


CR 2007/5 - Income tax: return of capital: Central Glass Pty Ltd

 This cover sheet is provided for information only. It does not form part of *CR 2007/5 - Income tax: return of capital: Central Glass Pty Ltd*



Class Ruling

Income tax: return of capital: Central Glass Pty Ltd

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	13
Ruling	21
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	25
Appendix 2:	
Detailed contents list	50

ⓘ 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. In this Ruling, the scheme is a proposed return of share capital (the Scheme) in Central Glass Pty Ltd (CGPL).

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); and
- section 104-135 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is all shareholders of CGPL who receive a return of capital as described in paragraphs 13 to 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 13 to 20 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.

6. This Ruling does not address the application of Part IVA of the ITAA 1936 to the scheme or to an associated or wider scheme of which the scheme is part.

7. This work is copyright. Apart from any use as permitted under the *Copyright Act 1968*, no part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

Commonwealth Copyright Administration
Attorney General's Department
Robert Garran Offices
National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/ccca>

Date of effect

8. This Ruling applies from 24 January 2007 to 30 June 2007. 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.

9. 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.

10. 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)).

11. 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.

12. 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

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 Class Ruling from CGPL, dated 18 October 2006;
- correspondence from CGPL dated 21 November 2006; and
- correspondence from CGPL dated 8 December 2006.

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

14. CGPL is a private company incorporated in Australia. It carries on a business consisting of the manufacture, supply and fitting of glazed aluminium products.

15. The issued capital in CGPL increased by \$65,000 in the income year ended 30 June 2006, following an issue of 10,000 shares to a senior employee who was considered critical to the continued growth and future of the company.

16. This new injection of capital is not required as working capital. CGPL now proposes to return to its shareholders \$66,000 of share capital which is considered excessive to the company's requirements.

17. An amount of \$5,000 was transferred into CGPL's share capital account when its share premium account was closed. Otherwise, all entries in CGPL's share capital account have originated from the proceeds of share issues.

18. No transfers have previously taken place to taint CGPL's share capital account.

19. In the six income years following the 1999 income year, dividend payments by CGPL were modest as retained profits were reinvested in the expansion of the business, by repaying bank and shareholder loans and replacing obsolete and inefficient plant. However, dividend payments to shareholders in the 2004 income year increased to an amount representing approximately 30% of after tax profits.

20. CGPL does not have a publicly disclosed dividend policy but has stated that it has sought to declare interim and final dividends in recent years at least equal to those paid in the previous income year. CGPL is currently in a position to fully frank any dividends it pays to its shareholders. CGPL has indicated that dividend payout levels are not expected to reduce after the proposed capital reduction is completed.

Ruling

21. The payment of the Capital Reduction Amount will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

22. 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 Capital Reduction Amount received by the Participating Shareholders.

23. CGT event G1 in section 104-135 of the ITAA 1997 will happen when CGPL pays the Capital Reduction Amount in respect of shares that Participating Shareholders own at the time of the payment. If the Participating Shareholder acquired their share before 20 September 1985 and the share is not subject to CGT event K6 in section 104-230 of the ITAA 1997, any capital gain is disregarded under subsection 104-135(5) of the ITAA 1997.

24. CGT event C2 in section 104-25 of the ITAA 1997 will happen when CGPL pays the Capital Reduction Amount to Participating Shareholders who cease to own their shares before the time of the payment.

Appendix 1 – Explanation

❗ *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

25. 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.

26. As the return of capital will be debited against an amount standing to the credit of CGPL'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

27. 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 return of capital than the other shareholders (the disadvantaged shareholders) who would have received or would receive dividends.

28. CGPL 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 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

29. 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, or one of the persons, entered into the scheme 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 (paragraph 45B(2)(c)).

30. Therefore, the following elements need to be satisfied before section 45B of the ITAA 1936 will apply to this scheme:

- the return of capital is a scheme for the purposes of section 45B;
- the shareholders will be 'provided with a capital benefit' as defined in subsection 45B(5) by CGPL under the proposed return of capital (the definition includes a distribution of share capital); and
- the CGPL shareholders will obtain a tax benefit under the scheme.

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

Relevant circumstances

32. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the circumstances set out under subsection 45B(8) of the ITAA 1936 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.

33. The purpose test is an objective one. The question is whether, objectively, it would be concluded that a person who entered into or carried out the scheme (or any part of it), 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.

34. In this case, the relevant taxpayers are the shareholders of CGPL. The relevant circumstances of this scheme are:

- \$65,000 of the proposed return of capital can be traced directly to the additional share capital funds raised in the income year ended 30 June 2006 from an issue of 10,000 shares to a senior employee considered critical to the continued growth and future of the company;
- CGPL has indicated that dividend payout levels are not expected to reduce after the proposed capital reduction is completed; and
- the return of capital is excessive to the company's requirements and is not attributable to profits.

35. Having regard to the circumstances outlined in paragraph 33 of this Ruling, it is considered that the scheme as described was not entered into for the purpose, not being an incidental purpose, of enabling a shareholder of CGPL to obtain a tax benefit.

36. Although a tax benefit has been provided to the shareholders of CGPL, any benefit is merely incidental. It is accepted that the purpose of the return of capital is to enable CGPL to return to shareholders the additional capital that is excessive to its requirements.

37. 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 return of capital.

38. 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 return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

Capital gains tax

CGT event G1 – section 104-135

39. CGT event G1, in section 104-135 of the ITAA 1997, will happen when CGPL pays the Capital Reduction Amount in respect of a share that a Participating 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.

40. CGPL proposes to make the Capital Reduction Payment to CGPL shareholders out of its untainted share capital account. This payment will not be a dividend as defined in subsection 995-1(1) of the ITAA 1997. If the Capital Reduction Amount of \$0.60 per share is not more than the cost base of the CGPL share at the time of the payment, the cost base and reduced cost base of the share are reduced by the amount of the Capital Reduction Amount (subsection 104-135(4) of the ITAA 1997).

41. A Participating Shareholder will make a capital gain if the Capital Reduction Amount is more than the cost base of their CGPL share under subsection 104-135(3) of the ITAA 1997. The amount of the capital gain is equal to this excess. However, a capital gain is disregarded pursuant to subsection 104-135(5) of the ITAA 1997 if the Participating Shareholder acquired the share before 20 September 1985, and the share is not subject to CGT event K6 in section 104-230 of the ITAA 1997.

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

43. A Participating Shareholder cannot make a capital loss under CGT event G1.

CGT event C2 – section 104-25

44. If, before the time for payment of the Capital Reduction Amount, a Participating Shareholder ceases to own some or all of their shares in CGPL the right to receive the payment in respect of each of the shares disposed of is considered to be a separate CGT asset. The right to receive the Capital Reduction Amount is retained by the Participating Shareholder when the share is sold.

45. The right of a CGPL shareholder to receive the payment will be discharged or satisfied when the payment is made under the scheme, 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, the capital proceeds will be the Capital Reduction Amount.

47. The cost base of the CGPL shareholder's right to receive a payment under the scheme is worked out in accordance with Division 110 of the ITAA 1997. 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.

48. Because the right to the payment of the Capital Reduction Amount was inherent in the share during the time it was owned, the right is considered to have been acquired at the time when the share was acquired (section 109-5 of the ITAA 1997).

49. Consequently, if the share to which the payment relates was originally acquired by a CGPL shareholder at least 12 months before the payment of the Capital Reduction 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.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	4
Date of effect	8
Scheme	13
Ruling	21
Appendix 1 – Explanation	25
Dividend	25
Sections 45A, 45B and 45C	27
<i>Section 45A – streaming of dividend and capital benefits</i>	27
<i>Section 45B – schemes to provide capital benefits in substitution for dividends</i>	29
<i>Relevant circumstances</i>	32
Capital gains tax	39
<i>CGT event G1 – section 104-135</i>	39
<i>CGT event C2 – section 104-25</i>	44
Appendix 2 – Detailed contents list	50

References

Previous draft:

Not previously issued as a draft

Subject references:

- return of capital
- share capital

Legislative references:

- ITAA 1936 45B(8)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1936 Pt IVA
 - ITAA 1997 104-25
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-135(4)
 - ITAA 1997 104-135(5)
 - ITAA 1997 104-230
 - ITAA 1997 109-5
 - ITAA 1997 Div 110
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25(1)
 - ITAA 1997 995-1(1)
 - TAA 1953
 - TAA 1953 Sch 1 357-75(1)
 - Copyright Act 1968
 - ITAA 1936 6(1)
 - ITAA 1936 44(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)(b)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(5)
-

ATO references

NO: 2007/639

ISSN: 1445-2014

ATOLaw topic: Income Tax ~~ Return of capital
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