


CR 2007/90 - Income tax: proposed return of capital: Austar United Communications Limited

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Class Ruling

Income tax: proposed return of capital: Austar United Communications 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;
 - Subdivision 115-A of the ITAA 1997; and
 - section 855-10 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 those shareholders who hold ordinary shares in Austar United Communications Limited (Austar) and who are registered on the Austar share register on the Record Date, being the date for determining entitlements to the proposed return of capital described in paragraphs 13 to 22 of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme in this 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 from 26 September 2007.

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. The relevant documents or parts of documents incorporated into this description of the scheme are:

- Class Ruling request from PricewaterhouseCoopers (PwC) on behalf of Austar dated 28 June 2007;
- copy of the Austar Quarter 1 results for the period ended 31 March 2007;
- copy of Notice of Annual General Meeting (AGM) held on 31 May 2007;
- Resolutions of AGM dated 31 May 2007;
- copy of Austar's Annual Report for 2006;
- correspondence providing further information dated 3 August 2007 from PwC; and
- copy of Austar's announcement to the Australian Stock Exchange (ASX) dated 20 August 2007.

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

14. Austar is an Australian resident public company which listed on the ASX in July 1999. The company was incorporated on 23 June 1999.

15. Austar is the parent entity of a group of entities that operate various businesses including subscription television, internet and mobile communications.
16. To date the more significant part of the overall group's business has been the subscription television business. This business is operated principally through two of Austar's wholly owned subsidiaries.
17. It is proposed that a pro-rata return of capital of up to \$300 million will be undertaken. It is expected that the return of capital will entitle each ordinary shareholder to a capital amount of approximately \$0.23 for each ordinary share held on the Record Date.
18. Austar's stated purpose in making the return of capital is to achieve the commercial objective of increasing its gearing ratio towards target levels.
19. Austar received shareholder approval at the AGM held on 31 May 2007 for a capital management program of up to \$300 million.
20. Austar will finance the \$300 million return of capital by way of interest bearing debt from one of its indirect wholly owned subsidiaries, which has a syndicated debt facility with various banks and financial institutions.
21. Austar has advised that it has not paid dividends to its shareholders since floating on the ASX in 1999. Austar also confirms that it does not expect to pay or be in a position to pay a dividend to shareholders in the near foreseeable future.
22. Austar will debit the return of capital against its share capital account. Austar has confirmed that there have been no transfers to its share capital account, as defined in section 975-300 of the ITAA 1997.

Ruling

Distribution is not a dividend for income tax purposes

23. The proposed return of capital to the ordinary shareholders of Austar 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 section 45A or section 45B that section 45C applies to the proposed return of capital. Accordingly, no part of the proposed capital return will be taken to be a dividend for income tax purposes.

Capital gains tax

25. CGT event G1, in section 104-135 of the ITAA 1997, will happen to an Austar ordinary shareholder who is registered as an Austar ordinary shareholder on the Record Date and continues to own the share at the time when the proposed return of capital is paid.

26. CGT event C2, in section 104-25 of the ITAA 1997, will happen to an Austar ordinary shareholder who is registered as an Austar ordinary shareholder on the Record Date but ceases to own their Austar share at the time when the proposed return of capital is paid.

27. Any capital gain arising under either CGT event G1 or CGT event C2 will be taxed as a discount capital gain provided that the conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Foreign resident shareholders

28. A foreign resident ordinary shareholder in Austar who receives the proposed return of capital can disregard any capital gain made when CGT event G1 happens if their shares in Austar are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

29. A foreign resident ordinary shareholder in Austar who has a right to the payment of the proposed return of capital can disregard any capital gain made when CGT event C2 happens if their right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation26 September 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

30. 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).

31. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, paragraph (d) in the definition of 'dividend' 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'.

32. 'Share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

33. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount, to which Division 197 of the ITAA 1997 applies, is transferred to the account and the account is not already tainted.

34. The proposed return of capital will be debited against Austar's share capital account. There have been no transfers into Austar's share capital account as defined in section 975-300 of the ITAA 1997. Therefore, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies and the proposed return of capital would not constitute a dividend.

Anti-avoidance provisions

35. 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.

Section 45A – streaming of dividends and capital benefits

36. 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 (the disadvantaged shareholders) have received or will receive dividends.

37. Although Astar will be providing its ordinary shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)), the capital benefit is to be provided to all the ordinary shareholders in Astar in direct proportion to their individual shareholding. The circumstances of the scheme do not indicate that there is a 'streaming' of capital benefits to advantaged shareholders and of dividends to disadvantaged shareholders. Accordingly, section 45A will not apply to the proposed return of capital and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the proposed return of capital.

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

38. Section 45B applies where certain payments are made to shareholders in substitution for dividends.

39. 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 (paragraph 45B(2)(a));
- under the scheme, a taxpayer (the relevant 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 (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Each condition is considered below.

Scheme

40. The proposed return of capital will be a 'scheme' for the purposes of section 45B.

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

Tax benefit

42. A shareholder 'obtains a tax benefit', as defined in subsection 45B(9), if:

- 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.

43. 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 is made. For a foreign resident shareholder the provisions of Division 855 of the ITAA 1997 will operate to disregard any capital gain or capital loss provided that the CGT asset is not 'taxable Australian property'. 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. Therefore, Austar shareholders will generally obtain tax benefits from the proposed return of capital.

Relevant circumstances

44. 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.

45. The test of purpose 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 the scheme 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.

46. 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.

47. Austar's balance sheet for the year ended 31 December 2006 discloses that shareholders' equity within the company is positive but negative within the group. These balances take into account the issued capital in Austar. On 20 August 2007, Austar made an announcement to ASX stating that 'Austar has received sufficient commitments to allow the refinancing and increase of its existing senior debt facilities to the amount of \$850 million under improved terms to the current facility. The proposed return of capital will be funded by increased borrowings from this facility.' Given these circumstances the distribution is considered to be a return of capital.

48. Austar has historically been in a loss position and has incurred further losses in the current year. Some subsidiaries have retained profit balances but these profits are not of similar magnitude to the proposed return of capital. Furthermore, Austar has confirmed that it does not have any reserves in its accounts that reflect any unrealised profits. Again, this points to the distribution being a return of capital.

49. 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. Austar does not have nor has it ever had a dividend policy. Austar does not anticipate having a dividend policy in the near future, and has not announced or otherwise conveyed a reasonable expectation of a distribution of profits in the near foreseeable future.

50. The relevant circumstances under subsection 45B(8) also cover the circumstances of the company and the tax profile of the shareholders. In this instance, as the proposed return of capital is made to all Austar shareholders regardless of individual circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to purpose.

51. The circumstances covered by paragraphs 45B(8)(i) and (j) pertaining to the provision of ownership interests and demerger are not relevant here. So, in this case, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

52. 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. Austar has demonstrated that the scheme, being a return of capital to its shareholders, is a legitimate return of capital aimed at the regearing of its balance sheet to better reflect industry ratios and at reducing its Weighted Average Cost of Capital.

53. Therefore, having regard to the relevant circumstances of the scheme to return capital to Austar's ordinary shareholders, as discussed in paragraphs 44 to 52 of this Ruling, it would not be concluded that Austar 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.

Section 45C – deeming dividends to be paid where determinations under section 45A or 45B are made

54. 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 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.

CGT event G1 – section 104-135

55. CGT event G1, in section 104-135 of the ITAA 1997, will happen when Austar pays the proposed return of capital amount in respect of an ordinary share that an Austar shareholder owns at the Record Date and continues to own at the time the proposed return of capital is paid, and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

56. Austar proposes to make a payment to its ordinary 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 proposed return of capital is not more than the cost base of the Austar share at the time of the payment, the cost base and reduced cost base of the share are reduced (but not below nil) by the amount of the proposed return of capital (subsection 104-135(4) of the ITAA 1997).

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

58. If an Austar ordinary shareholder makes a capital gain, the cost base and reduced cost base of the Austar ordinary share will be reduced to nil (subsections 104-135(3) of the ITAA 1997).

59. If the Austar ordinary share to which the payment relates was originally acquired by an Austar shareholder at least 12 months before the payment of the proposed 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).

60. An Austar ordinary shareholder cannot make a capital loss when CGT event G1 happens.

CGT event C2 – section 104-25

61. If, after the Record Date but before the time of the proposed return of capital, an Austar ordinary shareholder ceases to own some, or all, of their ordinary shares in Austar in respect of which the proposed return of capital is payable, the right to receive the payment in respect of each of the shares disposed of is considered to be a separate CGT asset. That right is one of the rights inherent in the share at the Record Date and is retained by the shareholder when the share is sold.

62. CGT event C2, in section 104-25 of the ITAA 1997, will happen when the return of capital is paid and the Austar ordinary shareholder's right to receive that payment ends.

63. The Austar ordinary shareholder will make a capital gain if the capital proceeds from the ending of the right are more than the cost of the right (subsection 104-25(3) of the ITAA 1997). The capital proceeds will be the amount of the payment from Austar (section 116-20 of the ITAA 1997).

64. The cost base of the Austar ordinary 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 no amount will have been paid for the right by the Austar ordinary shareholder, the cost base of the right is likely to be nil. Therefore, for an Austar ordinary shareholder, a capital gain equal to the amount received as the return of capital is likely to arise.

65. As the right to the payment from Austar was inherent in the Austar ordinary share during the time that it was owned the right is considered to have been acquired at the time when the Austar share was acquired (section 109-5 of the ITAA 1997). Consequently, if the Austar share was originally acquired by the former shareholder at least 12 months before the payment, a capital gain from CGT event C2 happening to 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

66. A foreign resident ordinary shareholder of Austar, can disregard a capital gain or loss from a CGT event that happens in relation to a CGT asset that is not 'taxable Australian property' (section 855-10 of the ITAA 1997). The term 'taxable Australian property' as described in the table in section 855-15 of the ITAA 1997 covers five categories of CGT assets. Broadly, these CGT asset categories are:

- (1) taxable Australian real property which is held directly;
- (2) indirect Australian real property interests which are not covered by item 5 of the table;
- (3) CGT assets used in carrying on a business through an Australian permanent establishment which are not covered by item 1, 2 or 5 of the table;
- (4) options or rights to acquire a CGT asset covered by item 1, 2 or 3 of the table; and
- (5) CGT assets where a capital gain or loss is deferred when an individual ceases to be an Australian resident.

Appendix 2 – Detailed contents list

67. 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:

- ITAA 1936 45C
- ITAA 1936 47
- 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
- ITAA 1997 104-25
- ITAA 1997 104-25(3)
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- ITAA 1997 116-20
- ITAA 1997 Div 197
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- ITAA 1997 Div 855
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- Copyright Act 1968
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- ITAA 1936 45B(2)
- ITAA 1936 45B(2)(a)
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- ITAA 1936 45B(8)(h)
- ITAA 1936 45B(8)(i)
- ITAA 1936 45B(8)(j)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)

ATO references

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 C3 - end of a CGT asset
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