



CR 2006/105 - Income tax: Baycorp Advantage Limited: return of capital

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Class Ruling

Income tax: Baycorp Advantage Limited: return of capital

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ⓘ This publication provides you with the following level of protection:

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997;
- subsection 115-25(1) of the ITAA 1997; and
- section 136-10 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the holders of ordinary shares in Baycorp Advantage Limited ('Baycorp Advantage') who hold those shares on capital account and who are to receive a return of capital under the Scheme described in paragraphs 13 to 18 of this Ruling. In this Ruling, this class of entities is referred to as 'Baycorp Advantage Shareholders'.

Qualifications

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

5. Baycorp Advantage Shareholders may rely on the contents of this Ruling provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 18 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme 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 from 18 October 2006. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

9. If this Class Ruling is inconsistent with a later public or private ruling, Baycorp Advantage Shareholders may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the Taxation Administration Act 1953 (TAA)).

10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, Baycorp Advantage Shareholders may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

12. This Ruling is withdrawn and ceases to have effect after 30 June 2007. However, the Ruling continues to apply after its withdrawal in respect of the relevant provisions ruled upon, to all Baycorp Advantage Shareholders who entered into the specified scheme during the term of the ruling subject to there being no change in the scheme or in the entities involved in the scheme.

Scheme

13. The scheme that is the subject of the Ruling is described below. The description is based on the following documents:

- Application for Class Ruling from Baycorp Advantage dated 11 July 2006; and
- Further correspondence from Baycorp Advantage dated 28 August 2006 and 15 September 2006.

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

14. Baycorp Advantage is an Australian resident public company listed on the Australian Stock Exchange. Baycorp Advantage is the parent company of the Baycorp Advantage Group ('the BCA Group'). On 5 May 2006, Baycorp Advantage announced the sale of the BCA Group's debt collection business, Baycorp Advantage Collection Services ('the BCS Group'). The sale was completed on 30 June 2006. Baycorp Advantage received net cash of approximately \$80 million as the proceeds of sale of the BCS Group.

15. The Board of Baycorp Advantage is proposing to return approximately \$78.5 million in cash to its shareholders through a return of capital of \$0.35 per share on a pro rata basis to all shareholders ('the proposed capital return'). This proposal is made in order to maintain the existing net debt level for Baycorp Advantage following the sale of the BCS Group.

16. The proposed capital return was announced to the shareholders of Baycorp Advantage at an Extraordinary General Meeting held on 26 June 2006. The proposed return of capital will be undertaken if approval is received from shareholders at Baycorp Advantage's annual General Meeting on 26 October 2006.

17. The proposed capital return of \$78.5 million principally represents a return of equity that had been invested by Baycorp Advantage into the BCS Group (by way of share capital and loans), and will be made out of Baycorp Advantage's share capital account. Baycorp Advantage currently has \$253 million in share capital, with approximately 224.7 million shares on issue.

18. Baycorp Advantage's share capital account is untainted.

Ruling

The application of sections 45A, 45B and 45C of the ITAA 1936 to the proposed return of capital

19. The Commissioner will not make a determination under sections 45A or 45B that section 45C applies to the proposed capital return. Accordingly, no part of the proposed capital return will be taken to be a dividend for income tax purposes under section 45C.

Capital gains tax consequences

20. CGT event G1 will happen to a Baycorp Advantage Shareholder when Baycorp Advantage pays the proposed capital return (section 104-135 of the ITAA 1997).

21. CGT event C2 will happen to a Baycorp Advantage Shareholder receiving the proposed capital return in respect of a share they own at the Record Date but have disposed of before the Payment Date (section 104-25 of the ITAA 1997).

22. Any capital gain made by a non-corporate Baycorp Advantage Shareholder in respect of shares held for at least 12 months may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

23. A non-resident Baycorp Advantage Shareholder who receives the proposed capital return will make a capital gain if their share has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Commissioner of Taxation

18 October 2006

Appendix 1 – Explanation

❶ *This Appendix 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.*

Anti-avoidance provisions

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

Section 45A of the ITAA 1936

25. 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') and it is reasonable to assume that the other shareholders have received or would receive dividends ('the disadvantaged shareholders').

26. Baycorp Advantage will provide shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)) under the proposed capital return. However, having considered the relevant circumstances of the proposed capital return, it cannot be concluded that capital benefits and dividends are being channelled by Baycorp Advantage to its shareholders, in a manner that enables advantaged shareholders to receive capital benefits while disadvantaged shareholders will receive dividends. This is because all shareholders of Baycorp Advantage would enjoy similar rights of access to the proposed capital return.

27. Therefore, section 45A has no application to the proposed capital return.

Section 45B of the ITAA 1936

28. The purpose of section 45B is to ensure that the relevant amounts distributed to shareholders are treated as dividends for tax purposes if certain payments, allocations and distributions are made in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- 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

- 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, (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

29. Each of these conditions is considered below.

30. A scheme for the purposes of section 45B is defined in terms of subsection 177A(1) of the ITAA 1936 by section 160APA of the ITAA 1936.

31. A scheme is defined in subsection 177A(1) of the ITAA 1936 to include:

- 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
- any scheme, plan, proposal, action, course of action or course of conduct.

32. The arrangement involving the proposed capital return will constitute a scheme for the purposes of section 45B.

33. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) and includes a distribution to a person of share capital. As the proposed capital return will be recorded by means of a debit to Baycorp Advantage's untainted share capital account, its shareholders would be taken to have been provided with a capital benefit as defined in paragraph 45B(5)(b).

34. 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 relevant 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.

35. As discussed in paragraph 33 of this Ruling, the distributions shareholders will receive under the proposed capital return will represent a return of capital and constitute a capital benefit. In the event that the relevant distribution did represent a dividend rather than a capital benefit, it is likely that some shareholders would have incurred a greater liability to tax. Consequently, the receipt of the capital benefit would have represented a tax benefit to those shareholders.

36. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the relevant circumstances (as outlined in subsection 45B(8)) of the scheme with a view to determine whether it could be concluded that entities that 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 the relevant taxpayer to obtain a tax benefit. Having considered all relevant circumstances, the Commissioner has formed the view that the capital benefits provided to the relevant taxpayers do not represent a payment in substitution for dividends.

37. Consequently section 45B will not apply to the proposed capital return.

The proposed capital return and CGT event G1

38. CGT event G1 in section 104-135 of the ITAA 1997 will happen when Baycorp Advantage pays the proposed capital return amount in respect of a share that a Baycorp Advantage Shareholder owned at the Record Date and continues to own at the payment time and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

39. Baycorp Advantage proposes to make the payment to its Baycorp Advantage Shareholders out of its share capital account. This payment will not be a dividend as defined. If the proposed capital return amount (\$0.35 per share) is not more than the cost base of the Baycorp Advantage share at the time of the payment, the cost base and reduced cost base of the share are reduced by that amount (subsection 104-135(4) of the ITAA 1997).

40. A Baycorp Advantage Shareholder will make a capital gain if the return of capital amount is more than the cost base of their Baycorp Advantage share. The amount of the capital gain is equal to this excess.

41. If a Baycorp Advantage Shareholder makes a capital gain, the cost base and reduced cost base of the share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

42. A Baycorp Advantage Shareholder cannot make a capital loss under CGT event G1.

43. Consequently, if the share was originally acquired by a non-corporate Baycorp Advantage Shareholder at least 12 months before the payment of the proposed capital return amount, a capital gain from CGT event G1 happening to the share may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

CGT event C2

44. If a Baycorp Advantage Shareholder has ceased to own some, or all, of their shares between the Record Date and the time of the payment of the proposed capital return, the right to the payment is considered to be a separate CGT asset. This is because the right to the payment has been separated from the bundle of rights that once attached to the share.

45. A Baycorp Advantage Shareholder's right to receive the payment will be discharged or satisfied when the payment is made under the arrangement, causing CGT event C2 in section 104-25 of the ITAA 1997 to happen.

46. In working out the capital gain or capital loss made from CGT event C2 happening, the capital proceeds from the event will be the return of capital amount.

47. The cost base of the Baycorp Advantage Shareholder's right to receive a payment under the arrangement is worked out in accordance with Division 110 of the ITAA 1997. However, the cost base of the right will be nil if the full cost base (or reduced cost base) of the share previously held by the Baycorp Advantage Shareholder has been applied in working out a capital gain or loss made when a CGT event happened to the share – for example, when the Baycorp Advantage Shareholder disposed of the share. In these cases, the Baycorp Advantage Shareholder will generally make a capital gain equal to the amount paid under the proposed capital return.

48. Because the right to a payment of the proposed capital return was inherent in the share during the time it was owned then, for the purposes of Subdivision 109-A of the ITAA 1997, the right is considered to have been acquired at the time when the share was acquired.

49. Consequently, if the share to which the payment relates was originally acquired by a non-corporate Baycorp Advantage Shareholder at least 12 months before the payment of the proposed capital return amount, a capital gain from CGT event C2 happening to the right may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

Non-resident shareholders

50. Pursuant to section 136-10 of the ITAA 1997, a non-resident Baycorp Advantage Shareholder will make a capital gain from the proposed capital return only if their Baycorp Advantage shares have the necessary connection with Australia. Under category 5 of the table in section 136-25 of the ITAA 1997, a Baycorp Advantage share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the proposed capital return, the Baycorp Advantage Shareholder together with their associates owned 10% or more by value of the issued shares in Baycorp Advantage.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Subject references:

- capital reduction
- reduction of share capital
- return of share capital
- share capital

Legislative references:

- | | |
|-----------------------|----------------------------|
| - Copyright Act 1968 | - ITAA 1936 45B(8) |
| - ITAA 1936 45A | - ITAA 1936 45B(9) |
| - ITAA 1936 45A(3)(b) | - ITAA 1936 45C |
| - ITAA 1936 45B | - ITAA 1936 160APA |
| - ITAA 1936 45B(2)(a) | - ITAA 1936 177A(1) |
| - ITAA 1936 45B(2)(b) | - ITAA 1997 104-25 |
| - ITAA 1936 45B(2)(c) | - ITAA 1997 104-135 |
| - ITAA 1936 45B(5) | - ITAA 1997 104-135(3) |
| - ITAA 1936 45B(5)(b) | - ITAA 1997 104-135(4) |
| | - ITAA 1997 Subdiv 109-A |
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| | - ITAA 1997 115-25(1) |
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ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 - shares
Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 - end of a CGT asset