


CR 2007/38 - Income tax: return of capital: Globe International Limited

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Class Ruling

Income tax: return of capital: Globe International Limited

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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 855-10 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is all of the shareholders of Globe International Limited (GIL) who receive a return of capital as described in paragraph 20 of this Ruling.

Qualifications

4. 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 12 to 21 of this Ruling.

5. 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

7. This Ruling applies from 16 May 2007 to 30 June 2008. However, the Ruling continues to apply after this date 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.

8. 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 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 Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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).

Scheme

12. The following description of the scheme is based on information provided by the applicant. This description is based on, and includes reference to the following documents:

- application for Class Ruling from PricewaterhouseCoopers (PwC), dated 5 February 2007; and
- correspondence and information from PwC and GIL provided from 21 March 2007 to 27 April 2007.

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

13. GIL is a public company incorporated in Australia. It carries on a worldwide business consisting of the wholesale and retail of action sports apparel and equipment.

14. During the financial year ending 30 June 2001, GIL was restructured which involved the purchase of various assets and businesses and the simplification of the ownership structure.

15. In May 2001, GIL completed its initial public offering (IPO) on the Australian Stock Exchange raising A\$74 million at the issue price of A\$1 per share and with total shares of 363.8 million. The contributed capital immediately after the IPO was A\$101 million.

16. On 24 May 2001, GIL acquired some of the assets and businesses of the Streetwear Division for a purchase price of A\$32.2 million using proceeds raised through the IPO and a share issue of A\$22 million. The Streetwear Division of GIL operated solely in Australia and New Zealand.

17. On 1 July 2002, GIL became the main operating entity for the Streetwear Division with some of the assets and liabilities of GIL's subsidiaries being transferred at book value to GIL.

18. On 30 June 2004, following a corporate restructure, all of the licences of the Streetwear Division were assigned to GIL with the trademarks of the Streetwear Division being assigned to Globe International Nominees Pty Ltd.

19. On 18 October 2006, GIL sold the assets of the Streetwear Division to an unrelated third party for A\$41.20 million with the sale being finalised on 7 February 2007. The sale comprised of part of the assets and businesses acquired on 24 May 2001 in relation to the IPO, part of the assets and businesses acquired before the IPO, and some assets and a business acquired after the IPO. An accounting loss was made by GIL on the sale of the Streetwear Division.

20. On 26 February 2007, GIL announced that it intended to make a pro-rata return of capital of A\$32 million to its shareholders. GIL will debit the whole of the return of capital against its share capital account. GIL confirms that its share capital account as defined in section 975-300 of the ITAA 1997 is untainted. The return of capital will be paid to all shareholders who hold GIL shares on the Record Date.

21. GIL did not pay a dividend in the 2006 income year, having negative retained earnings of approximately A\$50 million. GIL has reported a loss of A\$3.090 million for the half-year ended 31 December 2006.

Ruling

Dividend

22. The payment of the proposed return of capital will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

Sections 45A, 45B and 45C

23. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the payment of the proposed return of capital to be received by GIL shareholders.

Capital gains tax

24. CGT event C2 in section 104-25 of the ITAA 1997 will happen when GIL pays the proposed return of capital to a GIL shareholder who ceases to own their shares before the time of the payment.

25. CGT event G1 in section 104-135 of the ITAA 1997 will happen when GIL pays the proposed return of capital in respect of shares that GIL shareholders own at the time of the payment.

Foreign residents

26. For a foreign resident shareholder, the payment of the proposed return of capital will only have CGT consequences if their GIL shares are 'taxable Australian property' under section 855-10 of the ITAA 1997.

Commissioner of Taxation16 May 2007

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.*

Dividend

27. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income a dividend, as defined by subsection 6(1) of the ITAA 1936, which is paid to the shareholder out of company profits.

28. As the proposed return of capital will be wholly debited against an amount standing to the credit of GIL's share capital account, it will not constitute a dividend because of the exclusion in paragraph (d) in the definition of 'dividend' in subsection 6(1) of the ITAA 1936. That paragraph excludes a distribution from the meaning of 'dividend' if the amount of a distribution is debited against an amount standing to the credit of the company's share capital account.

Sections 45A, 45B and 45C

Section 45A – streaming of dividend and capital benefits

29. Section 45A of the ITAA 1936 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 benefit from the capital than the other shareholders (the disadvantaged shareholders) who would have received or would receive dividends.

30. GIL will provide its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936), and the capital benefit will be provided to all shareholders in direct proportion to the number of shares held. As all shareholders benefit equally from the proposed return of capital, there is no indication of 'streaming' capital benefits to some shareholders and not to others. Accordingly, section 45A of the ITAA 1936 does not apply to the return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C of the ITAA 1936 applies to the return of capital.

Section 45B – schemes to provide capital benefits in substitution for dividends

31. Section 45B of the ITAA 1936 applies where certain capital payments, including a return of capital, are made to shareholders 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 entered into the scheme or carried out the scheme or any part of the scheme for the purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

32. The shareholder 'obtains a tax benefit', as defined in subsection 45B(9) of the ITAA 1936, where the amount of tax payable or any amount payable under the ITAA 1936 or the ITAA 1997 by the shareholder 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.

33. On the basis of the information provided in the documents or parts of the documents that are incorporated into the description of the scheme, section 45B of the ITAA 1936 does not apply to this scheme.

34. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the proposed return of capital.

35. As the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 or subsection 45B(3) of the ITAA 1936 in relation to the scheme as described, section 45C of the ITAA 1936 will not deem the proposed return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

Capital gains tax

CGT event C2 – section 104-25

36. The right to receive the proposed return of capital is one of the rights inherent in the GIL share at the Record Date. If, after the Record Date but before the payment date of the proposed return of capital, a GIL shareholder ceases to own some or all of their GIL shares, the right to receive the proposed return of capital will be retained by the shareholder and is considered to be a separate CGT asset.

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

38. The GIL shareholder will make a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right (subsection 104-25(3) of the ITAA 1997). The capital proceeds will be the proposed return of capital amount (section 116-20 of the ITAA 1997).

39. The cost base of the GIL shareholder's right to receive the proposed return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As the GIL shareholder will have paid nothing for the right, the cost base of the right is likely to be nil. Therefore, a capital gain equal to the proposed return of capital will likely arise.

40. As the right to receive the proposed return of capital amount was inherent in the GIL share during the time it was owned, the right is considered to have been acquired at the time the share was acquired (section 109-5 of the ITAA 1997).

41. Consequently, if the GIL share to which the payment relates was originally acquired by the former shareholder at least 12 months before the proposed payment of the return of capital, 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).

CGT event G1 – section 104-135

42. CGT event G1, in section 104-135 of the ITAA 1997, will happen when GIL pays the proposed return of capital in respect of a share that a GIL shareholder owns at the time of the payment, 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.

43. GIL proposes to make the return of capital to GIL shareholders out of its untainted share capital account. Accordingly, the payment will not be a dividend as defined in subsection 995-1(1) of the ITAA 1997.

44. If the proposed return of capital amount of \$0.0772 per share is less than the cost base of the GIL share at the time of the payment, the cost base and reduced cost base of that GIL share will be reduced (but not below nil) by that amount of the proposed return of capital (subsection 104-135(4) of the ITAA 1997).

45. A GIL shareholder will make a capital gain if the proposed return of capital amount is more than the cost base of their GIL share. The amount of the capital gain is equal to this excess (subsection 104-135(3) of the ITAA 1997).

46. If a GIL shareholder makes a capital gain, the cost base and reduced cost base of the GIL share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

47. If the GIL share was acquired by the shareholder at least 12 months before the proposed payment of the return of capital, a capital gain from CGT event G1 happening 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).

48. A GIL shareholder cannot make a capital loss when CGT event G1 happens.

Foreign residents

49. A foreign resident shareholder can disregard any capital gain made from the proposed return of capital if their GIL shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997). The term 'taxable Australian property' includes an 'indirect Australian real property interest' (item 2 in the table in section 855-15 and section 855-25 of the ITAA 1997).

50. A GIL foreign resident shareholder will have an 'indirect Australian real property interest' if it holds a membership interest in GIL, and the interest passes the 'non-portfolio interest test' (section 960-195 of the ITAA 1997) and the 'principal asset test' (section 855-30 of the ITAA 1997).

51. GIL has advised that the GIL shares will not pass the 'principal asset test'. Accordingly, GIL's foreign resident shareholders do not have an 'indirect Australian real property interest'.

52. Therefore, a GIL share will only be 'taxable Australian property' if the foreign resident shareholder has used their GIL share in carrying on a business through a permanent establishment in Australia (item 3 in the table in section 855-15 of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Subject references:

- capital gains tax
- capital streaming
- dividend streaming arrangements
- dividends
- foreign residents
- return of capital on shares

Legislative references:

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 - ITAA 1936 47
 - ITAA 1997 104-25
 - ITAA 1997 104-25(3)
 - ITAA 1997 104-55
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-135(4)
 - ITAA 1997 109-5
 - ITAA 1997 Pt 3-1 Div 110
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 - ITAA 1997 Subdiv 115-A
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 - ITAA 1997 960-195
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ATO references

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