



Class Ruling

Income tax: return of capital: Babcock and Brown Capital 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 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
 - Division 855 of the ITAA 1997.

All legislative references in this Ruling 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 Babcock and Brown Capital Limited (BCM) who:

- (a) are registered on the BCM share register on the Record Date, being the date for determining entitlements under the proposed return of capital as described in paragraphs 9 to 25 of this Ruling; and
- (b) hold their shares on capital account.

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 is actually carried out in accordance with the scheme described in paragraphs 9 to 25 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 to the financial year ending 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).

Scheme

9. 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:

- application for Class Ruling dated 10 December 2008;
- BCM's Australian Securities Exchange (ASX) Releases dated 10 November 2008;
- BCM's Notice of General Meeting dated 27 January 2009;
- BCM's Explanatory Statement for the general meeting scheduled for the 27 February 2009; and
- BCM's Annual Report for the year ended 30 June 2008.

10. BCM was incorporated on 8 December 2004 in Australia. BCM was listed on the ASX on 14 February 2005 after an initial public offer (IPO).

11. The IPO offer raised \$1 billion of equity from the issue of 200 million ordinary shares with an issue price of \$5.00 per share.

12. BCM has made two acquisitions:

- In August 2006 BCM acquired a 57.1% interest in eircom representing an investment of A\$812 million. Following refinancing and a return of capital in November 2006, BCM's equity investment is approximately A\$448 million.
- In July 2007 BCM acquired 100% of Golden Pages for an enterprise value of A\$150 million. Following refinancing and return of capital in February 2008 BCM's equity investment is approximately A\$107 million.

13. On 28 August 2007, BCM announced an on-market buy-back program to purchase up to 5% of the issued capital of BCM.

14. On 25 January 2008, the buy-back program was expanded to 9.99% of BCM's issued capital.

15. On 28 February 2008, BCM announced a further capital management plan under which it was proposed that up to \$310 million be returned to shareholders through an off-market share buy-back and an extension of the existing on-market buy-back program.

16. On 21 April 2008, shareholders approved the buy-back of up to 50% of the Company's share capital.

17. On 2 June 2008, BCM increased the threshold of the buy-back to 20% of BCM's original issued capital (or 40 million ordinary shares). As at 30 June 2008, a total of 32,095,086 shares had been bought back on-market representing 16.05% of the original issued share capital.

18. On 29 October 2008, BCM announced that taking into account the current global turmoil in financial markets and other internal developments, BCM had deferred a decision of the optimal capital management program and that the off market buy-back program had been terminated.

19. Subject to approval by BCM shareholders, BCM proposes to terminate its existing management agreement with Babcock & Brown Capital Management Proprietary Limited. As a consequence of this and the possible impairment of the value of BCM's investments, it is considered that the retained profits of BCM may be significantly reduced.

20. On 10 November 2008, BCM announced that it intended to return capital of \$100.7 million to BCM shareholders (equating to 60 cents per ordinary share).

21. The proposed return of capital to BCM shareholders will be sourced from BCM's available cash reserves (approximately \$325 million as at 10 November 2008). The reserves are attributable to the initial capital raised on listing. The funds for the capital will not be sourced from profits. The proposed return of capital will be wholly debited to an amount standing to the credit of the share capital account of BCM. This share capital account is not a tainted share capital account for the purposes of Division 197 of Part 3-5 of the ITAA 1997.

22. As at 28 July 2008, BCM had available franking credits of \$7,213,897.

23. As of 10 December 2008, BCM has 167,904,914 shares on issue.

24. BCM has not made any dividend distributions since incorporation. BCM intends to retain and reinvest its capital unless the board of directors forms the view that the capital cannot be employed in further investments at a rate of return consistent with BCM's investment objectives.

25. BCM has not previously issued bonus shares or made a return of capital.

Ruling

Distribution is not a dividend for income tax purposes

26. The proposed return of capital to BCM shareholders 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

27. 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

28. CGT event G1 (section 104-135 of the ITAA 1997) will happen when BCM pays the proposed return of capital to a BCM shareholder in respect of a BCM share that they own at the Record Date and continue to own at the payment date.

29. CGT event C2 (section 104-25 of ITAA 1997) will happen when BCM pays the proposed return of capital to a BCM shareholder in respect of a BCM share that they owned at the Record Date but ceased to own before the payment date.

Foreign resident shareholders

30. A foreign resident BCM shareholder who is paid the proposed return of capital disregards any capital gain made from CGT event G1 happening if their BCM shares are not 'taxable Australian property' (section 855-10 of ITAA 1997).

31. A foreign resident BCM shareholder who is paid the proposed return of capital disregards any capital gain or capital loss made from CGT event C2 happening if their right to receive the return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation25 February 2009

Appendix 1 – Explanation

① *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

32. 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).

33. The term 'dividend' is defined in subsection 6(1) and includes any distribution made by a company to any of its shareholders. However, this broad definition is confined by later paragraphs in the definition which expressly excludes certain items from being a dividend for income tax purposes.

34. Paragraph (d) of the definition 'dividend' in section 6(1) specifically excludes from the definition:

...moneys 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 (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 capital.

35. The proposed return of capital will be wholly debited against the untainted share capital account of BCM. Therefore, paragraph (d) of the definition of 'dividend' applies and the proposed return of capital will not be a dividend as defined in subsection 6(1).

Subsection 6(4)

36. The exclusion in paragraph (d) of the definition of dividend 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 it to its share capital account; and
- returns it to another person or group of persons, giving them either cash or property, debiting it to its share capital account.

37. In the present case, no arrangement exists under which BCM raised share capital from certain shareholders and then distributed 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**

38. 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 – streaming of dividends and capital benefits

39. 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.

40. 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 BCM to its shareholders will constitute the provision of a capital benefit. However, as BCM will make the return of capital to all of its shareholders in respect of their ordinary shares it is considered that there will be no streaming of capital benefits to some shareholders and not to others.

41. 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

42. 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.

43. 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)).

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

45. Pursuant to subsection 45B(9), it is likely that each of the BCM 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.

46. However, having regard to the relevant circumstances of the scheme, it cannot be concluded that either BCM or the BCM shareholders will enter into or carry out the proposed scheme for the purpose of enabling the BCM shareholders to obtain a tax benefit. It cannot be said that the return of capital is attributable to the profits of BCM, nor does BCM's pattern of distributions indicate that the 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.

47. 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.

48. 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

49. CGT event G1 will happen when BCM pays the proposed return of capital to a BCM shareholder in respect of a share that they own in BCM at the Record Date and continue to own at the payment date (section 104-135 of the ITAA 1997).

50. If the return of capital (60 cents per share) is equal to or less than the cost base of the BCM 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).

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

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

53. 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 BCM 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

54. The right to receive the proposed return of capital is one of the rights inherent in a BCM share at the Record Date. If, after the Record Date but before the payment date, a BCM shareholder ceases to own a BCM share, the right to receive the return of capital in respect of that share will be retained by the shareholder and is a separate CGT asset.

55. 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.

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

57. 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).

58. The cost base of a BCM shareholder's right to receive the 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 BCM 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 BCM shareholder disposed of the share after the Record Date.

59. Therefore, if the full cost base or reduced cost base of a BCM 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.

60. As the right to receive the return of capital was inherent in the BCM share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997). Accordingly, if the BCM share was acquired at least 12 months before the return of capital, a capital gain 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.

Foreign resident shareholders

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

62. BCM has advised that a BCM share is not an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997) for any foreign resident BCM shareholder who is entitled to the return of capital.

63. Consequently, a BCM share is only 'taxable Australian property' for those foreign resident individuals who:

- (a) stopped being Australian residents while holding their BCM shares; and
- (b) chose, under subsection 104-165(2) of the ITAA 1997 to disregard a capital gain or capital loss from CGT event I1 (section 104-160 of the ITAA 1997) in relation to their BCM shares (subsection 104-165(3) of the ITAA 1997, subsections 104-165(1) and 104-165(2) of the *Income Tax (Transitional Provisions) Act 1997*).

64. A foreign resident BCM 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

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains tax
- capital streaming
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 - shares
- distributions
- dividends
- foreign residents
- return of capital on shares
- share capital

Legislative references:

- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 6(4)
 - ITAA 1936 44(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
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 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(5)(b)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1997
 - ITAA 1997 104-25
 - ITAA 1997 104-25(3)
 - ITAA 1997 104-135
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 - ITAA 1997 104-135(4)
 - ITAA 1997 104-160
 - ITAA 1997 104-165(2)
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 - ITAA 1997 Subdiv 115-A
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 - ITAA 1997 Div 197
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ATO references

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