


***CR 2009/63 - Income tax: proposed return of capital:
Forrestfield & Districts Community Financial
Services Limited***

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Class Ruling

Income tax: proposed return of capital: Forrestfield & Districts Community Financial Services 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); and
- section 104-135 of the ITAA 1997.

All legislative references are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies consists of the ordinary shareholders of Forrestfield & Districts Community Financial Services Limited (Forrestfield) who:

- (a) are registered on the Forrestfield share register on the Record Date; and
- (b) hold their Forrestfield shares on capital account.

4. In this Ruling, a person belonging to this class of entities is referred to as a 'Forrestfield shareholder'.

Qualifications

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 9 to 23 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 2009 to 30 June 2010. The Ruling continues to apply after 30 June 2010 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

9. 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.

10. Forrestfield is an Australian resident public company which was incorporated on 3 November 2000.

11. Forrestfield operates under a franchise agreement with Bendigo Bank and provides banking services in Forrestfield, WA. The Franchise Agreement establishes the relationship between Forrestfield and Bendigo Bank and sets out the parameters within which Forrestfield must operate. Under the Franchise Agreement, Bendigo Bank holds the banking licence and Forrestfield derives income by receiving a trailing commission on transactions undertaken or products sold.

12. A condition in the Franchise Agreement was that Forrestfield raise a minimum amount of capital. This amount was calculated to cover start-up costs, franchise fees and an additional amount to protect against failure during the early years of operation.

13. \$525,615 of capital was raised in the year ended 30 June 2001 through the issue of initial subscriber shares to the directors and the proceeds of a public share offer. An additional \$12,200 of capital was raised in the year ended 30 June 2002.

14. To date, no capital has been returned to shareholders; however, regular dividends have been paid.

15. There is no requirement under the Franchise Agreement for a particular level of capital to be maintained.

16. The directors of Forrestfield consider that the amount of capital raised is excess to the company's requirements.

17. Forrestfield is proposing to make a return of capital to shareholders to be applied equally to each holder of fully paid ordinary shares. The amount proposed to be returned is \$271,405, equating to 50 cents per share. No shares will be cancelled.

18. The proposed return of capital will be paid to all entities who own Forrestfield shares on the Record Date.

19. Forrestfield will debit the whole of the proposed return of capital against its share capital account. Forrestfield 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).

20. As at 30 June 2009, Forrestfield had only one class of share on issue comprising 542,810 fully paid ordinary shares. As at 30 June 2009, Forrestfield's issued capital was \$537,815.

- 21. There are no foreign resident shareholders.
- 22. Forrestfield's current dividend policy will not change after this proposed return of capital.
- 23. The current business plans of the company do not require any of the capital proposed to be returned to fund any planned expansions or other capital expenditures.

Ruling

Distribution is not a dividend

- 24. The proposed return of capital to Forrestfield shareholders will not be a dividend, as defined in subsection 6(1).

Distribution will not be deemed a dividend under section 45C

- 25. The Commissioner will not make a determination under sections 45A or 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.

Capital gains tax

- 26. CGT event G1 (section 104-135 of the ITAA 1997) will happen when Forrestfield pays the proposed return of capital to a Forrestfield shareholder in respect of a Forrestfield share that they own at the Record Date and continue to own at the Payment Date.
- 27. CGT event C2 (section 104-25 of the ITAA 1997) will happen when Forrestfield pays the proposed return of capital to a Forrestfield shareholder in respect of a Forrestfield share that they owned at the Record Date but ceased to own before the Payment Date.

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 shareholders 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).

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' 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.

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, except for certain limited purposes, if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the account and the account is not already tainted.

32. The proposed return of capital will be recorded as a debit to Forrestfield's share capital account. As the share capital account of Forrestfield 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 be a dividend as defined in subsection 6(1).

Subsection 6(4)

33. The exclusion in paragraph (d) of the definition of dividend in subsection 6(1) is limited by subsection 6(4) which applies in circumstances where, under an arrangement:

- a company raises share capital, receiving either cash or property from a person or group of persons, crediting the amount of money or the value of the property to its share capital account; and
- returns the money or property to another person or group of persons, debiting the amount of the money or the value of the property to its share capital account.

34. In the present case, no arrangement exists under which Forrestfield raised share capital from certain shareholders and then will distribute the capital raised to other shareholders. Accordingly, subsection 6(4) will have no application in respect of the proposed return of capital.

Anti-avoidance provisions

Sections 45A and 45B

35. 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 paid by the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

36. 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.

37. A reference to the ‘provision of a capital benefit to a shareholder in a company’ is defined in paragraph 45A(3)(b) to include a distribution to the shareholder of share capital. In the present case, the proposed return of share capital by Forrestfield to its shareholders will constitute the provision of a capital benefit. However, as Forrestfield will make a pro-rata return of capital to all of its shareholders in respect of their shares in Forrestfield, and there is only one class of share on issue, there will be no streaming of capital benefits to some shareholders and not to others.

38. Therefore, section 45A will have no application in respect of the proposed return of capital. Accordingly, the Commissioner will not 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

39. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. The effect of such a determination is that all or part of the distribution of capital received by the shareholder under the return of capital is treated as an unfranked dividend.

40. In broad terms, section 45B applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- (b) 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)); and
- (c) 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

41. Under the present scheme, Forrestfield proposes to make a distribution of share capital to all of the Forrestfield shareholders. This will constitute the provision of a capital benefit in accordance with paragraph 45B(5)(b).

42. Pursuant to subsection 45B(9), it is likely that each of the Forrestfield shareholders to which this Ruling applies will obtain a tax benefit due to the capital benefit being assessed at a later time via the CGT regime rather than being assessed immediately under subsection 44(1) as a dividend.

43. However, having regard to the relevant circumstances of the scheme (defined to include the circumstances set out in subsection 45B(8)), it cannot be concluded that either Forrestfield or the Forrestfield shareholders will enter into or carry out the proposed scheme for the purpose of enabling the Forrestfield shareholders to obtain a tax benefit. It cannot be said that the proposed return of capital is a disguised distribution of profits, nor does Forrestfield's pattern of distributions indicate that the proposed return of capital is being made in substitution for dividends. Similarly, the manner in which the proposed scheme is to be carried out, and the form and substance of the proposed scheme, do not indicate that the proposed capital return will be made in substitution for dividends.

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

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

Capital gains tax

CGT event G1 – section 104-135 of the ITAA 1997

46. CGT event G1 (section 104-135 of the ITAA 1997) will happen when Forrestfield pays the proposed return of capital to a Forrestfield shareholder in respect of a share that they own in Forrestfield at the Record Date and continue to own at the Payment Date as the payment will not be a dividend (as defined in subsection 995-1(1) of the ITAA 1997) or a deemed dividend under section 47 of the ITAA 1936.

47. If the proposed return of capital (50 cents per share) is equal to or less than the cost base of the Forrestfield share at the Payment Date, the cost base and reduced cost base of the share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

48. A Forrestfield shareholder will make a capital gain if the proposed return of capital is more than the cost base of the Forrestfield share (subsection 104-135(3) of the ITAA 1997). The amount of the capital gain is equal to that excess.

49. If a Forrestfield shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the Forrestfield share are reduced to nil. A Forrestfield shareholder cannot make a capital loss from CGT event G1 happening (note 1 to subsection 104-135(3) of the ITAA 1997).

50. A capital gain from CGT event G1 happening will be a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the Forrestfield share was acquired at least 12 months before the payment (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Subdivision are satisfied.

CGT event C2 – section 104-25 of the ITAA 1997

51. The right to receive the payment of the proposed return of capital is one of the rights inherent in a Forrestfield share at the Record Date. If, after the Record Date but before the Payment Date, a Forrestfield shareholder ceases to own some, or all, of their shares in Forrestfield, the right to receive the payment of the proposed 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.

52. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the proposed 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.

53. A Forrestfield 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 Forrestfield shareholder will make a capital loss if the capital proceeds from the ending of the right are less than its reduced cost base. The capital loss is equal to the amount of the difference (subsection 104-25(3) of the ITAA 1997.)

54. In working out the capital gain or capital loss made from CGT event C2, the capital proceeds will be the amount of the return of capital (subsection 116-20(1) of the ITAA 1997).

55. The cost base of a Forrestfield shareholder's right to receive the proposed 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 Forrestfield 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 Forrestfield shareholder disposed of the share after the Record Date.

56. Therefore, if the full cost base or reduced cost base of a Forrestfield 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 proposed return of capital will have a nil cost base.

57. As the right to receive the proposed return of capital was inherent in the Forrestfield 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). Accordingly, if the Forrestfield share was acquired at least 12 months before the payment, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain will be a discount capital gain under Subdivision 115-A of the ITAA 1997 provided the other conditions of that Subdivision are satisfied.

Appendix 2 – Detailed contents list

58. 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

Subject references:

- capital benefit
- capital gains tax
- capital reductions
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 – shares
- dividends
- return of capital on shares
- share capital

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 6(1)(d)
- ITAA 1936 6(4)
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)

- ITAA 1936 45B(2)(b)
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 - ITAA 1936 47
 - ITAA 1997
 - ITAA 1997 104-25
 - ITAA 1997 104-25(3)
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 - ITAA 1997 104-135(4)
 - ITAA 1997 109-5
 - ITAA 1997 Div 110
 - ITAA 1997 Div 112
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25
 - ITAA 1997 115-25(1)
 - ITAA 1997 116-20(1)
 - ITAA 1997 Div 197
 - ITAA 1997 197-50
 - ITAA 1997 975-300
 - ITAA 1997 975-300(3)
 - ITAA 1997 995-1(1)
 - TAA 1953
 - Copyright Act 1968
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ATO references

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