CR 2007/54 - Income tax: return of capital: Surfers Paradise Beach Resort Pty Ltd

Class Ruling

Income tax: return of capital: Surfers Paradise Beach Resort Pty Ltd

Contents Para

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 Surfers Paradise Beach Resort Pty Ltd (SPBR).

Relevant provision(s)

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

- definition of 'dividend' in subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- subsection 44(1) of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936; and
- section 45C of the ITAA 1936.

All subsequent legislative references are to the ITAA 1936 unless indicated otherwise.

Class of entities

3. The class of entities to which this Ruling applies is all shareholders of SPBR who receive a return of capital as described in paragraphs 13 to 23 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 23 of this Ruling.

5. This Ruling does not deal with the capital gains tax consequences of the return of share capital.

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.

Date of effect

8. This Ruling applies from 20 June 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 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 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.

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 following description of the scheme is based on information provided by the applicant. *The following documents or relevant parts of them form part of and are to be read with the description.*

- Application for Class Ruling from SPBR dated 8 March 2006; and
- Correspondence from SPBR dated 19 April 2006, 26 June 2006, 21 September 2006, 17 November 2006, 13 February 2007, 23 April 2007 and 14 May 2007.

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

14. SPBR is a private company incorporated in Australia on 29 June 1994 for the purpose of property development.

15. On 30 June 1994, SPBR purchased 3 parcels of land in Surfers Paradise for approximately $42.3 million which was funded by the issue of shares valued at $43 million. The first parcel of land was the site of the Q1 development.

16. SPBR entered into a joint venture agreement with a development group of companies in August 2000 to develop the Q1 site and the second parcel of land. The two parcels of land were entered into the joint venture at their then market value. That agreement was varied in July 2002 so that a specifically incorporated wholly owned subsidiary of SPBR, Q1 JV Pty Ltd (Q1 JV) was the vehicle through which SPBR participated in that joint venture.

17. Under the joint venture partnership, Q1 JV and its joint venture partner were to develop the Q1 site and receive a development fee from SPBR before developing the second parcel of land.

18. During the 2002 financial year, the third parcel of land was sold with the proceeds loaned to Q1 JV to fund the initial stages of the Q1 project. Construction of the Q1 project commenced in July 2002.

19. The development of the Q1 project was largely funded by debt with both senior and mezzanine finance being raised. The second parcel of land was sold on 21 April 2004 for $17.5 million, with SPBR's share of the proceeds loaned to Q1 JV to partially repay senior debt of the Q1 project.

20. Settlements of Q1 units commenced in October 2005 and shortly afterwards both the senior and mezzanine finance were repaid in full.

21. The vast majority of the units in the Q1 development have been sold which has freed up both capital and profit. At 31 December 2006 the share capital of the SPBR group was $43 million with retained earnings of the group $6.584 million.

22. SPBR proposes to distribute approximately $33.325 million to its shareholders before 30 June 2007. This will be made up of a share capital component of approximately $28.9 million ($0.6721 per share) together with a fully franked divided of approximately $4.425 million ($0.1029 per share). The return of share capital will be made uniformly across all participating shareholders and no shares will be cancelled.

23. The amount of share capital to be returned ($28.9 million) and the dividend to be paid ($4.425 million) are in proportion to the share capital ($43 million) and retained earnings ($6.584 million) of the SPBR group of companies as set out in their accounts as at 31 December 2006. If the actual amounts of profit and share capital at the time the scheme is implemented vary in a material way from those in the accounts the application of section 45B will need to be re-examined.

Ruling

24. The payment of the dividend will be assessable income under subsection 44(1).

25. The return of the share capital will not be a dividend, as defined in subsection 6(1).

26. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole, or any part, of the payment of the share capital received by the shareholders.

Commissioner of Taxation
20 June 2007

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

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

28. The dividend component of the distribution will satisfy the requirements of the definition of 'dividend' in subsection 6(1) as it will be a distribution made by a company to its shareholders that is not debited against the share capital account of the company. As the dividend component will be paid out of profits of the company it will be assessable income under subsection 44(1).

Return of capital

29. As the return of share capital component of the distribution will be debited against an amount standing to the credit of SPBR's share capital account, it will not constitute a dividend because of the exclusion in paragraph (d) of the definition of 'dividend' in subsection 6(1). 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.

Section 45A – streaming of dividend and capital benefits

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

31. SPBR will provide its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), 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 does 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.

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

32. Section 45B 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)).

33. Therefore, the following elements need to be satisfied before section 45B 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 SPBR under the proposed return of capital (the definition includes a distribution of share capital); and
- the SPBR shareholders will obtain a tax benefit under the scheme.

Scheme

34. A scheme for the purposes of section 45B is defined in subsection 177A(1) 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.

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

36. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) and includes a distribution to a person of share capital. As SPBR will debit the proposed return of capital against its untainted share capital account, its shareholders will be provided with a capital benefit.

Tax benefit

37. The 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 *Income Tax Assessment Act 1997* (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.

38. 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 shares, 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 shares that a capital gain arises. A capital gain may not arise at all for certain foreign resident shareholders. By contrast, a dividend would generally be included in the assessable income of a resident shareholder or in the case of a foreign resident, be subject to dividend withholding tax under section 128B of the ITAA 1936. Therefore, SPBR shareholders will obtain tax benefits from the return of capital.

Relevant circumstances

39. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the circumstances set out under 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.

40. 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.

41. The relevant circumstances under subsection 45B(8) cover both the circumstances of the company and the shareholders. In this case, the relevant taxpayers are the shareholders of SPBR.

42. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, SPBR will return to its shareholders part of the share capital that was realised upon the sale of units in the Q1 development together with a fully franked dividend which represents an appropriate proportion of the proceeds from the sale of the Q1 units. SPBR believes a portion of the proceeds generated from the disposal of the units are excess to its capital requirements and therefore proposes to distribute them back to its shareholders. This circumstance does not incline for, or against, a conclusion as to purpose.

43. 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. SPBR has never paid a dividend. The proposed return of capital will be made at the same time as a fully franked dividend is paid. The company has not previously made a return of capital. Accordingly, the company's pattern of distributions does not suggest that the proposed return of capital will be made in substitution for a dividend.

44. Paragraph 45B(8)(c) refers to whether the relevant taxpayer (the shareholders) has capital losses that apart from the scheme would be carried forward to a later year of income. Here we are advised that the current shareholders all acquired their shares for $1 per share and the proposed return of capital of $0.6721 per share will not result in a capital gain that would affect any capital losses the relevant taxpayer has. This circumstance does not incline for, or against, a conclusion as to purpose.

45. Paragraph 45B(8)(d) refers to whether any of the ownership interests were acquired before 20 September 1985. Here all the shares are post CGT assets and this circumstance does not incline for, or against, a conclusion as to purpose.

46. Paragraph 45B(8)(e) refers to whether the relevant taxpayer is a non-resident. Here we are advised that all shareholders are residents of Australia and as such this circumstance does not incline for, or against, a conclusion as to purpose.

47. Paragraph 45B(8)(f) refers to whether the cost base of the shares are not substantially less than the value of the capital benefit. Here the cost base of all the shares are more than the value of the capital benefit, and as such this circumstance does not incline for, or against, a conclusion as to purpose.

48. Paragraph 45B(8)(g) refers to whether the relevant taxpayer is a private company that would have been entitle to a rebate under section 46F. As section 46F has been repealed this circumstance does not incline for, or against, a conclusion as to purpose.

49. Paragraph 45B(8)(h) refers to whether the interest held by the relevant taxpayer after the distribution of share capital is the same as the interest would have been if an equivalent dividend had been paid instead. As the distribution of share capital will be the same for all shareholders this circumstance does not incline for, or against, a conclusion as to purpose.

50. The circumstances covered by paragraphs 45B(8)(i) and (j), pertaining to the provision of ownership interests and demerger, are not relevant to this scheme.

51. 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, its form and substance, and its financial and other implications for the persons involved. In relation to the scheme set out above the return of capital is a legitimate return of surplus capital.

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

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

Application of section 45C

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

Appendix 2 – Detailed contents list

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

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:

- 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)
- ITAA 1936 45B(8)
- ITAA 1936 45B(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(c)
- ITAA 1936 45B(8)(d)
- ITAA 1936 45B(8)(e)
- ITAA 1936 45B(8)(f)
- ITAA 1936 45B(8)(g)
- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(i)
- ITAA 1936 45B(8)(j)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 128B
- ITAA 1936 177A(1)
- ITAA 1936 177D(b)(i)
- ITAA 1936 177D(b)(ii)
- ITAA 1936 177D(b)(iii)
- ITAA 1936 177D(b)(iv)
- ITAA 1936 177D(b)(v)
- ITAA 1936 177D(b)(vi)
- ITAA 1936 177D(b)(vii)
- ITAA 1936 177D(b)(viii)
- ITAA 1936 318
- ITAA 1997 104-135
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

ATO references

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