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

Foreign resident shareholders

27. For a foreign resident shareholder, the payment of the return of capital only has CGT consequences if their DSF shares are 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

25 March 2009

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.*

Distribution is not a dividend

28. 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 a resident of Australia) and from an Australian source (if non-resident).

29. 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.

30. The term 'share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

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

32. The return of capital was debited against DSF's share capital account. As the share capital account was 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. Accordingly, the return of capital will not be a dividend as defined in subsection 6(1).

Anti-avoidance provisions

Sections 45A and 45B

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

Streaming of dividends and capital benefits: section 45A

34. Section 45A applies in circumstances where the 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.

35. DSF provided all its ordinary shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)). The capital benefit was provided to all shareholders in direct proportion to their individual shareholding. As all shareholders benefited equally from the return of capital, there was no indication of 'streaming' of capital benefits to some shareholders and not to others.

36. Accordingly, section 45A does not apply to the return of capital, and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the return of capital to the shareholders of DSF.

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

37. Section 45B applies where certain capital payments are provided to shareholders in substitution for dividends.

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

- 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 purposes 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

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

40. 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 DSF debited the return of capital against its share capital account, its shareholders were provided with a capital benefit.

Tax benefit

41. 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.

42. Ordinarily, a return of capital would be subject to the Capital Gains Tax (CGT) provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the share 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 share that a capital gain is made. A capital gain may not arise at all for certain foreign shareholders. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or, in the case of a non-resident, subject to dividend withholding tax under section 128B. Therefore, DSF shareholders obtained tax benefits from the return of capital.

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 was 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 DSF. The Commissioner cannot at this stage ascertain the purposes of DSF's numerous shareholders, all of whom were eligible to vote on the return of capital under section 256C of the *Corporations Act 2001* and all of whom participated in the return of capital to be paid. 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 voted 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 was made to all shareholders of DSF, regardless of individual shareholder circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to the purpose. The circumstances covered by paragraphs 45B(8)(i) and (j), pertaining to the provision of ownership interests and demerger respectively, are not relevant. 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, DSF has returned to its shareholders contributed share capital that is excess to current and future investment requirements. By July 2007, DSF had settled the sale of its remaining fishing vessels and NWSTF permits, and paid a special dividend of \$0.01 per share (\$585,397) from the proceeds to all ordinary shareholders in November 2007. DSF also paid a dividend of \$0.027 per share (\$1,580,571) on 25 September 2008. The dividend payment substantially cleared all of the retained realised profits of the company, and there are no substantial unrealised profits. Following the divestment of assets, the Board of DSF wanted the company to pursue a different investment policy and was of the opinion that the cash holdings were in excess of current and future capital requirements. Therefore, the capital distribution provided to shareholders is wholly attributable to share capital that is considered excess to requirements. No part of the return is attributable to specific profits, realised or unrealised, of DSF.

48. 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. DSF did not pay dividends in the 2004, 2005 and 2006 income years, though it did pay fully franked dividends in prior years. It paid fully franked special dividends of \$0.08 a share on 27 April 2007 and \$0.01 per share in November 2007 and an ordinary dividend of \$0.027 per share in September 2008. Accordingly the company's pattern of distributions does not suggest that the return of capital was made in substitution for a dividend.

49. 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, the timing of the scheme, its form and substance, and the financial and other implications for the parties involved.

50. DSF has demonstrated that the scheme seeks to return an amount of capital raised from the sale of its fishing business. The return has released capital which DSF has stated is excess to its current needs. The practical implications of the scheme are consistent with it having been, in form and substance, a return of capital.

51. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or any part, of the return of capital.

Application of section 45C

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

CGT event G1 – section 104-135

53. CGT event G1, in section 104-135 of the ITAA 1997, happened when DSF paid the return of capital in respect of each share that a DSF shareholder owned at the time of the payment as the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount that is taken to be a dividend under section 47.

54. Where the return of capital of \$0.016 per share is equal to or less than the cost base of the DSF share at the time of the payment, the cost base and reduced cost base of that DSF share is reduced (but not below nil) by the amount of the return of capital (subsection 104-135(4) of the ITAA 1997).

55. A DSF shareholder made a capital gain if the return of capital amount was more than the cost base of their DSF share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

56. Where a DSF shareholder made a capital gain as a result of the return of capital, the cost base and reduced cost base of their DSF share is reduced to nil (subsection 104-135(3) of the ITAA 1997).

57. If the DSF share was acquired by the shareholder at least 12 months before the time of payment of the return of capital, a capital gain made 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 Subdivision 115-A of the ITAA 1997 are satisfied).

58. A DSF shareholder cannot make a capital loss when CGT event G1 happens.

CGT event C2 – section 104-25

59. The right to receive the return of capital was one of the rights inherent in a DSF share at the Record Date. If, after the Record Date but before the Payment Date, a DSF shareholder ceased to own some, or all, of their shares in DSF, the right to receive the return of capital was retained by the shareholder and is considered to be a separate CGT asset.

60. CGT event C2 in section 104-25 of the ITAA 1997 happened when the return of capital was paid and the right to receive that payment ended.

61. A DSF shareholder made a capital gain if the capital proceeds from the ending of the right were more than the cost base of the right (subsection 104-25(3) of the ITAA 1997). The capital proceeds are the amount of the return of capital (section 116-20 of the ITAA 1997).

62. The cost base of the DSF shareholder's right to receive the return of capital is worked out in accordance with Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As the DSF shareholder has paid nothing for the right, the cost base of the right is nil. Therefore, the DSF shareholder made a capital gain equal to the amount of the return of capital.

63. As the right to receive the return of capital amount was inherent in the DSF 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).

64. Consequently, if the DSF share to which the payment relates was originally acquired by the former DSF shareholder at least 12 months before the payment of the return of capital, 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).

Foreign resident shareholders

65. A foreign resident disregards a capital gain or capital loss made from a CGT event that happens in relation to a CGT asset that is not 'taxable Australian property' (section 855-10 of the ITAA 1997). The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997 and covers five categories of assets.

66. Broadly, these categories are:

- taxable Australian real property which is held directly;
- indirect Australian real property interests which are not covered by item 5 of the table;
- CGT assets used in carrying on a business through a permanent establishment in Australia, and which are covered by item 1, 2 or 5 of the table;
- options or rights to acquire a CGT asset covered by item 1, 2 or 3 of the table; and
- CGT assets 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).

67. A foreign resident DSF shareholder who received a payment of the return of capital, and made a capital gain from CGT event G1 happening to the DSF shares, disregards the capital gain if the DSF shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

68. A foreign resident DSF shareholder who has a right to the payment of the return of capital, disregards any capital gain or capital loss made from CGT event C2 happening to that right because the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Previous Rulings/Determinations:

CR 2007/97

Subject references:

- capital benefit
- capital gains tax
- capital reductions
- dividend substitution
- return of capital on shares

Legislative references:

- ITAA 1936
- 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)(a)
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- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1936 128B
- ITAA 1936 177D(b)(i)
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- ITAA 1936 177D(b)(viii)
- ITAA 1936 318
- ITAA 1997
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
- ITAA 1997 104-135
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- ITAA 1997 104-165(3)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20
- ITAA 1997 Div 197
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 975-300
- ITAA 1997 975-300(3)
- ITAA 1997 995-1(1)
- Corporations Act 2001 256C
- TAA 1953
- Copyright Act 1968

ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 – shares