

CR 2005/64 - Income tax: return of capital: Endeavour HealthCare Ltd

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Class Ruling

Income tax: return of capital: Endeavour HealthCare Ltd

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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:
- 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; and
 - section 45C of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies are the shareholders in Endeavour HealthCare Ltd (Endeavour HealthCare) who will receive a return of capital payment for the cancellation of shares, as described in the Arrangement part of this Ruling. In this Ruling they are referred to as 'participating shareholders'.

4. This Ruling deals with whether the payment to participating shareholders is a dividend. It does not deal with the capital gains tax consequences of the share cancellation. For example, it does not deal with the consequences of CGT event C2 in section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997) happening on the share cancellation.

Qualifications

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

6. 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 11 to 31.

7. 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

9. This Class Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) for a participating shareholder in which that shareholder receives the return of capital payment for the cancellation of shares. The arrangement will be completed within that income year. For participating shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2006. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*;

- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2006. However, the Ruling continues to apply after its withdrawal, 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. This is subject to there being no change in the Arrangement or in the persons' involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents:

- The Application for Class Ruling from Ernst & Young dated 4 January 2005; and
- Correspondence from Ernst & Young dated 2 and 17 March 2005, 22 April 2005, 13 and 25 May 2005, 8 and 23 June 2005.

These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description.

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

12. Endeavour HealthCare is an unlisted public company that was incorporated in February 2000 for the purpose of establishing a corporate healthcare organisation in Australia.

13. Endeavour HealthCare is the parent entity of a group of entities that acquired a number of medical centres, pathology and radiology businesses, and corporate healthcare businesses in Western Australia, New South Wales, Victoria and South Australia.

14. The Endeavour HealthCare group made its acquisitions at a time when competitors were also acquiring medical and healthcare businesses. The competitive market increased purchase prices and acquisition costs, leading to lower financial returns than those originally anticipated by Endeavour HealthCare.

15. The unsatisfactory financial performance of the group prompted a restructure that involved selling off unprofitable businesses and retreating from all states except Western Australia and New South Wales. This initial restructure took place in 2002. The efficiency of the remaining operations did improve after the initial restructure, however the directors of Endeavour HealthCare determined that the potential value of the Endeavour HealthCare group as a stand-alone business was unlikely to meet shareholder expectations and recoup the shareholders' initial investment in the business. The directors considered that an existing operator of similar businesses would most likely be able to extract synergy benefits and a value beyond that achieved with Endeavour HealthCare remaining as a stand-alone entity.

16. In October 2004, Endeavour HealthCare entered into contracts with independent third parties to dispose of its medical centres and pathology businesses. In December 2004, Endeavour HealthCare entered into contracts with independent third parties to dispose of its remaining healthcare businesses. The total proceeds received under the sale agreements is \$37.3 million.

17. The October 2004 contracts included a warranty clause that requires Endeavour HealthCare to retain 7.5% of the sale proceeds in a separate bank account in order to satisfy any warranty claims arising under the sale agreements. The warranty period is 12 months from the date of sale. There was no similar warranty clause included in the December 2004 contracts.

18. The Endeavour HealthCare group of entities will be liquidated shortly after the expiration of the warranty period and the discharge of any outstanding liabilities.

19. The directors have proposed that a return of capital will be made to the participating shareholders for the cancellation of two of every three shares held. The return of capital will be funded solely from the sale proceeds. The entire return of capital amount will be debited against the share capital account of Endeavour HealthCare.

20. At a shareholder meeting to be held on 18 August 2005, the shareholders of Endeavour HealthCare will be asked to approve two separate resolutions. The first resolution will cancel two ordinary shares for every three ordinary shares held by each shareholder at 19 August 2005, being the Record Date, and for each ordinary share cancelled a return of capital payment of \$0.346 will be made. The second resolution will cancel two non-voting shares for every three non-voting shares held by each shareholder at the Record Date and for each non-voting share cancelled a return of capital payment of \$0.346 will be made. The share cancellations will take effect on 2 September 2005.

21. As at the Record Date there will be 86,080,866 ordinary voting shares and 474,024 ordinary non-voting shares on issue in Endeavour HealthCare. The total amount of share capital to be returned is \$19,965,328. The return of capital will be debited entirely against Endeavour HealthCare's share capital account.

22. The Endeavour HealthCare group of companies elected to become a consolidated group from 1 July 2002 with Endeavour HealthCare as the head entity.
23. On a consolidated basis Endeavour HealthCare had contributed share capital of \$92,484,000 and accumulated losses of \$60,788,000 as at 30 June 2004. The accumulated losses of Endeavour HealthCare for accounting purposes at the time of the proposed return of capital is expected to be in the range of \$61 million to \$62 million.
24. The total proceeds received under the sale agreements will be less than the total cost base of the business assets disposed of under those sale agreements. That is, Endeavour HealthCare will make a capital loss from the sale of the business assets.
25. The return of capital will not be treated as a dividend for accounting purposes and Endeavour HealthCare will not be in a position to pay a dividend for accounting or Corporations Law purposes.
26. Since incorporation, Endeavour HealthCare has not paid any dividends and has not undertaken any returns of share capital.
27. Endeavour HealthCare has advised, having regard to the prices at which shares were issued to shareholders by Endeavour HealthCare, and its knowledge of the consideration paid by shareholders for shares acquired from third parties, it is expected that less than 5% of the shareholders may derive capital gains as a result of the return of capital.
28. The shareholders of Endeavour HealthCare are a mix of resident individuals, companies and superannuation funds and non-resident investors. Non-resident investors hold less than 5% of the ordinary shares in Endeavour HealthCare.
29. All of the shares in Endeavour HealthCare were issued after 19 September 1985.
30. Endeavour HealthCare will have no franking credits available at the time of making the return of capital.
31. Endeavour HealthCare confirms that its share capital account, as defined in section 6D of the ITAA 1936, is not tainted as there have been no transfers to the share capital account from other accounts.

Ruling

32. All references are to the ITAA 1936 unless otherwise specified.

Dividends

33. The return of capital of \$0.346 per share under the Arrangement is not a 'dividend' as defined by subsection 6(1) and therefore it would not be included in participating shareholders' assessable income under section 44.

Anti-avoidance provisions

34. The Commissioner will not make a determination under either subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole, or any part, of the return of capital to be received by the participating shareholders for the cancellation of two of every three shares they own.

Explanation

Dividends

35. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholder out of profits derived by the company from any source (if resident in Australia) and from an Australian source (if non-resident).

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

37. Relevantly, the specific exclusion in paragraph (d) of the definition of dividend in subsection 6(1) provides:

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 company.

38. The return of capital paid for the cancellation of shares will be debited against Endeavour HealthCare's untainted share capital account. Therefore, paragraph (d) of the definition of 'dividend' applies and the return of capital will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

Anti-avoidance provisions**Sections 45A and 45B**

39. Sections 45A and 45B are anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C that all or part of the return of capital is treated as an unfranked dividend.

Section 45A

40. 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 and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

41. Although Endeavour HealthCare will be providing its participating shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), the capital benefit is to be provided to all of the participating shareholders in Endeavour HealthCare. The circumstances of the Arrangement do not indicate that there is a 'streaming' of capital benefits to advantaged shareholders and dividends to disadvantaged shareholders. Accordingly, section 45A has no application to the proposed payment of the return of capital.

Section 45B

42. Section 45B applies where certain capital payments 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, who entered into the scheme 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)).

43. In the circumstances of the Arrangement, the conditions of paragraphs 45B(2)(a) and (b) are satisfied, as the proposed return of capital payment will provide participating shareholders with a capital benefit (as defined in subsection 45B(5)). This is because shareholders generally pay less tax on return of capital amounts than they do on an equivalent amount of dividend (a 'tax benefit' as defined in subsection 45B(9)).

44. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the circumstances set out under subsection 45B(8) to determine whether any part of the Arrangement would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

45. The test of purpose is an objective one. The question is whether, objectively, it would be concluded that a person who entered into or carried out the scheme, did so for the purpose of obtaining a tax benefit for the relevant taxpayer in respect of the capital benefit. The purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

46. In this regard, the relevant taxpayers are the participating shareholders of Endeavour HealthCare. The relevant circumstances of this arrangement are:

- Endeavour HealthCare will fund the distribution solely from the proceeds of the sale of the health care businesses owned within the group. These funds are surplus to the requirements of Endeavour HealthCare as the company will be liquidated after the expiration of the warranty period. The entire amount of the capital returned to participating shareholders will be debited against the share capital account of Endeavour HealthCare. Endeavour HealthCare has accumulated losses and will generate capital losses from the sale of the health care businesses. Consequently, Endeavour Healthcare has no profits (realised or unrealised) that are available to pay a dividend (paragraph 45B(8)(a) and (b));
- Endeavour HealthCare is an unlisted public company with a wide range of shareholders being a mix of individuals, companies, institutional investors and non-residents. All of the shares in Endeavour HealthCare were acquired after 19 September 1985. Endeavour HealthCare has estimated the percentage of non-resident investors to be approximately 5%. Endeavour HealthCare has also estimated that 95% of participating shareholders will make a capital loss from the share cancellation and return of capital (paragraphs 45B(8)(c), (d), (e) and (f));
- paragraphs 45B(8)(g), (i) and (j) are not relevant to Endeavour HealthCare's proposed share cancellation and return of capital;

- the comparative rights and interests held by the participating shareholders after the return of capital will be the same as those that would have been held had an equivalent dividend been paid instead of the capital benefit (paragraph 45B(8)(h)); and
- the matters referred to in paragraph 45B(8)(k) are the relevant circumstances listed in subparagraph 177D(b)(i) to (viii) in relation to the arrangement for the purpose of determining whether a scheme was entered into to obtain a tax benefit under Part IVA. In the present circumstances, the return of capital will apply to all participating shareholders of Endeavour HealthCare equally. The form and substance of Endeavour HealthCare's proposed share cancellations and return of capital does not lead to a view that the arrangement was entered into for the purpose of obtaining such a tax benefit.

47. Having regard to the circumstances outlined in paragraph 46, it is considered that the arrangement as described will not be entered into for the purpose, not being an incidental purpose, of enabling a participating shareholder of Endeavour HealthCare to obtain a tax benefit. Although a tax benefit would be provided to the shareholders of Endeavour HealthCare, any benefit is merely incidental. It is accepted the purpose of the proposed return of capital is to return capital surplus to Endeavour HealthCare's present requirements to its shareholders.

48. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the return of capital.

49. As the Commissioner will not make a determination pursuant to subsection 45B(3) in relation to the arrangement as described, section 45C will not deem the return of capital provided to be an unfranked dividend for the purposes of ITAA 1936 or ITAA 1997.

Detailed contents list

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

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Commissioner of Taxation

13 July 2005

<i>Previous draft:</i>	- ITAA 1936 45B(8)(a)
Not previously issued as a draft	- ITAA 1936 45B(8)(b)
	- ITAA 1936 45B(8)(c)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(8)(d)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 45B(8)(e)
TR 97/16	- ITAA 1936 45B(8)(f)
	- ITAA 1936 45B(8)(g)
<i>Subject references:</i>	- ITAA 1936 45B(8)(h)
- capital benefit	- ITAA 1936 45B(8)(i)
- return of capital	- ITAA 1936 45B(8)(j)
	- ITAA 1936 45B(8)(k)
	- ITAA 1936 45B(9)
<i>Legislative references:</i>	- ITAA 1936 45C
- ITAA 1936 6(1)	- ITAA 1936 Pt IVA
- ITAA 1936 6D	- ITAA 1936 177D(b)(i)
- ITAA 1936 44	- ITAA 1936 177D(b)(ii)
- ITAA 1936 44(1)	- ITAA 1936 177D(b)(iii)
- ITAA 1936 45A	- ITAA 1936 177D(b)(iv)
- ITAA 1936 45A(2)	- ITAA 1936 177D(b)(v)
- ITAA 1936 45A(3)(b)	- ITAA 1936 177D(b)(vi)
- ITAA 1936 45B	- ITAA 1936 177D(b)(vii)
- ITAA 1936 45B(2)(a)	- ITAA 1936 177D(b)(viii)
- ITAA 1936 45B(2)(b)	- ITAA 1997 104-25
- ITAA 1936 45B(2)(c)	- ITAA 1997 995-1(1)
- ITAA 1936 45B(3)	- TAA 1953 Pt IVA
- ITAA 1936 45B(5)	- Copyright Act 1968
- ITAA 1936 45B(8)	

ATO references

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