


CR 2006/115 - Income tax: IBT Education Limited return of capital

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Class Ruling

Income tax: IBT Education 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 (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided 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:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45A of the 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; and
- section 136-10 of the ITAA 1997.

All references are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of IBT Education Limited (IBT) who are registered on the IBT Share Register on the Record Date, being the date for determining entitlements to the proposed return of share capital and who receive distributions under the proposed return of capital.

Qualifications

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 22 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 to the income year (as defined in subsection 995-1(1) of the ITAA 1997) ending 30 June 2007. 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, the relevant class of entities 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, the relevant class of entities 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 entities within the specified class 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. This description is based on, and includes reference to, the following documents:

- Application for the Class Ruling from PKF Chartered Accountants & Business Advisors (PKF) dated 27 June 2006;
- Correspondence from PKF dated 17 July 2006 and 4 August 2006;
- Notice of AGM and Proxy Form dated 6 October 2006; and
- IBT Australian Stock Exchange (ASX) Release – Results of AGM held on 8 November 2006.

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

14. IBT is an Australian resident public company listed on the ASX. IBT was incorporated on 18 June 2004 and listed officially on the ASX on 15 December 2004 to establish a suitable capital structure to pursue growth opportunities.

15. IBT is an industry leader in providing pre-university and university pathway programs for domestic and overseas students, as well as Year 10-12 English preparatory courses, Foundation, Degree, Pre-Masters and Masters Programs in a wide range of disciplines.

16. During 2005, IBT acquired the following businesses with the goal of further improving shareholder returns:

- CSM Knowledge Pty Ltd (CSMK) on 12 July 2005. CSMK is a knowledge and learning solutions provider focused on the delivery of accredited competency based vocational education training courses to a variety of corporate and government clients; and
- ACL Pty Ltd (ACL) on 12 October 2005. ACL is the largest private provider of English language training in Australia including training for migrants and refugees under contract to the Australian Government.

17. An economic framework was adopted by IBT that best suited IBT's objectives. Under the chosen framework the focus is on growing earnings after making allowances for the cost of capital employed in the business. This seeks to boost performance by aligning management's goals with those of the shareholders.

18. In January 2006, IBT engaged professional advisors to conduct a capital management review and examine ways to improve the efficiency of its balance sheet.

19. In line with IBT's economic framework, the advisors recommended a return of capital of 15 cents per share (\$52 million in total), in order to improve surplus cash efficiency. Under the economic framework, surplus cash is inefficient in that it generates returns which are substantially lower than the required rate of 12%.

20. Following the advisor's recommendation, IBT's board proposes to make a return of capital of 10 cents per share equating to a total of approximately \$35 million and will be debited entirely to IBT's untainted share capital account.

21. The return of capital was given shareholder approval at the Annual General Meeting on the 8 November 2006.

22. The return of capital will be funded by cash reserves or a small amount of debt. In this regard IBT have negotiated a \$100 million credit facility to facilitate any cash shortfalls.

Ruling

Is the return of capital a dividend as defined in subsection 6(1)?

23. The proposed return of capital of 10 cents per ordinary share will not be a dividend as defined in subsection 6(1).

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

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

Capital gains tax consequences

25. CGT event G1 will happen to IBT shareholders when the return of capital is paid (section 104-135 of the ITAA 1997).

26. CGT event C2 will happen to IBT shareholders receiving the return of capital that cease to own their IBT shares after the Record Date but before the payment of the return of capital (section 104-25 of the ITAA 1997).

27. A foreign resident shareholder will only make a capital gain as a result of the return of capital if the relevant asset (the IBT share) has the necessary connection with Australia (section 136-10 of the ITAA 1997).

Commissioner of Taxation

22 November 2006

Appendix 1 – Explanation

① *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.*

Dividends

28. 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 the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

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

30. Relevantly, paragraph (d) specifically excludes from the definition of 'dividend' in subsection 6(1):

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

31. The return of capital will be debited against IBT's share capital account. There have been no transfers into IBT's share capital account as defined in section 6D from any of IBT's other accounts. Therefore, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies and the return of capital would not constitute a dividend.

Anti-avoidance provisions

32. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to determine that all or part of a distribution is treated as an unfranked dividend that is paid by the company out of profits to the shareholder.

Streaming of dividends and capital benefit: section 45A

33. Section 45A applies in circumstances where capital benefits are streamed to advantaged shareholders who would, in the year of income in which the capital benefits are provided, derive a greater capital benefit than the other shareholders (the disadvantaged shareholders) who would receive dividends.

34. IBT will provide all of its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), and the capital benefit is to be provided to all shareholders in direct proportion to their individual shareholding. As all shareholders benefit equally from the return of capital, there is no indication of 'streaming' of capital benefits to some shareholders and not to other shareholders. Accordingly, section 45A will not apply to the return of capital, and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the return of capital.

Schemes to provide capital benefits in substitution for dividends: section 45B

35. Section 45B applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

36. 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 for a purpose (other than an incidental purpose) of enabling a taxpayer to obtain a tax benefit.

Each of these conditions is considered below.

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

38. The phrase 'provided with a capital benefit' is defined at subsection 45B(5). Relevantly, it includes a distribution to a person of share capital. As IBT proposes to debit the return of capital against its share capital account, its shareholders will be provided with a capital benefit.

39. A shareholder '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.

40. Ordinarily, a return of capital would be subject to the CGT provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the share there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). It is only to the extent (if any) that the distribution exceeds the cost base of the share that a capital gain is made. A capital gain may not arise at all for certain foreign shareholders: see paragraph 58 and 59 of this Ruling. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or, in the case of a non-resident, subject to dividend withholding tax. Therefore, the shareholder will obtain tax benefits from the return of capital.

Relevant circumstances

41. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the 'relevant circumstances' set out in subsection 45B(8) to determine whether any part of the scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit. However, the list of relevant circumstances in subsection 45B(8) is not exhaustive and regard may be had to other circumstances on the basis of their relevance.

42. The test of purpose is an objective one. The question is whether 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 requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

43. The purpose which causes section 45B to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is concerned only with the purpose of IBT. The Commissioner cannot at this stage ascertain the purposes of IBT's numerous shareholders, all of whom are eligible to vote on the return of capital under section 256C of the *Corporations Act 2001* and all of whom would participate in the return of capital should the proposal be approved. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company should, generally speaking, not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who vote in favour of the proposal.

44. The relevant circumstances under subsection 45B(8) cover the circumstances of the company and the tax profile of the shareholders. In this instance, as the return of capital is made to all shareholders of IBT regardless of individual shareholder circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(i) and (j) pertaining to the provision of ownership interests and a demerger respectively are not relevant. In this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

45. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital or profits (realised and unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, the return of capital is referable to surplus capital and improving the surplus cash efficiency following the advisors recommendations. Furthermore, IBT proposes to distribute 100% of its current undistributed accounting profits as part of the interim fully franked dividend. In these circumstances, the capital benefit is attributable to capital not profits, realised or unrealised.

46. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate (within the meaning of section 318) of the company. IBT's dividend payout ratio is 100% of the net profit after tax due to IBT's strong balance sheet and capital structure.

47. Since being listed on the ASX on 15 December 2004, IBT has not made a return of capital to its shareholders. The pattern of distributions made by IBT does not suggest that the return of capital is made in substitution for a dividend.

48. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (viii). These are matters by reference to which a scheme is able to be examined from a practical perspective in order to identify and compare its tax and non-tax objectives. The matters include the manner in which the scheme is carried out, the timing of the scheme, its form and substance, and the financial and other implications for the parties involved. IBT has demonstrated that the scheme, being a return of capital to its shareholders, is a legitimate return of surplus capital aimed at improving its surplus cash efficiency. This should result in a higher rate of return to shareholders on their investment in the company. Additionally, the return of capital will improve the company's surplus cash return towards its targeted 12% under the economic framework. In this case, the practical implications of the scheme are consistent with it being, in form and substance, a distribution of share capital.

49. Therefore, having regard to the relevant circumstances of the scheme to return capital to IBT's shareholders, as discussed in paragraphs 41 to 48 of this Ruling, it would not be concluded that IBT will enter into or carry out the scheme for more than an incidental purpose of enabling the shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the return of capital.

Deeming dividends to be paid where a determination is made: section 45C

50. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) in relation to the scheme as described, section 45C will not apply.

CGT event G1: section 104-135 of the ITAA 1997

51. CGT event G1 (section 104-135 of the ITAA 1997) will happen if a company makes a payment to a shareholder in respect of a share they own in a company and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

52. The cost base and reduced cost base of each IBT share will be reduced (but not below nil) by the amount of the return of capital (subsections 104-135(3) and (4) of the ITAA 1997).

53. An IBT shareholder may make a capital gain if the return of capital by the company in relation to each IBT share exceeds the cost base of the share (subsection 104-135(3) of the ITAA 1997). If the IBT share was acquired by the shareholder at least 12 months before the date of payment, a capital gain from the share may qualify as a discount capital gain (subsection 115-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

CGT event C2: section 104-25 of the ITAA 1997

54. A person who is a registered ordinary shareholder of IBT on the Record Date for the proposed return of capital acquires the right to receive the return of capital on that date. A shareholder continues to have the right to the return of capital even if the shareholder ceases to own the shares before the payment is made. The right is a CGT asset separate from the IBT share.

55. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the return of capital is paid and the right to receive that payment ends.

56. A capital gain will result if the capital proceeds for the event are more than the cost base of the right. The capital proceeds will be the amount of the payment from IBT. As no amount will have been paid for the right, its cost base is likely to be nil. Therefore, a capital gain equal to the payment of the return of capital will likely arise.

57. The right to payment from IBT was inherent in the IBT share during the time that it was owned. Therefore, for the purposes of Subdivision 109-A of the ITAA 1997 the right is considered to have been acquired at the time when the IBT share was acquired. Consequently, if the IBT share was originally acquired by the former shareholder at least 12 months before the payment, a capital gain from the right may qualify as a discount capital gain (subsection 115-25(1) of the ITAA 1997) if the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Foreign resident shareholders: Division 136 of the ITAA 1997

58. If the IBT shareholder is not an Australian resident for income tax purposes, a CGT event G1 capital gain cannot be made unless the shares have the necessary connection with Australia (section 136-25 of the ITAA 1997). Broadly, shares in public companies will not have the necessary connection with Australia, and a capital gain or a capital loss will not be made, where the foreign resident shareholder and their associates beneficially own less than 10% by value of the shares in the company during the 5 years before the CGT event happens.

59. As rights to receive a return of capital cannot have a necessary connection with Australia (section 136-25 of the ITAA 1997) there will be no CGT event C2 gain or loss for a foreign resident shareholder.

Appendix 2 – Detailed contents list

60. The following is a detailed contents list for this Ruling:

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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
- Corporations Act 2001 256C
- ITAA 1936 6(1)
- ITAA 1936 6(4)
- ITAA 1936 6D
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
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- ITAA 1936 45B(8)
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- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
- ITAA 1936 177D(b)(iii)
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- ITAA 1936 177D(b)(v)
- ITAA 1936 177D(b)(vi)
- ITAA 1936 177D(b)(vii)
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- ITAA 1936 318
- ITAA 1997 104-25
- ITAA 1997 104-135
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 Subdiv 109-A
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 Div 136
- ITAA 1997 136-10
- ITAA 1997 136-25
- ITAA 1997 995-1(1)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)

ATO references

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 Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 – shares
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