


# ***CR 2016/39 - Income tax: Service Stream Limited - return of capital and share consolidation***

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## Class Ruling

### Income tax: Service Stream Limited – return of capital and share consolidation

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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

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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 44 of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- section 177D of the ITAA 1936
- section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 112-25 of the ITAA 1997
- Division 115 of the ITAA 1997

- section 855-10 of the ITAA 1997
- section 855-15 of the ITAA 1997
- section 975-300 of the ITAA 1997, and
- subsection 995-1(1) of the ITAA 1997.

## Class of entities

3. The class of entities to which this Ruling applies are the holders of ordinary shares in Service Stream Limited (SSM) who:

- held ordinary shares in SSM on 3 June 2016 (the Record Date) and 10 June 2016 (the Payment Date)
- are either residents or non-residents for the purposes of the Australian income tax legislation, including by virtue of the operation of any double tax agreement between Australia and any other country
- are not 'temporary residents' of Australia within the meaning of subsection 995-1(1) of the ITAA 1997
- hold their SSM shares on capital account (and not as trading stock, on revenue account or shareholders who acquired their shares under the Executive and Employee Option Plan) for income tax purposes
- are not shareholders which are exempt from Australian income tax, and
- are not subject to the taxation of financial arrangement rules in Division 230 of the ITAA 1997 in relation to gains and losses on their SSM shares.  
**(Note:** Division 230 will not generally apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, an entity belonging to this class of entities is referred to as an SSM shareholder.

## Qualifications

4. The Commissioner makes this Ruling based 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 8 to 26 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

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7. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

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8. 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.

### Background

9. SSM is an Australian resident company which has been listed on the Australian Securities Exchange since October 2004.

10. SSM is the head company of an Australian income tax consolidated group, referred to in this Ruling as the SSM Group.

11. The SSM Group provides specialist services which are used to develop and operate Australian communications, energy and water networks.

12. As of 31 December 2015, the share capital of SSM comprised 386,389,873 fully paid ordinary shares and issued share capital of \$231.01 million. Also as of 31 December 2015, the SSM Group had:

- nil borrowings
- accumulated losses of \$56.15 million, and
- cash of \$37.65 million.

## 2014 Capital Raising

13. During the 2014 financial year, SSM undertook a fully underwritten capital raising of \$20.05 million (the Capital Raising), consisting of:

- a Share Placement to certain sophisticated and professional investors for \$9.35 million completed on 24 January 2014, and
- a non-renounceable Rights Issue to all SSM shareholders with an Australian or New Zealand registered address at the Record Date for \$10.7 million completed on 1 May 2014.

14. The purpose of the Capital Raising was to address short-term financing constraints that faced SSM at the time.

## Return of capital

15. On 10 June 2016, SSM returned capital of \$0.05 per share to each of its shareholders, constituting a return of \$19,319,494 in total (the Return of Capital).

16. The Return of Capital was made under section 256B and section 256C of the *Corporations Act 2001* (Cth). SSM held an Extraordinary General Meeting (EGM) on 31 May 2016, at which it obtained shareholder approval for the Return of Capital.

17. The Return of Capital was debited entirely to SSM's share capital account.

## Share consolidation

18. Immediately after the Record Date for the Return of Capital, SSM undertook a share consolidation of 1 for approximately 0.9318. SSM reduced its ordinary shares on issue from approximately 386.39 million to approximately 360.04 million.

19. The share consolidation applied to all ordinary shares. Any shareholders who held a fractional number of shares following the consolidation had their holding rounded up to the next whole number.

20. The share consolidation was undertaken in accordance with section 254H of the *Corporations Act 2001* (Cth). SSM obtained shareholder approval for the share consolidation at the EGM on 31 May 2016.

## Other relevant matters

21. In addition to the Return of Capital, on 14 April 2016, SSM paid all shareholders a \$0.01 fully franked interim dividend.

22. SSM has historically paid fully franked dividends in each of the 2007-2009, 2012-2013 and 2015 income years.

23. As of 31 January 2016, the shareholders of SSM are, for Australian income tax purposes:

- 99.34% Australian residents, and
- 0.66% non-residents.

24. According to SSM's financial report for the year ended 30 June 2015, no one shareholder (together with associated entities) holds more than 29.95% of the ordinary shares in SSM.

25. SSM's 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.

26. The market value of SSM's taxable Australian real property assets do not exceed the market value of its non-taxable Australian real property assets.

## **Ruling**

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### **Distribution is not a dividend**

27. The Return of Capital to SSM shareholders is not a dividend, as defined in subsection 6(1) of the ITAA 1936. No part of the Return of Capital will be included in the assessable income of SSM shareholders pursuant to subsection 44(1) of the ITAA 1936.

### **The application of sections 45A, 45B and 45C of the ITAA 1936**

28. The Commissioner will not make a determination under section 45A of the ITAA 1936 that section 45C applies to the Return of Capital.

29. The Commissioner will not make a determination under section 45B of the ITAA 1936 that section 45C applies to the Return of Capital.

### **Capital gains tax (CGT) consequences**

#### ***CGT event G1***

30. CGT event G1 happened when SSM paid the Return of Capital to an SSM shareholder in respect of an SSM share that they owned at the Record Date and continued to own at the Payment date (section 104-135 of the ITAA 1997).

## **Foreign resident shareholders**

31. An SSM shareholder who is a foreign resident or the trustee of a foreign trust for CGT purposes and who was paid the Return of Capital disregards any capital gain or loss made when CGT event G1 happened if their SSM share is not taxable Australian property (section 855-10 of the ITAA 1997).

## **Share consolidation**

32. No CGT event will occur as a result of the consolidation of shares in SSM (section 112-25).

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**Commissioner of Taxation**

15 June 2016

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## 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**

33. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends 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.

34. 'Dividend' is defined in subsection 6(1) of the ITAA 1936 to include any distribution made by a company to any of its shareholders. However, paragraph (d) specifically excludes a distribution from the definition of 'dividend' if the amount of the distribution is debited against an amount standing to the credit of the company's share capital account.

35. A 'share capital account' is an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited was an amount of share capital (subsection 975-300(1) of the ITAA 1997). An account is not a share capital account if it is tainted (subsection 975-300(3) of the ITAA 1997).

36. SSM debited the entire amount paid as part of the Return of Capital to its share capital account, which is an account the company keeps of its share capital. As that share capital account is not tainted within the meaning of Division 197 of the ITAA 1936, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 will apply.

37. Accordingly, the Return of Capital did not constitute payment of a dividend as defined in subsection 6(1), and no part of the Return of Capital will be included in the assessable income of SSM shareholders under subsection 44(1) of the ITAA 1936.

### **Application of sections 45A, 45B and 45C of the ITAA 1936**

38. 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 to SSM shareholders as an unfranked dividend paid out of company profits.



## ***Section 45A of the ITAA 1936 – streaming of dividends and capital benefits***

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

40. Although SSM has provided its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936), the capital benefit will be provided to all SSM shareholders in direct proportion to their shareholding. SSM also paid a fully franked dividend of \$0.01 to all shareholders on 14 April 2016.

41. The circumstances of the scheme do not indicate that there is a 'streaming' of capital benefits to advantaged shareholders and of dividends to disadvantaged shareholders. Accordingly, section 45A of the ITAA 1936 does not apply to the Return of Capital.

42. Therefore, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the capital benefit.

## ***Section 45B of the ITAA 1936 – schemes to provide capital benefits***

43. Section 45B of the ITAA 1936 applies to ensure that amounts are treated as dividends for taxation purposes if certain payments, allocations and distributions are made in substitution for dividends.

44. Section 45B applies where:

- 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 entered into or carried out the scheme for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

45. The arrangement involving the Return of Capital to SSM shareholders constitutes a 'scheme' (defined broadly in subsection 995-1(1) of the ITAA 1997) for the purposes of section 45B.

46. The Return of Capital has been recorded as a debit to SSM's share capital account and SSM shareholders have received a distribution of share capital to the value of \$0.05 per share. Therefore, SSM shareholders have been provided with a capital benefit (paragraph 45B(5)(b) of the ITAA 1936).

47. A relevant taxpayer obtains a tax benefit if its tax payable is less than the amount that would have been payable, or would have been payable at a later time than it would otherwise have been payable if the capital benefit had been an assessable dividend instead (subsection 45B(9) of the ITAA 1936). As a return of capital to a resident or non-resident shareholder will generally result in either a deferral of any tax liability or a lesser amount of tax being payable than if the distribution had been a dividend, SSM shareholders have obtained a tax benefit.

48. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the 'relevant circumstances' set out in subsection 45B(8) of the ITAA 1936 to objectively 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.

49. Having regard to the relevant circumstances of the scheme as set out in subsection 45B(8), it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling SSM shareholders to obtain a tax benefit.

### ***Section 45C of the ITAA 1936***

50. As the Commissioner will not make a determination under subsections 45A(2) or 45B(3) of the ITAA 1936 in relation to the scheme as described, section 45C of the ITAA 1936 will not deem any part of the Return of Capital to be an unfranked dividend for the purposes of the ITAA 1936 or the ITAA 1997.

### **CGT consequences**

#### ***CGT event G1***

51. Section 104-35 of the ITAA 1997 provides that CGT event G1 happens when:

- a company makes a payment to a shareholder in respect of a share they own in the company;
- some or all of the payment is not a dividend or an amount taken to be a dividend; and
- the payment is not included in the shareholder's assessable income.

52. As concluded above, no part of the Return of Capital to an SSM shareholder is a dividend, nor is it included in an SSM shareholder's assessable income. Accordingly, CGT event G1 happened when SSM paid the Return of Capital to an SSM shareholder in respect of an SSM share that they owned at the Record Date and continued to own at the Payment Date.

53. If the Return of Capital is not more than the cost base of the SSM share at the Payment Date, then the cost base and reduced cost base of the share is reduced (but not below nil) by the amount of the Return of Capital (subsection 104-135(4) of the ITAA 1997).

54. An SSM shareholder makes a capital gain if the amount of the Return of Capital is more than the cost base of the SSM share (subsection 104-135(3)). The amount of the capital gain is equal to that excess.

55. If an SSM shareholder makes a capital gain from CGT event G1 happening, the cost base and reduced cost base of the SSM share is reduced to nil. An SSM shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3)).

56. If the SSM share to which the Return of Capital relates was acquired by an SSM shareholder at least 12 months before the payment, a capital gain 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 Division 115 are satisfied.

### ***Foreign resident shareholders***

57. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens, and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

58. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property
Item 2	an indirect Australian real property interest not covered by item 5
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3, and
Item 5	a CGT asset that is 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).

59. SSM has advised that the market value of its taxable Australian real property assets do not exceed the market value of its non-taxable Australian real property assets such that its shares are not 'taxable Australian property' within the meaning of section 855-15 of the ITAA 1997.

60. A foreign resident SSM shareholder will therefore disregard any capital gain made when CGT event G1 happened on payment of the Return of Capital.

### ***Share consolidation***

61. Section 112-25 of the ITAA 1997 provides that where:

- one CGT asset is split into two or more assets or changes in whole or in part into an asset of a different nature; or
- two or more CGT assets are merged into one asset,

but an entity remains the beneficial owner of the original and new assets, the split, change or merge is not a CGT event.

62. Where a company converts its shares into a larger or smaller number in accordance with section 254H of the *Corporations Act 2001*:

- the original shares are not cancelled or redeemed in terms of corporations law;
- there is no change in the total amount allocated to the share capital account of the company; and
- the proportion of equity owned by each shareholder in the share capital account is maintained.

63. While there was a change in the form of the original shares, there was no change in their beneficial ownership as a result of the share consolidation. Accordingly, subsection 112-25(2) applies and that change was not a CGT event.

64. The converted shares have the same date of acquisition as the original shares to which they relate.

65. Where the original shares were acquired on or after 20 September 1985, subsection 112-25(4) of the ITAA 1997 provides that each element of the cost base and reduced cost base of the converted shares is the sum of the corresponding elements of each original share.

## Appendix 2 – Detailed contents list

66. 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

### *Legislative references:*

- 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 177D(2)
- ITAA 1997
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 112-25
- ITAA 1997 112-25(2)
- ITAA 1997 112-25(4)
- ITAA 1997 Div 115
- ITAA 1997 115-25(1)
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-10
- ITAA 1997 855-10(1)
- ITAA 1997 855-15
- ITAA 1997 975-300(1)
- ITAA 1997 975-300(3)
- ITAA 1997 995-1(1)
- Corporations Act 2001 256B
- Corporations Act 2001 256C
- Corporations Act 2001 254H
- TAA 1953
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(i)
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### ATO references

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