



Class Ruling

Senetas Corporation Limited – return of capital

❶ Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

Table of Contents	Paragraph
What this Ruling is about	1
Who this Ruling applies to	4
When this Ruling applies	6
Ruling	7
Scheme	15
Appendix – Explanation	29

What this Ruling is about

1. This Ruling sets out the tax consequences for a shareholder of Senetas Corporation Limited (Senetas) who received the return of capital payment of \$0.000462 per ordinary Senetas share on 13 December 2019 (Payment Date).
2. Full details of this return of capital arrangement are set out in paragraphs 15 to 28 of this Ruling.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you:
 - were registered on the Senetas share register on 29 November 2019 (Record Date)
 - held your Senetas shares on capital account. That is, you did not hold your Senetas shares as revenue assets (as defined in section 977-50) or as trading stock (as defined in subsection 995-1(1)) on the Record Date, and
 - received the return of capital payment of \$0.000462 per Senetas share on the Payment Date.

5. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 15 to 28 of this Ruling.

Note: Division 230 will not apply to individuals, unless they have made an election for it to apply.

When this Ruling applies

6. This Ruling applies from 1 July 2019 to 30 June 2020.

Ruling

Return of capital is not a dividend

7. No part of the return of capital payment will be included in your assessable income as a dividend under section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936).

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

8. The Commissioner will not make a determination under either subsection 45A(2) or paragraph 45B(3)(b) that section 45C of the ITAA 1936 applies to any part of the return of capital Senetas paid to you on the Payment Date.

Capital Gains Tax (CGT) consequences

CGT event G1

9. CGT event G1 (section 104-135) happened to you when Senetas paid you the return of capital of \$0.000462 per share in respect of the Senetas shares you owned at the Record Date and continued to own at the Payment Date.

10. CGT event G1 happened because:

- Senetas made a payment to you in respect of shares you owned in Senetas
- some or all of the payment is not a dividend (or an amount that is taken to be a dividend under section 47 of the ITAA 1936), and
- the payment is not otherwise included in your assessable income.

CGT event C2

11. CGT event C2 (section 104-25) happened to you when Senetas paid you a return of capital of \$0.000462 per share in respect of Senetas shares you owned at the Record Date and ceased to own at the Payment Date.

CGT discount

12. You can treat a capital gain made when CGT event G1 or CGT event C2 happened as a 'discount capital gain' under Subdivision 115-A provided that you acquired your Senetas shares at least 12 months before the Payment Date (subsection 115-25(1)) and the other conditions in that Subdivision are satisfied.

Non-resident shareholders

13. Non-resident Senetas shareholders disregard any capital gain or capital loss made from CGT event G1 and CGT event C2, if their Senetas ordinary shares or right to receive the relevant return of capital is not 'taxable Australian property' under section 855-10.

14. A CGT asset constitutes 'taxable Australian property' where the asset:

- constituted an 'indirect Australian real property interest' (table item 2 of section 855-15)
- was used at any time by the shareholder in carrying on a business through a permanent establishment in Australia (table item 3 of section 855-15), or
- the Senetas share is covered by subsection 104-165(3) (table item 5 of section 855-15).

Scheme

15. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

Background

16. Senetas is an Australian resident company limited by shares and listed on the Australian Securities Exchange (ASX).

17. At 30 June 2019 Senetas had 1,081,329,448 ordinary shares on issue.

18. Senetas is a developer and manufacturer of certified, high-assurance encryption; and an advanced encrypted file sharing application.

Return of capital payment

19. On 26 August 2019, Senetas announced to the ASX that it would be conducting an equal access return of capital of \$0.000462 per share, subject to shareholder approval which would be sought at the company's annual general meeting on 22 November 2019.

20. The total amount to be returned to the shareholders would be approximately \$500,000.

21. Subsequently, on 22 November 2019, Senetas' shareholders voted to approve the proposed return of capital. Senetas made the payment to the relevant shareholders of \$499,582.71 on 13 December 2019.

22. Senetas conducted a return of capital because:

- it had surplus capital in the form of cash but was not permitted to pay a dividend in circumstances where it made an after-tax loss of approximately \$463,345 in the financial year ended 30 June 2019
- it had accumulated losses, and
- it had insufficient current year profits to pay a dividend or an interim dividend.

23. Senetas' after-tax loss in the financial year ended 30 June 2019 was principally caused by the revaluation of Senetas' investment in the United Kingdom company Smart Antenna Technologies Ltd and the recognition of losses in an associate entity, Votiro Cybersec Global Limited.

24. Notwithstanding the after-tax loss, the Board of Senetas determined that Senetas had more share capital than is required for its needs. It had sufficient cash reserves available to justify and fund a distribution by way of an equal return of capital to all shareholders.

25. Senetas' Annual Financial Report for the year ended 30 June 2019 showed that it had no debt and the cash balance at 30 June 2019 was \$17.86 million.

26. As at 30 June 2019 Senetas had contributed equity of \$104,728,595 and accumulated losses of \$85,824,079.

27. The total amount of the return of capital payment was debited against Senetas' share capital account and was funded entirely from Senetas' existing cash reserves.

Other matters

28. Senetas' share capital account, as defined in section 975-300, is not tainted within the meaning of Division 197.

Commissioner of Taxation

12 February 2020

Appendix – Explanation

❶ *This Explanation 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.*

Table of Contents	Paragraph
Return of capital is not a dividend	29
Sections 45A, 45B and 45C do not apply	34
<i>Section 45A – streaming of dividends and capital benefits</i>	35
<i>Section 45B – scheme to provide capital benefits</i>	38
CGT events G1 and / or C2 happen	41
<i>CGT event G1</i>	41
<i>CGT event C2</i>	45

Return of capital is not a dividend

29. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends paid to the shareholder out of profits derived by the company from any source if the shareholder is a resident of Australia.

30. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and 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.

31. The term 'share capital account' is defined in section 975-300 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.

32. Subsection 975-300(3) provides that an account is generally taken not to be a share capital account if it is tainted. Senetas have confirmed that its share capital account is not tainted within the meaning of Division 197.

33. The return of capital was recorded as a debit to Senetas' untainted share capital account. As such, paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 applies and the return of capital is not a dividend as defined in subsection 6(1).

Sections 45A, 45B and 45C do not apply

34. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of such a determination is that all or part of the distribution of capital received under the return of capital is treated as an unfranked dividend.

Section 45A - streaming of dividends and capital benefits

35. Section 45A of the ITAA 1936 applies when a company:

- streams the provision of 'capital benefits' (such as the distribution of share capital by way of the return of capital payment) to shareholders who would derive a greater benefit from the capital benefits than other shareholders, and
- it is reasonable to assume that the other shareholders have received, or likely to receive, dividends.

36. Although a 'capital benefit' was provided to Senetas shareholders, the circumstances of the return of capital indicate that there was no streaming of capital benefits to some Senetas shareholders as all Senetas shareholders received the return of capital payment of \$0.000462 per share.

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

Section 45B – scheme to provide capital benefits

38. Section 45B of the ITAA 1936 applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, section 45B of the ITAA 1936 applies where:

- there is a scheme under which a person is provided with a capital benefit by a company
- under the scheme, a taxpayer (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, 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 (relevant taxpayer) to obtain a tax benefit.

39. The return of capital satisfies the first two conditions. However, having regard to the relevant circumstances of the scheme, it cannot be concluded that the scheme was entered into or carried out for a more than incidental purpose of enabling Senetas shareholders to obtain a tax benefit.

40. Accordingly, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the return of capital.

CGT events G1 and/or C2 happen**CGT event G1**

41. CGT event G1 happens if a company makes a payment to a shareholder in respect of a share they own in the company, some or all of the payment (the non-assessable part) is not a dividend, or an amount that is taken to be a dividend under section 47 of the ITAA 1936, and the payment is not included in the shareholder's assessable income (section 104-135).

42. CGT event G1 happened to a Senetas shareholder when Senetas made the return of capital to them in respect of Senetas shares they owned at the Record Date and continued to own at the Payment Date (section 104-135).

43. A Senetas shareholder will make a capital gain from CGT event G1 happening if the amount of the return of capital of \$0.000462 per share is more than the cost base of the shareholder's Senetas share. If so, the capital gain is equal to the amount of the excess and the cost base and reduced cost base of the Senetas share is reduced to nil (subsection 104-135(3)). No capital loss can be made from CGT event G1 (Note 1 to subsection 104-135(3)).

44. If the amount of the return of capital of \$0.000462 per share is not more than the cost base of the shareholder's Senetas share, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the return of capital (subsection 104-135(4)).

CGT event C2

45. If, after the Record Date but before the Payment Date, a Senetas shareholder ceased to own a Senetas share in respect of which the return of capital was payable, the right to receive the return of capital in respect of that share is retained by the Senetas shareholder and is a separate CGT asset from the Senetas share.

46. CGT event C2 happened when the return of capital was made. The right to receive the return of capital, being an intangible asset, ended by the right being discharged or satisfied when the return of capital was made (section 104-25).

47. A Senetas shareholder will make a capital gain under CGT event C2 if the capital proceeds from the ending of the right are more than the cost base of the right. The capital gain is equal to the amount of the excess. A Senetas shareholder will make a capital loss if the capital proceeds from the ending of the right are less than the reduced cost base of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

48. In working out the capital gain or capital loss when CGT event C2 happens, the capital proceeds are equal to the amount of the return of capital (\$0.000462 per share) (subsection 116-20(1)).

49. The cost base of the Senetas shareholder's right to receive each return of capital is worked out under Division 110 (modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by a Senetas shareholder to the extent that it was applied in working out a capital gain or capital loss made when a CGT event happened to the share, for example, when the Senetas shareholder disposed of the share after the Record Date and before the Payment Date. Therefore, if the cost base or reduced cost base of the share previously owned by a Senetas shareholder has been fully applied in working out a capital gain or capital loss on the share, the right to receive the return of capital will have a nil cost base. As a result, a Senetas shareholder will, in those circumstances, make a capital gain equal to the capital proceeds, being \$0.000462 per Senetas share owned at the Record Date.

References*Previous draft:*

Not previously issued as a draft

- ITAA 1997 104–135(4)
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20(1)
- ITAA 1997 Div 197
- ITAA 1997 Div 230
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 975-300
- ITAA 1997 975–300(3)
- ITAA 1997 977-50
- ITAA 1997 995-1(1)

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(3)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997 104-135
- ITAA 1997 104–135(3)

ATO references

NO: 1-K6AQA0Y

ISSN: 2205-5517

BSL PGI

ATOlaw topic: Income tax ~~ Assessable income ~~ Dividend income ~~ Dividend income
 Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events C1 to C3 –
 end of a CGT asset
 Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events G1 to G3 –
 shares
 Income tax ~~ Capital gains tax ~~ Capital proceeds
 Income tax ~~ Capital gains tax ~~ Discount capital gains
 Income tax ~~ Capital management ~~ Anti avoidance rules ~~ Section 45A
 Income tax ~~ Capital management ~~ Anti avoidance rules ~~ Section 45B
 Income tax ~~ Capital management ~~ Anti avoidance rules ~~ Section 45C
 Income tax ~~ Capital management ~~ Returning capital ~~ Share capital
 return

© AUSTRALIAN TAXATION OFFICE FOR THE COMMONWEALTH OF AUSTRALIA

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).