


CR 2005/95 - Income tax: return of share capital by Credit Union Services Corporation (Australia) Limited

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Class Ruling

Income tax: return of share capital by Credit Union Services Corporation (Australia) 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 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 law dealt with in this Class Ruling is section 45B of the *Income Tax Assessment Act 1936* (ITAA 1936). This Ruling does not cover the application of the capital gains and losses provisions of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of Credit Union Services Corporation (Australia) Limited (CUSCAL). In this Ruling they are referred to as 'participating shareholders'.

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 11 to 20.

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- this Ruling may be withdrawn or modified.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 Class Ruling applies to the year of income (as defined in subsection 995-1(1) of the ITAA 1997) for a participating shareholder in which that shareholder received a payment representing a return of capital. For participating shareholders who do not have a substituted accounting period this will be the year of income ending 30 June 2006.

9. However, the 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore this Ruling 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 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, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of this 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 the arrangement are:

- the application for Class Ruling from Deloitte on behalf of CUSCAL dated 4 August 2005;
- CUSCAL 's 2004 Annual Report;
- CUSCAL's Constitution (as revised 22 November 2004); and
- CUSCAL's 2005 Annual Financial Report.

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

12. CUSCAL is an Australian unlisted public company.

13. CUSCAL provides products and services for the benefit of Australian credit unions and their members.

14. Only credit unions are eligible to be CUSCAL members and at the time of the arrangement, CUSCAL will have 165 member shares. Each member is required to hold at least one \$9.75 member share.

15. A member holding a member share is:

- obliged to pay annual subscriptions;
- entitled to vote on an election of Industry Association Advisory Committee members;
- entitled to vote at a meeting of members in accordance with the terms of CUSCAL's Constitution;
- entitled to cast votes on a reserved question at a meeting of members;
- entitled to receive notices of, and attend, a meeting of members;
- not entitled to nominate candidates for election to the board;
- not entitled to participate in a dividend in respect of a member share; and
- entitled to participate, upon a winding up, in repayment of the total amount of the nominal value paid on the member shares.

16. For a credit union to avail itself of the CUSCAL banking services it is required to hold commercial shares. The number of \$0.75 commercial shares required to be held by a credit union is based on the relative size of the credit union.
17. A member holding commercial shares is:
- obliged to maintain a commercial shareholding and must execute and remain party to a Participation Agreement at all times in order to participate in banking services;
 - entitled jointly, with two other members holding commercial shares, to nominate one candidate for election to the board;
 - entitled to vote at an election of directors;
 - entitled to attend, receive notices of and vote at a meeting of members;
 - entitled to participate in any dividend payable in respect of commercial shares; and
 - entitled to participate, upon a winding up, in the repayment of the total amount of the nominal value paid up on commercial shares.
18. CUSCAL decided to return to its core businesses and sold a number of substantial businesses and subsidiaries. This has resulted in a substantial reduction in the level of capital required to operate its businesses. As an authorised deposit-taking institution CUSCAL is supervised by the Australian Prudential Regulatory Authority (APRA) and is rated by Standard & Poors (S&P). Therefore, before CUSCAL implemented its plan to return capital to its shareholders, it consulted with both APRA and S&P. As a result of those consultations, CUSCAL undertook to return capital to its shareholders in two stages. Therefore, this second return of capital so soon after the first return of capital is not indicative of a trend, but rather reflects the regulatory and commercial exigencies of CUSCAL's business.
19. CUSCAL proposes to make a return of capital distribution of \$0.15 on each member and commercial share in early 2006. The total distribution proposed is \$22,423,094.55 and is to be funded from cash on hand. The return of capital will occur pursuant to Part 2J.1 of the Corporations Act 2001, and in particular section 256B. That is, the return of capital will represent a share capital reduction with the total distribution being debited against the credit amount in the 'share capital accounts' (as defined in section 6D of the ITAA 1936) of CUSCAL.
20. CUSCAL intends to maintain its dividend pay-out ratios.

Ruling

21. Subject to the qualifications in paragraphs 4 to 7 of this Ruling, it is confirmed that 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 proposed return of capital.

Explanation

22. 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.

23. Section 45B of the ITAA 1936 applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends. Subsection 45B(2) of the ITAA 1936 sets out the conditions under which the Commissioner will make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies. These conditions are that:

- (a) there is a **scheme** under which a person is **provided with a capital benefit** by a company;
- (b) under the scheme, a taxpayer (the relevant taxpayer), who may or may not be the person provided with the capital benefit, **obtains a tax benefit**; 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 the relevant taxpayer to obtain a tax benefit**.

Arrangement is a 'scheme'

24. The term 'scheme' in Part IIIAA of the ITAA 1936 is broadly defined by section 177A of the ITAA 1936 as:

- (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- (b) any scheme, plan, proposal, action, course of action or course of conduct.

25. The arrangement described in this Ruling which involves the return of capital on member and commercial shares held by CUSCAL members will constitute a scheme.

A person 'provided with a capital benefit'

26. A reference to a person being 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936 to include the distribution to the person of share capital or share premium.

27. Therefore, CUSCAL's members will receive a capital benefit in relation to their member shares.

28. Also CUSCAL members who hold commercial shares will receive a capital benefit in relation to their commercial shares.

A person obtains a 'tax benefit'

29. The meaning of 'obtaining a tax benefit' is in subsection 45B(9) of the ITAA 1936:

A relevant taxpayer '**obtains a tax benefit**' if an amount of tax payable, or any other amount payable under this Act, by the relevant taxpayer would, apart from this section, be less than the amount that would have been payable, or would be payable at a later time than it would have been payable, if....the capital benefit had been a dividend.

30. The return of capital allows CUSCAL to carry forward its franking credits to be utilised in future income years, this constitutes a tax benefit for CUSCAL members. Shareholders would therefore obtain a 'tax benefit', as defined in subsection 45B(9) of the ITAA 1936, under the arrangement.

With regards to 'relevant circumstances of scheme'

31. The nature of paragraph 45B(2)(c) of the ITAA 1936 is more complex than the other requirements in this section. It requires a conclusion to be formed that person or persons who entered into the scheme did so for the purpose of enabling the 'relevant taxpayer' to obtain a tax benefit. It is necessary to consider the 'relevant circumstances of the scheme' to determine objectively the purpose of the scheme. Subsection 45B(2) of the ITAA 1936 will not apply if the seeking of the tax benefit is only incidental to the purpose of entering or carrying out the scheme or any part of the scheme. The meaning of 'relevant circumstances of scheme' is defined in subsection 45B(8) of the ITAA 1936.

32. Paragraph 45B(8)(a) of the ITAA 1936 refers to the extent to which a capital benefit is attributable to realised and unrealised profits of the company and its associates. The proposed distribution by CUSCAL is not considered to be attributable to profits as the source of funds to be used for the return of capital can be traced to capital previously invested and now released in the non-core businesses that have been sold. The return of capital is funded from cash on hand.

33. Paragraph 45B(8)(b) of the ITAA 1936 refers to the pattern of distribution of dividends, bonus shares and returns of paid up capital by the company or its associates. CUSCAL has consistently paid dividends when profits have been made and intends to continue with its policy of paying, at least annually, a substantial rate of the operating profit for the relevant period as a dividend.

34. Paragraph 45B(8)(c) of the ITAA 1936 refers to the extent that the relevant taxpayer is able to utilise capital losses. The return of capital should not (of itself) result in a capital gain for either commercial or member shareholders. Therefore, any capital losses held by the shareholders will not be utilised as a result of the arrangement.

35. Having regard to all the relevant circumstances, it is considered reasonable to conclude that the arrangement as described will not be entered into for a more than incidental purpose of obtaining a tax benefit for CUSCAL members.

36. Therefore, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of this Act applies to the distribution proposed under the arrangement.

Detailed contents list

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

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Commissioner of Taxation

16 November 2005

- Previous draft:*
- TAA 1953 Pt IVAAA
- Not previously issued as a draft
- ITAA 1936 6D
 - ITAA 1936 45B
- Related Rulings/Determinations:*
- ITAA 1936 45B(2)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(5)
 - ITAA 1936 45B(8)
- CR 2001/1; TR 92/1; TR 92/20;
TR 97/16
- Subject references:*
- capital benefit
 - capital reduction
 - dividend substitution
 - return of capital
- ITAA 1936 45B(8)(a)
 - ITAA 1936 45B(8)(b)
 - ITAA 1936 45B(8)(c)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
- Legislative references:*
- ITAA 1936 177A
 - ITAA 1997 995-1(1)
- Copyright Act 1968
- Corporations Act 2001 256B
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ATO references

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