



CR 2003/87 - Income tax: Preference share buy-back: Village Roadshow Limited

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Class Ruling

Income tax: Preference share buy-back: Village Roadshow Limited

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a ‘public ruling’ and how it is binding on the Commissioner.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

What this Class Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- Section 6D 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 159GZZZM of the ITAA 1936; and
- Section 159GZZZP of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies is the preference shareholders of VRL who dispose of shares under the VRL preference share off-market buy-back scheme of arrangement as resubmitted for shareholders' approval in accordance with VRL's announcement of 20 November 2003, and as described in the Arrangement part of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 16.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement 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 year ended 30 June 2004 unless and until it is withdrawn (see paragraph 9 of this Ruling). Furthermore, this Ruling applies to the extent that the relevant tax laws are not amended.

Note: The Addendum to this Ruling that issued on 3 December 2003 applies on and from 3 December 2003.

Withdrawal

9. This Class Ruling is withdrawn and ceases to have effect after 30 June 2004. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the 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 arrangement are:

- Application for Class Ruling dated 13 August 2003;
- Appendix B (Scheme of arrangement) to the buy-back scheme booklet for preference shareholders;
- Correspondence from Shaddick & Spence dated 29 August 2003, 3 September 2003, 4 September 2003 and 8 September 2003.

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

11. VRL is an Australian resident, listed public company.

12. VRL has two classes of shares on issue, fully paid ordinary shares and fully paid A Class preference shares. The preference shares carry limited voting rights and have some degree of priority on the winding up of the company. The preference shares are not convertible into ordinary shares or any other class of securities, except in certain limited circumstances relating to a takeover of VRL as specified in the VRL Constitution.

13. VRL proposes to buy-back all of the preference shares on issue at the time the scheme of arrangement is implemented. At that time, there will be 250,215,147 preference shares on issue. Under the scheme of arrangement, the buy-back consideration for the VRL preference shares is to be \$1.25 for each preference share.

14. However, preference shareholders will be taken to have agreed to apply \$1.00 out of each \$1.25 towards the acquisition of an unsecured note. Each note is to be issued for a period of three years and carry semi-annual interest payments at a rate of 10% per annum. Each note will have a face value of \$1.00 and will be repaid in three instalments: 33 cents on the first anniversary of the issue date, 33 cents on the second anniversary of the issue date, and 34 cents on the third anniversary of the issue date. Interest will be calculated on the principal outstanding. The 25c per share remainder of the buy-back consideration is to be paid in cash.

15. Accordingly, the buy-back will be financed partly by the issue of unsecured notes. The cash component of the buy-back consideration is to be financed from an advance of funds from a subsidiary company to the extent that VRL lacks sufficient funds.

16. Preference shares bought back are to be cancelled. The buy-back consideration will be debited entirely against VRL's issued share capital.

17. VRL's published accounts for the financial year ended 30 June 2003 disclosed the parent company's interest in consolidated equity of \$957.3 million, consisting of \$925.2 million contributed share capital and \$105.3 million consolidated retained profits. The difference between these amounts is attributable mainly to a deficiency in consolidated reserves. VRL's franking account balance as at 30 June 2003 was a surplus of \$2,189,680.

18. The shareholders of VRL are a mix of individuals, companies and institutional investors. VRL has both Australian resident and non-resident members holding its ordinary and preference shares.

Ruling

19. Under the law in force at the date of this Ruling no amount will be included under section 44 of the ITAA 1936 in the assessable income of VRL preference shareholders who receive consideration in respect of the sale of preference shares under the off-market buy-back scheme.

20. The Government has announced its intention to introduce laws with effect from 1 July 2002 dealing with the tainting of share capital accounts [Minister for Revenue and Assistant Treasurer's Press Release C104/02 of 27 September 2002]. Although such laws may be relevant to the application of section 44, this Ruling cannot and does not extend to the application of these proposed laws.

21. The Commissioner will not make a determination under either section 45A or 45B of the ITAA 1936, that section 45C will apply to

deem any part of the buy-back consideration to be an unfranked dividend paid out of profits.

Explanation

Dividend for the purposes of section 44 of the ITAA 1936

22. For an amount to be included by section 44 of the ITAA 1936 in the assessable income of a VRL preference shareholder under the buy-back arrangement, some or all of the buy-back consideration must be either:

- a *dividend* paid to the shareholder by the company out of profits; or
- taken, by section 159GZZZP of the ITAA 1936, to be a dividend paid to the shareholder by the company out of profits.

Distribution debited to share capital account

23. Subsection 6(1) of the ITAA 1936 defines a *dividend* to include:

- (a) any distribution made by a company to any of its shareholders, whether in money or other property; and
- (b) any amount credited by a company to any of its shareholders as shareholders.

24. However, paragraph (d) of the subsection 6(1) definition goes on to state that a distribution would **not** constitute a dividend if the distribution is debited against the company's *share capital account*, provided subsection 6(4) does not apply. Subsection 6(4) does not apply to the buy-back scheme as there is no arrangement of the kind contemplated by that subsection.

25. *Share capital account* is defined in subsection 6(1) as having the meaning given by section 6D of the ITAA 1936. A *share capital account* is defined by subsection 6D(1) of the ITAA 1936 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.

26. Subsection 6D(3) states that an account (for 'dividend' definition purposes) is not a share capital account if it is tainted for the purposes of Division 7B of Part IIIAA of the ITAA 1936. An account, that would otherwise be a share capital account, is tainted for the purposes of Division 7B if an amount is transferred from another account except in the circumstances provided for by section

160ARDM of the ITAA 1936. VRL has confirmed that no transfers have taken place that would taint its share capital account.

27. However, this rule only applies to transfers before 1 July 2002, as section 160AOAA of the ITAA 1936 states that (apart from certain transitional provisions) Part IIIAA does not apply to events that occur on or after that date.

28. Although the Government has expressed an intention to introduce laws dealing with the tainting of share capital accounts [Minister for Revenue and Assistant Treasurer's Press Release C104/02 of 27 September 2002], no such legislation had been enacted by Parliament as at the date of this Ruling.

29. Subject to any change in the law reflecting the Government's announcement, the distribution made to preference shareholders pursuant to the buy-back scheme will be debited entirely against VRL's share capital account, and therefore will not constitute a dividend for income tax purposes.

Off-market share buy-back

30. An amount is taken to be a dividend under section 159GZZZP of the ITAA 1936 if the *purchase price* in respect of an off-market purchase exceeds the amount debited against the company's *share capital account*. The proposed buy-back of preference shares by VRL is an off-market buy-back, as defined by section 159GZZZK of the ITAA 1936.

31. The *purchase price* is defined in subsection 159GZZZJ, for the purposes of Division 16K of Part III of the ITAA 1936, as having the meaning given by section 159GZZZM. Section 159GZZZM provides that if the seller has received, or is entitled to receive, both an amount of money and property other than money as a result of or in respect of the buy-back, the purchase price is equal to the sum of that amount and the market value of that property at the time of the buy-back. Under the buy-back scheme, preference shareholders will, as a result of or in respect of the buy-back scheme, receive an amount of 25 cents in cash and an unsecured note for each preference share bought back by VRL.

32. As only part of the buy-back consideration is to be paid in cash, acceptance of the buy-back offer will indicate that, at the margin, preference shareholders will attribute a value to the unsecured note equal to its face value of \$1. Accordingly, the market value of the note at the time of the buy-back will be \$1.

33. The purchase price for the purposes of Division 16K of Part III of the ITAA 1936 will therefore be \$1.25 per share. The amount debited to VRL's share capital account will also be \$1.25 for each

preference share bought back. See paragraphs 25 to 28 about the law relating to share capital accounts which applies in the same way to Division 16K. Subject to any change in the law reflecting the Government's announcement, no amount of the purchase price in respect of the buy-back will be taken to be a dividend under section 159GZZZP.

Determinations under section 45C of the ITAA 1936

34. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C that all or part of the distribution of capital received by the shareholder under the buy-back is treated as an unfranked dividend.

Streaming of capital benefits - section 45A of the ITAA 1936

35. Section 45A applies in circumstances where capital benefits are streamed to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) [paragraph 45A(1)(a)] and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders) [paragraph 45A(1)(b)].

36. The 'provision of capital benefit' is defined in subsection 45A(3) to mean either:

- (a) the provision to the shareholder of shares in the company; or
- (b) the distribution to the shareholder of share capital or share premium; or
- (c) something that is done in relation to a share that has the effect of increasing the value of a share (which may or may not be the same share) held by the shareholder.

37. Under the buy-back scheme, participating shareholders will receive a distribution of share capital, so the buy-back would constitute the provision of a capital benefit.

38. However, it is not reasonable to assume that other VRL shareholders will receive dividends. Therefore, the second condition of subsection 45A(1) is not satisfied.

39. Nor are there circumstances that suggest that participating shareholders would derive a greater benefit from the buy-back than other shareholders.

40. Although a capital benefit will be provided to participating shareholders, the circumstances of the buy-back indicate that there is

no streaming of capital benefits to some shareholders and dividends to other shareholders.

41. As section 45A will not apply to the proposed buy-back, the Commissioner will not make a determination under section 45A that section 45C will apply to deem any part of the buy-back consideration to be an unfranked dividend paid out of profits.

Capital benefits in substitution for dividends - section 45B of the ITAA 1936

42. Section 45B applies where certain capital benefits are made to shareholders in substitution for dividends. Specifically, the provision 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, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit [paragraph 45B(2)(c)].

43. Under the buy-back scheme, VRL will *provide a capital benefit* to participating shareholders in the form of a distribution of share capital, within the meaning conveyed by paragraph 45B(5)(b).

44. As preference shareholders will derive either a capital loss, or a capital gain (for some holders who acquired their shares on the secondary market), they will pay less income tax than if the buy-back proceeds had been a dividend. Preference shareholders will therefore *obtain a tax benefit* within the meaning conveyed by subsection 45B(9).

45. However, having regard to the relevant circumstances specified in subsection 45B(8) it cannot be concluded that a person would enter into, or carry out, the buy-back scheme for a (more than incidental) purpose of enabling preference shareholders to *obtain a tax benefit*. The buy-back consideration cannot be said to be attributable to profits as it would be less than the capital subscribed at the time the preference shares were issued. Also, the pattern of dividend distributions to preference and ordinary shareholders does not indicate that the buy-back consideration is being paid in substitution for a dividend. The fact that participating shareholders will relinquish their

ownership interest in VRL also tends against the buy-back consideration being in substitution for a dividend.

46. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) are met, having regard to the relevant circumstances of the scheme, it cannot be concluded that the purpose (other than an incidental purpose) of entering into the scheme or carrying out the scheme would be to enable a taxpayer to obtain a tax benefit.

47. As section 45B will not apply to the proposed buy-back, the Commissioner will not make a determination under section 45B that section 45C will apply to deem any part of the buy-back consideration to be an unfranked dividend paid out of profits.

Detailed contents list

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8 October 2003

Previous draft:

Not previously issued in draft form.

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 97/16

Subject references:

- deemed dividends
- dividend streaming arrangements
- dividend substitution
- share buy backs
- share capital

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 6(3)
- ITAA 1936 6(4)
- ITAA 1936 6D
- ITAA 1936 Div 7B
- ITAA 1936 Div 7B Pt IIIAA
- ITAA 1936 Div 16K
- ITAA 1936 Div 16K of Pt III

- ITAA 1936 44
- ITAA 1936 45A
- ITAA 1936 45A(1)
- ITAA 1936 45A(1)(a)
- ITAA 1936 45A(1)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(5)(b)
- ITAA 1936 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 159GZZZJ
- ITAA 1936 159GZZZK
- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZP
- ITAA 1936 160AOAA
- ITAA 1936 160ARDM
- Copyright Act 1968
- TAA 1953 Pt IVAAA

ATO references

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