CR 2006/80 - Income tax: proposed return of capital: Austar United Communications Limited

Class Ruling

Income tax: proposed return of capital: Austar United Communications Limited

Contents Para

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 (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and 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;
- 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 136-10 of the ITAA 1997.

All references are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Austar United Communications Limited (Austar) who are registered on the Austar Share Register on the Record Date, being the date for determining entitlements to the proposed return of capital and who receive distributions under the proposed return of capital described in paragraphs 13 to 21 of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in the 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 13 to 21 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

8. This Ruling applies from 16 August 2006. However, 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.

9. If this Class 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)).

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

11. 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).

Withdrawal

12. This Ruling is withdrawn and ceases to have effect after 30 June 2007. However, the Ruling continues to apply after its withdrawal, in respect of the relevant provisions ruled upon, to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entity's involvement in the scheme.

Scheme

13. The scheme that is the subject of this Ruling is described below. This description is based on a number of documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- Class Ruling request from Ernst & Young dated 26 July 2006, which replaced an earlier application of 14 June 2006, incorporating further information provided in relation to that earlier application;
- correspondence providing further particulars dated 13 July 2006 from Ernst & Young;
- a copy of the Austar News Release dated 27 April 2006; and
- a copy of Austar's Annual Report for 2005.

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

14. Austar is an Australian resident public company listed on the Australian Stock Exchange (ASX). Austar was listed on the ASX in July 1999.

15. Austar is the parent entity of a group of entities that operate various media businesses including Pay TV, internet and mobile communications.

16. Austar's Board proposes to return share capital totalling approximately $202 million to its ordinary shareholders. This will equate to approximately 16 cents for each ordinary share held on the Record Date.

17. Austar's stated purpose in making the return of capital is to achieve the following commercial objectives:

- to move interest cover and gearing ratios towards target levels;
- to minimise its Weighted Average Cost of Capital (WACC) by optimising its capital structure and minimising funding costs;
- to maximise total shareholder returns through the reduction of WACC;
- to demonstrate to the market Austar's commitment to its capital management strategy; and
- to take advantage of new debt facilities.

18. The return of capital was approved by shareholders at the Annual General Meeting of Austar held on 31 May 2006.

19. The return of capital is to be sourced from a new senior debt facility.

20. Austar confirms that it does not anticipate having a dividend policy in the near future, being the next two financial years. Austar confirms that the Austar Board have not disclosed, announced or otherwise conveyed a reasonable expectation of a distribution of profits in the near foreseeable future.

21. Austar will debit the return of capital against its share capital account. Austar confirms that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997, from any of its other accounts.

Ruling

Is the return of capital a divided as defined in subsection 6(1)?

22. The proposed return of capital 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

23. The Commissioner will not make a determination (under sections 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 under section 45C.

Capital gains tax consequences

24. CGT event G1 will happen to an Austar shareholder when the return of capital is paid (section 104-135 of the ITAA 1997).

25. CGT event C2 will happen to an Austar shareholder receiving the return of capital, who ceases to own their Austar share after the Record Date but before the payment of the return of capital (section 104-25 of the ITAA 1997).

26. A foreign resident shareholder will only make a capital gain as a result of the return of capital if the relevant asset has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Commissioner of Taxation
23 August 2006

Appendix 1 – Explanation

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.

Dividends

27. 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).

28. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, later paragraphs in that subsection exclude certain items from being a dividend for income tax purposes.

29. Relevantly, paragraph (d) specifically excludes from the definition of 'dividend' in subsection 6(1):

> money paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection 6(4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

30. 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.

31. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account 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 return of capital will be debited against Austar's share capital account. There have been no transfers into Austar's share capital account as defined in section 975-300 of the ITAA 1997. Therefore, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies and the return of capital would not constitute a dividend.

Anti-avoidance provisions

33. 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.

Streaming of dividends and capital benefits: section 45A

34. Section 45A applies in circumstances where capital benefits are streamed to advantaged shareholders who would, in the year of income in which the capital benefits are provided, derive a greater capital benefit than the other shareholders (the disadvantaged shareholders) who would receive dividends.

35. Austar will provide all of its shareholders with a ‘capital benefit’ (as defined in paragraph 45A(3)(b)), and the capital benefit is to be provided to all shareholders in direct proportion to their individual shareholding. As all shareholders benefit equally from the return of capital, there is no indication of ‘streaming’ of capital benefits to some shareholders and not to other shareholders. Accordingly, section 45A will 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.

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

36. Section 45B applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

37. 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;
- under the scheme a person (the relevant taxpayer), who may or may not be the person provided with the capital benefit, obtains a tax benefit; and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into or carried out the scheme or any part of the scheme for a purposes (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

Each of these conditions is considered below.

38. The return of capital is a ‘scheme’ within the broad meaning of that term.

39. 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 Austar proposes to debit the return of capital against its share capital account, its shareholders will be provided with a capital benefit.

40. 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.

41. Ordinarily, a return of capital would be subject to the 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. 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. Therefore, a shareholder will obtain tax benefits from the return of capital.

Relevant circumstances

42. 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.

43. 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 must be more than an incidental purpose.

44. 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 Austar. The Commissioner cannot at this stage apprehend the purposes of Austar's ordinary shareholders, all of whom are eligible to vote on the return of capital under section 256C of the *Corporations Act 2001* and all of whom would participate in the return of capital. 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 vote in favour of the proposal.

45. 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 is made to all shareholders of Austar regardless of individual shareholder 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 a demerger respectively are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

46. 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. Austar has historically been in a loss position and whilst it has recently commenced generating profits, these profits are not of a similar magnitude to the proposed return of capital. Further, Austar has confirmed that there have been no accretions to the value of corporate assets held by Austar.

47. 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. Austar does not have nor has it ever had a dividend policy. Austar does not anticipate having a dividend policy in the near future, being the next two financial years. The Austar Board have not disclosed, announced or otherwise conveyed a reasonable expectation of a distribution of profits in the near foreseeable future.

48. 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. Austar has demonstrated that the scheme, being a return of capital to its shareholders, is a legitimate return of capital aimed at the regearing of its balance sheet to better reflect industry ratios and at reducing its WACC.

49. Therefore, having regard to the relevant circumstances of the scheme to return capital to Austar's shareholders, as discussed in paragraphs 42 to 48 of this Ruling, it would not be concluded that Austar 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 under subsection 45B(3) that section 45C applies to the return of capital.

Deeming dividends to be paid where a determination is made: section 45C

50. 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.

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

51. CGT event G1 (section 104-135 of the ITAA 1997) will happen if a company makes a payment to a shareholder in respect of a share they own in a company and 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.

52. The cost base and reduced cost base of each Austar share will be reduced (but not below nil) by the amount of the return of capital (subsections 104-135(3) and (4) of the ITAA 1997).

53. An Austar shareholder may make a capital gain if the return of capital by the company in relation to each Austar share exceeds the cost base of the share (subsection 104-135(3) of the ITAA 1997). If the Austar share was acquired by the shareholder at least 12 months before the date of payment, a capital gain from the share may qualify as a discount capital gain (subsection 115-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

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

54. A person who is a registered ordinary shareholder of Austar on the Record Date for the return of capital acquires the right to receive the return of capital on that date. A shareholder continues to have the right to the return of capital even if the shareholder ceases to own the shares before the payment is made. The right is a CGT asset separate from the Austar share.

55. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the return of capital is paid and the right to receive that payment ends.

56. A capital gain will result if the capital proceeds for the event are more than the cost base of the right. The capital proceeds will be the amount of the payment from Austar. As no amount will have been paid for the right, its cost base is likely to be nil. Therefore, a capital gain equal to the payment of the return of capital will likely arise.

57. The right to payment from Austar was inherent in the Austar share during the time that it was owned. Therefore, for the purposes of Subdivision 109-A of the ITAA 1997 the right is considered to have been acquired at the time when the Austar share was acquired. Consequently, if the Austar share was originally acquired by the former shareholder at least 12 months before the payment, a capital gain from the right may qualify as a discount capital gain (subsection 112-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Foreign resident shareholders: Division 136 of the ITAA 1997

58. If the Austar shareholder is not an Australian resident for income tax purposes, a CGT event G1 capital gain cannot be made unless the shares have the necessary connection with Australia (section 136-25 of the ITAA 1997). Broadly, shares in public companies will not have the necessary connection with Australia, and a capital gain or a capital loss will not be made, where the foreign resident shareholder and their associates beneficially own less than 10% by value of the shares in the company during the 5 years before the CGT event happens.

59. As rights to receive a return of capital cannot have a necessary connection with Australia (section 136-25 of the ITAA 1997) there will be no CGT event C2 gain or loss for a foreign resident shareholder.

Appendix 2 – Detailed contents list

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

References

Previous draft:
Not previously issued as a draft

Subject references:
- capital reduction
- reduction of share capital
- return of share capital
- share capital

Legislative references:
- Copyright Act 1968
- Corporations Act 2001 256C
- ITAA 1936 6(1)
- ITAA 1936 6(4)
- ITAA 1936 6D
- 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)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(5)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
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- ITAA 1936 45B(9)
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- ITAA 1936 47
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
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- 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 104-25
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
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- ITAA 1997 Subdiv 109-A
- ITAA 1997 112-25(1)
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- ITAA 1997 Div 197
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- ITAA 1997 975-300
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ATO references

NO: 2006/14561
ISSN: 1445-2014
ATOlaw topic: Income Tax ~~ Return of capital
Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 - shares
Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 - end of a CGT asset