


CR 2005/3 - Income tax: return of capital: STW Communications Group Limited

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Class Ruling

Income tax: return of capital: STW Communications Group Limited

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Preamble

*The number, subject heading, **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.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' 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 45B of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 45C of the ITAA 1936;
 - section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
 - Division 136 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the ordinary shareholders in STW Communications Group Limited (STW) who hold shares on 10 January 2005 (the record date) and who receive a return of capital consisting of cash under the arrangement as described below.

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 18.

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- this Ruling may be withdrawn or modified.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 This Ruling applies to the year ended 30 June 2005 unless and until it is withdrawn (see paragraph 9 of this Ruling). However this 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 this Ruling (see paragraphs 21 to 22 of the Taxation Ruling TR 92/20). Furthermore this Ruling applies to the extent that the relevant tax laws are not amended.

Withdrawal

9. This Class Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect to 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 of the Ruling. This is subject to there being no change in the arrangement or in the persons involved in the arrangement.

Arrangement

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

- Class Ruling request from Horwath (NSW) Pty Limited, dated 16 November 2004;
- Explanatory Statement dated 23 November 2004;
- Correspondence from Horwath (NSW) Pty Limited dated 27 November 2004; and
- Correspondence from Horwath (NSW) Pty Limited dated 3 December 2004.

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

11. STW is an Australian listed company engaged in advertising, communications and media operations.

12. On 22 October 2004 STW announced that it intended to return net proceeds received from the sale of its investment in an Indonesian television network by way of return of capital.

13. Prior to making the announcement, STW had determined that it had capital surplus to its requirements and based on its calculations it anticipated little or no gain from the sale.

14. STW has raised capital over a number of years through share issues, its dividend reinvestment plan and debt. The acquisition of the interest in the Indonesian television network was funded through these means of raising capital by STW.

15. Having regard to the factors outlined in paragraphs 12 to 14, STW considered that it is appropriate to debit the whole amount of the aggregate return of capital to its untainted share capital account.

16. Following the disposal of STW's interests in the Indonesian television network, STW is to return the net proceeds of the sale (estimated to be A\$47 million) to all its ordinary shareholders by way of a pro-rata return of capital.

17. The return of capital will be equal to approximately 27 cents per ordinary share. This amount will be wholly debited to the share capital account reducing it from approximately A\$189.4 million to A\$142.4 million.

18. The proposed sale of the Indonesian television investment and the return of capital is subject to approval at the General Meeting of Shareholders to be held on 22 December 2004.

Ruling

19. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the return of capital distribution to STW shareholders. The distribution will, therefore, not be taken to be dividend for income tax purposes.

20. CGT event G1 in section 104-135 of the ITAA 1997 will happen when STW pays the capital reduction amount in respect of a share which has been owned by a participating shareholder.

21. Pursuant to subsections 104-135(3) and (4), the cost base and reduced cost base of each STW share will be reduced (not below nil) by the return of capital amount. A shareholder will make a capital gain from CGT event G1 occurring to each share to the extent that the payment exceeds the share's cost base in accordance with subsection 104-135(3) of the ITAA 1997.

22. However, a capital gain is disregarded if the shareholder acquired the STW share before 20 September 1985, pursuant to subsection 104-135(5) of the ITAA 1997.

23. A non resident shareholder who receives the return of capital will make no capital gain pursuant to section 136-10 of the ITAA 1997, provided the non-resident shareholder (and its associates) beneficially owned less than 10% by value of the shares during the 5 years before the return of capital.

Explanation

Section 45B of the ITAA 1936

24. Section 45B of the ITAA 1936 is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C of the ITAA 1936 applies to treat all or part of a return of capital payment as an unfranked dividend.

25. Section 45B of the ITAA 1936 applies where certain amounts of a capital nature, including a return of capital, are provided to shareholders in substitution for dividends. 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 did so for a **purpose** (other than an incidental purpose) **of enabling a taxpayer to obtain a tax benefit**.

Each of these conditions is considered below.

26. The proposed return of capital is a 'scheme' within the broad meaning of that term.

27. The phrase 'provided with a capital benefit' is defined in subsection 45B(5). A person is provided with a capital benefit if:

- ownership interests in a company are issued to the person;
- there is a distribution to the person of share capital; or
- the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest held by that person.

As STW proposes to debit the distribution to its share capital account, its shareholders will be provided with a capital benefit.

28. A taxpayer '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.

29. A return of capital, ordinarily, would be subject to tax under the capital gains and losses provisions of the income tax law. Unless the amount of the proposed distribution exceeds the cost base of the shares there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). This will happen if the shareholder is a resident of Australia for income tax purposes, or a non-resident whose shares are CGT assets having the necessary connection with Australia (category number 5 of the table in section 136-25 of the ITAA 1997). Shareholders would therefore obtain a 'tax benefit', as defined in subsection 45B(9), under the arrangement.

30. As the conditions of paragraphs 45B(2)(a) and (b) are satisfied, the remaining condition in paragraph 45B(2)(c), that is, whether the requisite degree of purpose (of enabling STW shareholders to obtain a tax benefit) is present, must be considered.

31. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are met, the requisite purpose of enabling the shareholder to obtain a tax benefit – by way of a capital distribution – is not present. The purpose of the return of capital is to return the surplus of STW's present requirements to shareholders. The tax profiles of the wide class of shareholders are not known to STW and as such, the purpose of ensuring that particular shareholders obtain a tax benefit cannot exist.

32. Having regard to the relevant circumstances of the scheme (as set out in subsection 45B(8) of the ITAA 1936) it cannot be concluded that either STW or the participating shareholders entered into or carried out the scheme for the purpose of enabling such shareholders to obtain a tax benefit:

- The return of capital cannot be said to be attributable to the profits of STW as most of the profits are returned to shareholders as franked dividends. The history of the dividend payments by STW does not indicate that the return of capital is being paid in substitution for a dividend. STW does not intend to alter its dividend policy as a consequence of the return of capital.
- The acquisition of the Indonesian investment was funded by the shareholders and loan funds. The sale of the Indonesian investment is to enable STW to concentrate on its core operations, creating a surplus to its current needs. Accordingly, the proposed return of capital is to repay the capital invested by shareholders in the Indonesian investment.
- The sale of the Indonesian investment and return of capital is not influenced by the income tax benefit received but by commercial factors such as the desire for STW to focus on its core operations and to divest itself of an Indonesian investment.

Therefore, section 45B of the ITAA 1936 will not apply to the Arrangement and the Commissioner will not make a determination pursuant to section 45C of the ITAA 1936.

CGT Event G1 section 104-135 of the ITAA 1997

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

34. STW proposes to make a payment to its shareholders out of its share capital account. This payment will not be a dividend or taken to be a dividend. Accordingly, CGT event G1 will occur. A capital gain will arise if the amount of the non-assessable part is more than the cost base of the shareholder's share. A capital gain is disregarded if the share was acquired prior to 20 September 1985.

35. Section 136-10 of the ITAA 1997 states that a non-resident shareholder will not make a capital gain on a capital payment for shares unless the shares have the necessary connection with Australia.

36. Relevantly, a non-resident shareholder and/or its associates must have (at any time during the 5 years) immediately before the Return of capital) held at least 10% by value of the shares in order for the shares to have necessary connection with Australia.

Detailed contents list

37. Below is a detailed contents list for this Class Ruling:

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Commissioner of Taxation

19 January 2005

CR 2005/3

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20;
TR 97/16

Subject references:

- capital benefit
- dividend substitution
- return of capital

Legislative references:

- TAA 1953 Pt IVA
- Copyright Act 1968
- ITAA 1936 45B
- ITAA 1936 45B(2)

- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(5)
- ITAA 1936 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 104-135(5)
- ITAA 1997 Div 136
- ITAA 1997 136-10
- ITAA 1997 136-25

ATO references

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