


CR 2008/18 - Income tax: proposed Equity Return: MYOB Limited

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Class Ruling

Income tax: proposed Equity Return: MYOB 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 177EA of the ITAA 1936;
 - subsection 6-5(1) of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-25 of the ITAA 1997;
 - section 104-135 of the ITAA 1997; and
 - subsection 204-30(3) of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of MYOB Limited (MYOB) who:
- (a) are 'residents of Australia' within the meaning of that expression in subsection 6(1) of the ITAA 1936;
 - (b) hold their shares on capital account; and
 - (c) who are registered on the MYOB share register on the Record Date, being the date for determining entitlements to the capital return under the proposed share capital reduction and proposed special dividend under the Equity Return as described in paragraphs 17 to 25 of this Ruling.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified 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 26 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 will apply from 28 April 2008 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

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 dated 22 November 2007, and
- correspondence dated 29 January 2008 and 12 February 2008.

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. MYOB is an Australian resident public company incorporated in 1999 and is listed on the Australian Securities Exchange (ASX). The original MYOB business was founded in 1991.

15. Currently MYOB has only one class of share on issue comprising approximately 385 million fully paid ordinary shares.

16. MYOB's share register and associated information indicate that as at August 2007:

- approximately 84.9% of the issued shares are held by the top 25 shareholders, of whom approximately 6.2% are non-residents;
- approximately 49.9% of the issued shares are held by resident institutional shareholders; and
- approximately 28.3% of the issued shares are held by related resident persons.

Details of the Equity Return

17. MYOB proposes to undertake a transaction which will return \$80 million of surplus equity capital to its shareholders in a single arrangement (the Equity Return). This approximates a return of 30% of the consolidated equity capital of MYOB to its shareholders.

18. The Equity Return is proposed to be structured as:

- (a) a one-off equal share capital reduction of approximately \$69.4 million (**the proposed share capital reduction**) to be paid out of the issued share capital of MYOB; and
- (b) a special dividend of approximately \$10.6 million (**the proposed special dividend**) to be paid out of retained earnings and reserves.

19. The Equity Return is proposed to be funded by way of debt funding sourced from an external financial institution of \$65 million and \$15 million out of existing cash balances.

20. The **proposed share capital reduction** will be an 'equal share capital reduction' within the meaning of section 256B(2) of the *Corporations Act 2001*.

21. The proposed share capital reduction will involve 18.03 cents per share being returned to each shareholder for every share held.

22. The entirety of the proposed share capital reduction is to be debited to the share capital account of MYOB. There have been no transfers of any amounts to this account apart from amounts credited to the account as a result of the operation of a dividend reinvestment plan from 2000 to 2005. MYOB's share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

23. The **proposed special dividend** will be payable in addition to ordinary dividends and it will not adversely affect the ability of MYOB to pay dividends in the future. MYOB intends to pay an ordinary fully franked dividend of 3.25 cents per share (in accordance with its regular dividend policy), in the 2008 calendar year.

24. Since listing on the ASX, shares in MYOB have traded in the range of approximately \$0.38 to \$5.30.

25. There have been no recent disposals of major assets or extraordinary transactions that have given rise to a profit which could be seen to relate to the proposed distribution of share capital.

Timeline

26. Subject to shareholder approval which will be sought at the Annual General Meeting scheduled for 24 April 2008, the proposed share capital reduction and the proposed special dividend ex-date will occur on 28 April 2008, Record Date will occur on 2 May 2008 and payment to shareholders will be completed by 9 May 2008.

Ruling

Capital return is not a dividend

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

Capital return is not ordinary income

28. The proposed return of capital will not constitute ordinary income and hence will not be assessable to shareholders under subsection 6-5(1) of the ITAA 1997.

Capital gains tax

29. CGT event G1 (section 104-135 of the ITAA 1997) will happen when MYOB pays the return of capital to a registered shareholder in respect of a MYOB share that they own at both the Record Date and the date of payment.

30. CGT event C2 (section 104-25 of the ITAA 1997) will happen when MYOB pays the return of capital to a shareholder in respect of a MYOB share that they owned at the Record Date but which they ceased to own before the date of payment.

Sections 45A and 45B

31. The Commissioner will not make a determination under section 45A of the ITAA 1936 that section 45C of the ITAA 1936 applies to the proposed return of capital.

32. The Commissioner will not make a determination under section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole or any part of the proposed return of capital.

Imputation benefits

33. The Commissioner will not make a determination under subsection 177EA(5) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by shareholders in relation to the proposed special dividend.

34. The Commissioner will not make a determination under subsection 204-30(3) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received by shareholders under the proposed special dividend.

Commissioner of Taxation

5 March 2008

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.*

Capital return is not a dividend

35. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income a dividend, as defined in subsection 6(1) of the ITAA 1936, which is paid to the shareholder out of the profits derived by the company from any source (if the shareholder is a resident of Australia for tax purposes).

36. The term 'dividend' in subsection 6(1) of the ITAA 1936 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.

37. As the proposed return of capital will be debited against the company's untainted share capital account, the proposed return of capital will not constitute a dividend because it meets the exclusion in paragraph (d) in the definition of a 'dividend' in subsection 6(1).

Capital return is not ordinary income

38. Subsection 6-5(1) of the ITAA 1997 provides that the assessable income of a taxpayer includes income according to ordinary concepts, which is called ordinary income. Ordinary income includes income from property.

39. Each MYOB shareholder will receive the proposed return of capital because they hold shares in MYOB. The proposed return of capital will not be paid by MYOB to the MYOB shareholder out of profits but will be a partial distribution of the share capital of MYOB.

40. Accordingly, distributions to shareholders under the proposed share capital reduction will not constitute ordinary income. The distributions to shareholders will not be assessable under section 6-5 of the ITAA 1997.

Capital gains tax

CGT event G1 – section 104-135

41. CGT event G1 (section 104-135 of the ITAA 1997) will happen when MYOB pays the proposed return of capital amount in respect of a share that a MYOB 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 or an amount taken to be a dividend under section 47 of the ITAA 1936.

42. If the proposed return of capital is not more than the cost base of the MYOB share at the time of payment, the cost base and the 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).

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

44. If a MYOB shareholder makes a capital gain, the cost base and reduced cost base of the MYOB share are reduced to nil (subsection 104-135(3) of the ITAA 1997). A MYOB shareholder can not make a capital loss when CGT event G1 happens.

45. If the MYOB share to which the payment relates was acquired by a MYOB shareholder at least 12 months before the payment of the return of capital, a capital gain from CGT event G1 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 C2 – section 104-25

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

47. A MYOB shareholder's right to receive the payment will be discharged or satisfied when the payment is made under the scheme, causing CGT event C2 to happen.

48. A MYOB 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. A MYOB shareholder will make a capital loss if the capital proceeds from the ending are less than the reduced cost base of the right (subsection 104-25(3) of the ITAA 1997).

49. In working out the capital gain or capital loss made from CGT event C2 happening, the capital proceeds will be the amount of the return of capital (section 116-20 of the ITAA 1997).

50. The cost base of the MYOB 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).

51. The cost base of the right does not include the cost base (or reduced cost base) of the share previously owned by the MYOB shareholder that has been applied in working out a capital gain or capital loss when a CGT event happened to the share – for example, when the MYOB shareholder disposed of the share. Therefore, if the full cost base (or reduced cost base) of the MYOB share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share then, in applying subsection 104-25(3) of the ITAA 1997 to work out the capital gain for the ending of the right, the right will have a nil cost base. Therefore a capital gain equal to the amount received as the return of capital is likely to arise.

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

53. Consequently, if the MYOB 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 under subsection 115-25(1) of the ITAA 1997 (provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied).

Anti-avoidance provisions

Section 45A – streaming of dividends and capital benefits

54. Section 45A of the ITAA 1936 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.

55. Although MYOB will be providing its shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936), the capital benefit is to be provided to all the shareholders in MYOB in direct proportion to their individual shareholding. Furthermore, all shareholders of MYOB will also be receiving a fully franked dividend. 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 of the ITAA 1936 will not apply to the proposed return of capital and the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the proposed return of capital.

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

56. Section 45B of the ITAA 1936 applies where certain payments are made to shareholders in substitution for dividends.

57. The purpose of section 45B of the ITAA 1936 is to ensure that relevant amounts distributed to shareholders of a company are treated as dividends for tax purposes if certain payments, allocations and distributions are made in substitution for dividends.

58. Subsection 45B(2) of the ITAA 1936 sets out the conditions under which the Commissioner may make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies. These conditions are that:

- (a) there is a scheme under which a person is provided with a demerger benefit or a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
- (b) under the scheme, a taxpayer (the relevant taxpayer), who may or may not be the person provided with the demerger benefit or the capital benefit, obtains a tax benefit (paragraph 45B(2)(b) of the ITAA 1936); and
- (c) 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) of the ITAA 1936).

Each condition is considered below.

Scheme

59. The proposed share capital reduction will be a 'scheme' for the purposes of section 45B of the ITAA 1936.

60. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936. Relevantly, it includes a distribution to a person of share capital. As MYOB 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

61. The information provided suggests that since listing on the ASX, the cost base of MYOB shares acquired over the years has generally ranged from \$0.38 to \$5.30. The extent of MYOB shares with a cost base of less than 18.03 cents per share is considered to be immaterial. Consequently, as the 18.03 cents per share return of capital does not exceed this cost base, the tax implications at the time of the proposed return of capital will, in most cases, be merely an adjustment to the cost base of the share rather than a liability to tax. Therefore, the proposed return of capital in effect results in a deferral of any liability to tax and will therefore constitute a tax benefit as defined in subsection 45B(9) of the ITAA 1936.

Relevant circumstances

62. For the purposes of paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the 'relevant circumstances' set out in subsection 45B(8) of the ITAA 1936 to determine whether any part of the scheme was 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) of the ITAA 1936 is not exhaustive and regard may be had to other circumstances on the basis of their relevance.

63. 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.

64. The purpose which causes section 45B of the ITAA 1936 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 MYOB. The Commissioner cannot at this stage ascertain the purposes of MYOB's numerous shareholders, all of whom are eligible to vote on the proposed return of capital under the *Corporations Act 2001* and all of whom will participate in the proposed return of capital. 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 voted in favour of the proposal.

65. The relevant circumstances under subsection 45B(8) of the ITAA 1936 cover both the circumstances of the company and the shareholders. In this instance, as the proposed return of capital is to be made to all shareholders of MYOB 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 demergers, are not relevant. In this case, the circumstances described in paragraphs 45B(8)(a), (b) and (k) are the more relevant.

66. The relevant circumstances of a scheme under paragraph 45B(8)(a) of the ITAA 1936 includes the extent to which the capital benefit is attributable to capital or the extent to which the capital benefit is attributable to profits (realised or unrealised) of the company. As the proposed return of equity is conducted in a manner that results in a proportionate reduction of share capital and retained profits, the proposed return of capital cannot be viewed as a disguised distribution of profits in this instance.

67. Paragraph 45B(8)(b) of the ITAA 1936 covers the relevant circumstance that includes the pattern of distributions of dividends and returns of capital by the company. Based on the dividend distribution history of MYOB, the company has a solid history of distributing profits to its shareholders. Further, MYOB will, in accordance with its regular dividend policy, pay a fully franked dividend in the 2008 year in respect of the year ending 31 December 2007. In this instance it is considered that the proposed return of capital is not a strategy to substitute the distribution of profits with a return of capital. Rather, the proposed return of capital is in addition to the regular dividend payments made by the company.

68. Paragraph 45B(8)(k) of the ITAA 1936 refers to the matters in subparagraphs 177D(b)(i) to (viii) of the ITAA 1936. 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 parties involved. In this case, the practical implications of the scheme for MYOB and its shareholders are consistent with it being, in form and substance, a distribution of share capital.

69. Therefore having regard to the relevant circumstances of the scheme involving the return of the capital and the payment of a special dividend to MYOB shareholders, as discussed in paragraphs 13 to 26 of this Ruling, it cannot be concluded that MYOB will enter into or carry out the scheme for a purpose other than a merely incidental purpose of enabling the shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936, that section 45C of the ITAA 1936 applies to the whole, or a part, of the capital benefit represented by the return of capital.

Section 45C

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

Imputation benefits**Section 177EA**

71. Section 177EA of the ITAA 1936 is an anti-avoidance section intended to prevent abuse of the franking credit system. The section has application inter alia to a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate entity (paragraph 177EA(3)(a)).

72. The meaning of the term 'a scheme for a disposition of a membership interest' is provided in subsection 177EA(14) of the ITAA 1936. The definition is an inclusive definition and is therefore not limited to the specific items which are listed in subsection 177EA(14). A membership interest includes each interest, or set of interests, in the entity or each right, or set of rights, in relation to the entity (section 960-135 of the ITAA 1997). Each share in MYOB constitutes a separate membership interest in the company.

73. A share in a company is a bundle of rights or congeries of rights, but it is not correct to state that each right, or chose in action, is a separate piece of property (see *Re Alex Russell, deceased* [1968] VR 285). The terms of the proposed reduction of capital will not result in any of the rights attaching to each share being cancelled or changed. The reduction will merely alter the quantum of the paid up amount of each share. There is neither a disposition of any right or an alteration in any right attaching to each share. As the membership interests in the company will not alter there is no scheme for the disposition of a membership interest as required under subsection 177EA(14) of the ITAA 1936.

Section 204-30

74. Section 204-30 of the ITAA 1997 is a general anti-streaming measure. It is designed to curb the unintended use of franking credits through streaming arrangements. It permits the Commissioner to make determinations where an entity streams one or more distributions, whether in a single franking period or in a number of franking periods, in such a manner whereby:

- an imputation benefit is, or apart from this section would be, received by a member of the entity as a result of a distribution or distributions; and

- that member derives a greater benefit from franking credits than another member of the entity; and
- the other member of the entity receives a lesser imputation benefit, or receives no imputation benefits, whether or not the other member receives other benefits.

75. A member that derives a greater benefit from franking credits is the favoured member while a member that derives lesser imputation benefits is a disadvantaged member.

76. Streaming is the act of selectively directing the flow of franked distributions to favoured members to the exclusion of disadvantaged members. The result of such action by a company is the reduction or elimination of the intended wastage of franking credits, inherent in the design of the imputation system. A definite strategy designed to achieve this outcome would need to have been put in place by the company, before an arrangement could be classified as a streaming arrangement.

77. The proposed arrangement includes the payment of a fully franked special dividend of approximately 2.76 cents per share which will be paid to all holders of MYOB shares in proportion to their shareholding. The scheme does not have any regard to the ability of the recipient shareholders to effectively utilise the franking credits in determining which shareholders will receive the franked distribution.

78. Therefore, it cannot be concluded that the proposed arrangement in any way involves the payment of franked distributions in a selective manner to favoured members to the exclusion of disadvantaged members. Consequently, section 204-30 of the ITAA 1997 will not apply to this transaction.

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
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- ITAA 1936 177D(b)(viii)
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- ITAA 1936 45B(8)(j)
- ITAA 1936 45B(8)(k)
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- ITAA 1936 45C
- ITAA 1936 47

Case references:

- Re Alex Russell, deceased
[1968] VR 285

ATO references

NO: 2008/2950
 ISSN: 1445-2014
 ATOlaw topic: Income Tax ~~ Return of capital