


CR 2009/22 - Income tax: Dairy Farmers Milk Co-operative Limited: return of capital

 This cover sheet is provided for information only. It does not form part of *CR 2009/22 - Income tax: Dairy Farmers Milk Co-operative Limited: return of capital*



Class Ruling

Income tax: Dairy Farmers Milk Co-operative Limited: return of capital

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	9
Ruling	42
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	46
Appendix 2:	
Detailed contents list	86

ⓘ 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 177E of the ITAA 1936.
- subsection 177F(1) of the ITAA 1936; and
- subsection 177F(2A) of the ITAA 1936.

All legislative references in this Ruling are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies are the registered members of Dairy Farmers Milk Co-operative Limited (DFMC).

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 9 to 41 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.

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
Copyright Law Branch
Attorney-General's Department
National Circuit
Barton ACT 2600

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

Date of effect

8. This Ruling applies from 1 July 2008 to 30 June 2010. The Ruling continues to apply after 30 June 2010 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. 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 application for a Class Ruling dated 17 November 2008 with attachments; and
- correspondence received on 5 February 2009 and 3 April 2009.

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

10. DFMC and Australian Co-operative Foods Limited (ACF) were both Australian resident co-operatives registered under the *Co-operatives Act 1992* (NSW) (the Co-operatives Act) and for the purposes of Division 9 of Part III of the ITAA 1936. ACF converted into a company limited by shares in 2008. DFMC remains a resident co-operative registered under the Co-operatives Act.

11. DFMC's members supply raw milk produce to DFMC under individual supply contracts for periods of usually 2 or 3 years. DFMC sells all the raw milk produce it receives from its members to ACF.

ACF restructure

12. During the 2004 income year, ACF was demerged (the demerger) from DFMC pursuant to Division 125 the *Income Tax Assessment Act 1997* (ITAA 1997). This effectively split the operations into two parts. DFMC was responsible for milk supply and ACF continued to operate the manufacturing and processing business.

13. Following the demerger, DFMC retained 20% of the share capital in ACF. The remaining 80% of the share capital was issued to the shareholders of DFMC as at the date of the demerger.

Capital management

14. Under the Rules of DFMC, the capital of DFMC is raised by the issue of shares (all being of the same class and ranking equally) at a nominal value of \$1.00 each. There is also a minimum shareholding requirement whereby each member must hold at least 2,000 shares and a maximum shareholding limit whereby no one member can hold shares with a nominal value of greater than \$5,000,000. Further, under section 289 of the Co-operatives Act, no one may hold a relevant interest in the shares of DFMC that would exceed 20% of the nominal value of issued share capital.

15. As a co-operative, DFMC is required by existing Australian Accounting Standards to recognise in its balance sheet members' share capital as a liability.

16. Where a member ceases to supply milk to DFMC for whatever reason for a period of 12 months, he or she is considered to be an inactive member. The inactive members' membership in DFMC will be cancelled after 12 months of inactivity. They will forfeit their shares and DFMC will repay the members' paid up capital. The amount to be repaid is \$1.00 per share.

17. DFMC's share capital has grown since 2004 due in part to the share acquisition programme, its dividend re-investment policy (both now ceased) and new members commencing the supply of milk to DFMC.

18. The compulsory share acquisition programme was operated by ACF since 1993 (before DFMC was interposed as the head entity and ACF subsequently demerged). This programme required each member of ACF to contribute up to 1 cent per litre of milk supplied toward shares in ACF. Following the demerger in 2004, the compulsory share acquisition programme operated through DFMC. Money raised by DFMC was on lent to ACF in order to fund ACF's business operations.

19. At the time of the demerger ACF's share capital was \$129,248,222 (being 129,248,222 shares at \$1.00 per share). As a result of the demerger of ACF, DFMC retained a 20% interest in ACF. DFMC's current share capital is approximately \$33,730,695 (but subject to continuous movements in the ordinary course as current members leave and new members join).

20. DFMC's dividend policy has previously been to distribute all dividends it receives from ACF (including any franking credits attached to those dividends).

Scheme of arrangement

21. On 25 August 2008, ACF and a third party announced a proposal whereby, pursuant to a scheme of arrangement between ACF and its members, ACF would convert to a company limited by shares and the third party would then acquire all the shares in ACF.

22. The third party has acquired all of the shares in ACF for cash consideration of approximately \$5.65 per share. The cash consideration of \$5.65 per share was provided as follows:

- \$5.06 per share paid by the third party in return for the transfer of the shares in ACF; plus
- \$0.59 per share paid by ACF as a fully franked special dividend.

23. Subject to DFMC obtaining the necessary approvals, DFMC has agreed with the third party to distribute the Net Proceeds to the DFMC Members, DFMC former members who have not had their capital repaid and any other person legally entitled to participate in the distribution. DFMC proposes to retain cash reserves of approximately \$21 million to enable it to have sufficient financial resources to maintain its existing and on-going future business operations.

24. The accounting profit on disposal of the investment in ACF is approximately \$64.28 million before tax. This is represented by the gross sale consideration of \$81.99 million less the accounting cost of the investment (approximately \$16.20 million) and after allowing for estimated transaction costs of \$1.5 million.

25. The pro-forma 2009 balance sheet of DFMC (post completion of the ACF proposal) anticipates the current year accounting profit of DFMC to be approximately \$73.96 million. This accounting profit includes the gain on the sale of the ACF shares of \$64.28 million and the franked dividend of approximately \$9.68 million.

26. After the completion of the sale of its investment in ACF, DFMC proposes to distribute approximately \$86.55 million to its members, being the proceeds of the sale of the ACF investment less costs and repayment of loans from former members.

27. It is proposed that two separate categories of distributions will be made by DFMC to its members as follows:

- Dividends to members of approximately \$62.97 million comprised of a fully franked dividend portion of approximately \$10.73 million and an unfranked dividend portion of approximately \$52.24 million. This dividend amount is intended to be paid in two instalments. The amount of approximately \$56.93 million was paid to members in late December 2008. The balance of the dividend (approximately \$6 million) is intended to be paid out following confirmation of the rights of certain former members recently reinstated as members by the Co-operatives Council under section 129 of the Co-operatives Act. DFMC has appealed this decision to the NSW Supreme Court. If the NSW Supreme Court rules in favour of the former members the balance will be paid as a dividend to those reinstated former members. If the NSW Supreme Court rules against the former members the balance is intended to be paid as a dividend to DFMC members (excluding the unsuccessful former members). Either way, this balance is intended to be paid as a dividend to DFMC members. However, the timing of any payment of this dividend (and the identity of the member recipient) is dependent upon the determination by the NSW Supreme Court.

- A share cancellation of approximately \$23.58 million at \$1.00 per DFMC share on the basis of 7 DFMC shares for every 10 DFMC shares held subject to each DFMC member retaining sufficient DFMC shares to satisfy the minimum shareholding requirement.

28. Once the net proceeds have been returned to members as outlined above, DFMC will retain approximately \$21.2 million represented by approximately \$11 million of retained earnings and \$10.2 million of share capital. These funds are to be used to generate sufficient future investment income to meet the day to day operating and administration costs associated with DFMC's business.

29. The franked dividend component of the distribution to members will be sourced mainly from the franked dividends received from ACF. It is anticipated that at the time of the share cancellation, DFMC will have distributed approximately 91% of its franking credit balance to its members.

30. The unfranked dividend component of the distribution to members will be sourced entirely from the expected capital gain arising from the sale of ACF shares.

31. The proposed share cancellation will be pro rata at a cost of \$1.00 per share. The cancellation will be subject to a scheme of arrangement pursuant to which 75% of the members of DFMC who participate in a postal ballot must give approval. The cancellation will take effect in accordance with section 344 of Part 13 of the Co-operatives Act.

32. Subject to each DFMC member retaining sufficient DFMC shares to satisfy the minimum shareholding requirement, the share cancellation will be applied equally to each member at the nominated record date, in proportion of the number of shares held.

33. The consideration provided to members in respect of the share cancellation will be paid by way of debiting the share capital of DFMC. It will not be sourced from either current year profit or retained earnings of DFMC.

Commercial reasons for the return of capital

34. Prior to the sale of ACF, ACF was legally restrained from purchasing milk directly from dairy farmers. However, following the sale, ACF is free to acquire milk from dairy farmers making ACF a competitor of DFMC. Presently, most DFMC members have committed to supplying milk to DFMC until either 30 June 2010 or 30 June 2011. However, after this date, many dairy farmers will have the option to either supply DFMC or supply ACF or another processor directly.

35. A significant reduction in the number of members or in DFMC's milk volumes is likely to have a substantial adverse impact on DFMC's ability to achieve the best possible terms of sale for its dairy farmer members. The Board of DFMC (the Board) believes the retention of members who supply large amounts of milk will be a critical factor in DFMC's ongoing success.

36. Pursuant to the provisions of the Co-operatives Act and the Rules of DFMC, DFMC is compelled to cancel the membership of any person who has not supplied DFMC for 12 months and DFMC must repay that member's share capital.

37. Members who supply milk to ACF directly will have no money locked up in connection with such supplies. On the other hand, members who supply milk to DFMC will have DFMC share capital locked up in connection with their supply. This means a significant proportion of DFMC members may decide to unlock this capital by terminating their supply with DFMC and entering into new contracts directly with the third party or ACF.

38. The Board wishes to ensure that DFMC's capital structure does not operate as an incentive for members to cease supplying DFMC. Accordingly, the Board believes that it is important for members' capital, contributed in the past to support ACF, to be reduced if it is not to be exploited by its competitors to induce suppliers to enter into direct contracts with DFMC's competitors.

39. A pro rata share cancellation of 70% will significantly reduce the risk of members seeking to discontinue supply in order to have their share capital repaid. The Board believes a substantial reduction in the number of DFMC members will substantially threaten DFMC's ongoing ability to achieve its objectives and therefore threaten its ongoing viability.

40. The structural change in the milk industry which included the sale of ACF necessitated a dramatic shift in the capital of DFMC if it were to continue to be a viable entity. By structuring the mixture of its retained earnings and share capital, it will result in less incentive for members to leave as a significant amount of their interest in DFMC will now be tied up in retained earnings which is not subject to members' call when they leave.

41. DFMC has also provided the following reasons for undertaking the pro rata share cancellation:

- revise the capital requirements of each farm stakeholder in order to return share capital back to farmer members that is not required to fund the operations of DFMC;
- reduce the inequality between member's contributions to DFMC and the services rendered by DFMC to members;

- reduce the liabilities on the balance sheet of DFMC as capital in a co-operative is a liability for accounting purposes;
- reduce the future financial risk associated with members becoming inactive by ceasing supply to DFMC which in turn compels the directors of DFMC to repay such inactive members' share capital. Without a proportion of retained earnings being held in reserve members funds may quickly be eroded and DFMC's ability to fund its day to day activities would diminish through members leaving DFMC; and
- provide a stable economic and financial base for all participating members. A strong balance sheet is necessary to ensure DFMC is perceived as being a strong and viable ongoing operation.

Ruling

Dividend

42. The distribution of share capital by DFMC in the form of a pro rata share cancellation will not be a dividend, as defined in subsection 6(1).

The anti-avoidance provisions

43. The Commissioner will not make a determination under section 45A or section 45B that section 45C applies to the distribution of share capital. Accordingly, no part of the distribution will be taken to be a dividend for income tax purposes.

44. The Commissioner will not make a determination pursuant to subsection 177F(1) or 177F(2A) in respect of the proposed pro rata compulsory share cancellation.

45. The scheme will not be regarded as a scheme by way of or in the nature of dividend stripping, or a scheme having substantially the effect of a scheme by way of or in the nature of a dividend strip to which section 177E is applicable.

Commissioner of Taxation

22 April 2009

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

46. Subsection 6(1) defines a 'dividend' to include any distribution made by a company to its shareholders. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) 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.

47. 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.

48. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account if it is tainted.

49. The share cancellation will be recorded as a debit to DFMC's share capital account. As the share capital account of DFMC is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 applies. Accordingly, the proposed distribution of share capital will not constitute a dividend.

The anti-avoidance provisions

50. 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 benefit

51. Section 45A applies in circumstances where capital benefits are streamed to some shareholders (the advantaged shareholders), who would derive a greater benefit from the capital benefits than other shareholders (the disadvantaged shareholders) and these disadvantaged shareholders receive, or are likely to receive, dividends.

52. The proposed distribution of share capital by DFMC to its members will constitute the provision of a capital benefit. However, pursuant to the proposed transaction, DFMC will provide all of its members with the capital benefit as well as both franked and unfranked dividends in direct proportion to their individual shareholding. As all members will essentially receive the same distribution from DFMC in more or less the same proportion to their existing shareholding, except for small shareholders who are subject to the minimum shareholding rule, there is no indication of 'streaming' of capital benefits to some shareholders and not to other shareholders, and the payment of dividends to those other shareholders. Accordingly, section 45A will not apply to the distribution of share capital, and the Commissioner will not make a determination under subsection 45A(2) that section 45C applies to the distribution.

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

53. Section 45B applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

54. 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 person (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, 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Each of these conditions is considered below.

Scheme

55. The sale by DFMC of its interest in ACF, the pro rata cancellation of its shares and the distribution of DFMC's share capital is a 'scheme' within the broad meaning of that term.

Capital benefit

56. 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 DFMC will debit the distribution in respect of the share cancellation wholly against its share capital account, its shareholders will be provided with a capital benefit.

Tax benefit

57. A shareholder 'obtains a tax benefit' as defined in subsection 45B(9) of the ITAA 1936 if:

- the amount of tax payable; or
- any other amount payable under the ITAA 1936 or the ITAA 1997,

would, apart from the operation of section 45B of the ITAA 1936:

- 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 instead had been a dividend.

58. As discussed above, the distribution to the shareholders of DFMC constitutes a capital benefit. In the event that the relevant distribution did represent a dividend rather than a capital benefit, it is likely that the shareholders would have incurred a greater tax liability. Consequently, the receipt of the capital benefit will represent a tax benefit.

Relevant circumstances

59. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the 'relevant circumstances' set out in 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.

60. 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 did so for the purpose of obtaining a tax benefit for the relevant taxpayer. The requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

61. The circumstances covered by the paragraphs in subsection 45B(8) includes the circumstances of the company and the tax profile of the shareholders. In this instance, as the distribution will be made to all members of DFMC regardless of individual member circumstances, paragraphs 45B(8)(c) to (f) do not incline for or against a conclusion as to purpose. The circumstances covered by subparagraphs 45B(8)(i) to (j) are not relevant to this arrangement. In relation to this arrangement, the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b), (h) and (k).

62. 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. Under the arrangement, DFMC will record an accounting profit of approximately \$64.28 million upon the disposal of the ACF shares. DFMC will also receive a fully franked special dividend of approximately \$9.68 million from ACF.

63. DFMC has made a distribution of approximately \$56.93 million (comprising of a fully franked portion of approximately \$9.5 million and an unfranked portion of approximately \$47.5 million) and proposes a share cancellation of approximately \$23.58 million. It is intended that an additional dividend of approximately \$6 million will be distributed once DFMC has confirmation from the NSW Supreme Court regarding the entitlements of former members.

64. However, of the \$73.96 million profits derived by DFMC from the disposal of ACF and the receipt of fully franked dividend from ACF, DFMC has distributed approximately \$56.93 million of profits to its members. This gives rise to a difference of approximately \$17 million of the profits of the transaction not being immediately distributed (of which an additional \$6 million is intended to be distributed as a dividend following confirmation of the former member claims by the NSW Supreme Court). Furthermore, the capital that is directly attributable to DFMC's investment in ACF is approximately \$16.20 million. In these circumstances, it is considered that more share capital is being distributed than that released from the ACF sale. This would point towards the presence of the requisite tax purpose.

65. 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. The DFMC dividend policy has been to distribute all dividends it receives from ACF (including any franking credits attached to those dividends). Approximately 91% of the franking credits received by DFMC in connection with the ACF proposal have been distributed to members on a pro rata basis. The balance of the franking credits has been retained by DFMC pending resolution of former member claims.

66. However, DFMC has distributed all of its profits in the past. By retaining approximately \$17 million (of which an additional \$6 million is intended to be distributed as a dividend following confirmation of the former members claims by the NSW Supreme Court), DFMC is interrupting its pattern of profit distribution which tends to point towards the requisite tax purpose.

67. Paragraph 45B(8)(h) considers whether the shareholder's equity interest in the company after the share capital reduction is the same as the interest would have been if an equivalent dividend had been paid.

68. Under the proposed arrangement, following the proposed pro rata share capital cancellation, the proportionate and actual voting interests of each member in DFMC will remain unchanged. However, the proportion of capital that each member has relative to other members will change. Although there is a change in the proportionate capital contributed by each member, the nature of DFMC is such that the actual voting interests of each member and the relative proportion of those voting interests amongst the members do not change. This factor appears to be neutral in the circumstances of this arrangement.

69. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (viii). These matters are 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.

70. DFMC is a co-operative registered under the Co-operatives Act. DFMC's membership is comprised of individual dairy farmers who supply milk to the co-operative. Under the Co-operatives Act, each member has one vote regardless of the amount of capital invested in DFMC. Milk supplied by members to DFMC will in turn be purchased by ACF (which is the milk processor). Prior to the sale of ACF to the third party, ACF was prevented from purchasing milk directly from the DFMC members. DFMC supplied all of ACF's milk. DFMC's representatives state that this arrangement was possible under the *Trade Practices Act* because DFMC and ACF were related parties.

71. However, following the sale of ACF to the third party, it is no longer possible to restrain ACF from purchasing its milk from a party other than DFMC. In other words, ACF is now able to purchase milk directly from DFMC's members.

72. For a number of years, DFMC also operated a compulsory share acquisition programme whereby 1c for every litre of milk supplied by members was contributed towards the share capital of DFMC. As a result, larger milk suppliers have a large amount of capital invested in DFMC whilst their voting rights are the same as all other members.

73. Under the Co-operatives Act, DFMC's share capital does not represent permanent capital for the business because members can have their capital (but not surplus or retained earnings) returned within 12 months of ceasing to be an active member. A member can cease to be an active member by simply ceasing to supply the requisite volume of milk to DFMC. DFMC's share capital represents a liability to its members for accounting purposes.

74. DFMC's existing capital structure potentially creates a disincentive for members to remain as members. Following the sale of ACF to the third party, members will have the option to either supply milk to DFMC or ACF or other third party processors directly. Most DFMC members have agreements with DFMC until 30 June 2010 or 30 June 2011. As direct suppliers to ACF, they will have no money locked up in connection with such supplies because upon ceasing to supply milk to DFMC, members will have their capital returned within 12 months. The existing capital structure creates a potential incentive for large suppliers to stop supplying to DFMC and enter into new contracts with ACF after 30 June 2010 or 30 June 2011 respectively.

75. Given this threat to DFMC's capital structure and existence, it has proposed to make a distribution that would allow it to continuously represent its members in future milk transactions and act as a collective agent in achieving and obtaining a better milk price for its members. By retaining an appropriate amount as profits, DFMC's share capital (which is essentially temporary capital) is converted into a more permanent form of capital which is not subject to call by members when they cease to supply to DFMC. The structural change in the industry has necessitated a dramatic shift in the capital structure of DFMC in order to remain a viable ongoing entity.

76. This factor strongly points towards a commercial objective being pursued by DFMC in order to secure its ongoing operation as a co-operative which represents its members.

77. This is a finely balanced matter after considering the competing tax and non-tax drivers of the arrangement. However, having regard to the relevant circumstances of the scheme, it could not be concluded that DFMC will enter into or carry out the scheme for more than an incidental purpose of enabling the members to obtain a tax benefit. The commercial decision to make the proposed distribution of capital to the members of DFMC is a sound and reasonable business decision which does not display a more than incidental purpose of obtaining a tax benefit. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the proposed pro rata compulsory cancellation of DFMC shares.

Subsection 177F(1) and subsection 177F(2A)

78. The Commissioner has the discretion to cancel all or part of a 'tax benefit' that has been obtained, or would, but for section 177F, be obtained, by a taxpayer in connection with a scheme to which Part IVA applies.

79. Before the Commissioner can exercise the discretion in subsection 177F(1), the requirements of Part IVA must be satisfied. These requirements are that:

- (i) a 'tax benefit', as identified in section 177C or 177CA, was or would, but for section 177F, have been obtained;
- (ii) the tax benefit was or would have been obtained in connection with a 'scheme' as defined in section 177A; and
- (iii) having regard to section 177D, the scheme is one to which Part IVA applies.

80. In this case, all members, with the exception of those subject to the minimum shareholding requirement, will participate in the cancellation. The consideration that DFMC members will receive for the share cancellation will be sourced from the share capital of DFMC and no part of the distribution will be sourced from the profit of DFMC.

81. Having regard to the manner and the facts of this arrangement, Part IVA will not apply as it cannot be concluded that DFMC entered into the scheme for the dominant purpose of enabling DFMC to obtain a tax benefit as defined in section 177C. Therefore, the Commissioner will not make a determination under subsection 177F(1) in relation to the proposed share cancellation as it does not constitute a scheme to which Part IVA applies.

82. Subsection 177F(2A) is a provision in Part IVA which is designed to counter the avoidance of withholding tax. Subsection 177F(2A) allows the Commissioner to make a determination that a taxpayer is subject to withholding tax under section 128B where a tax benefit relates to withholding tax under section 177CA has been obtained. This applies to payments made after 20 August 1996.

83. Based on the reasoning above, the Commissioner will not make a determination under subsection 177F(2A) in relation to the proposed share cancellation. The arrangement does not constitute a scheme to which Part IVA applies because the dominant purpose is not the obtaining of a tax benefit as defined in section 177CA.

Dividend stripping

84. Broadly, section 177E applies where:

- a company's property is disposed of under a scheme in the nature of, or that has a similar effect to, a dividend stripping scheme;
- the Commissioner concludes that the disposal represents in whole or in part a distribution of the company's past, present or future profits; and
- if immediately before the scheme was entered into the company notionally paid a dividend out of the profits represented by the disposal of the property, the amount represented by the dividend would have been, or might reasonably be expected to have been, included in the assessable income of a taxpayer.

85. In relation to this arrangement, the transaction is not considered to constitute a scheme in the nature of, or that has a similar effect to, a dividend strip. As such section 177E does not apply to the pro rata capital return and the Commissioner will not make a determination under subsection 177E(1).

Appendix 2 – Detailed contents list

86. 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	9
ACF restructure	12
Capital management	14
Scheme of arrangement	21
Commercial reasons for the return of capital	34
Ruling	42
Dividend	42
The anti-avoidance provisions	43
Appendix 1 – Explanation	46
Dividend	46
The anti-avoidance provisions	50
Section 45A – streaming of dividends and capital benefits	51
Section 45B – schemes to provide capital benefits in substitution for dividends	53
Scheme	55
Capital benefit	56
Tax benefit	57
Relevant circumstances	59
Subsection 177F(1) and subsection 177F(2A)	78
Dividend stripping	84
Appendix 2 – Detailed contents list	86

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- cancellation of shares
- capital benefits
- co-operative companies
- dividend income
- dividend streaming arrangements
- dividend stripping
- return of capital on shares

Legislative references:

- | | |
|-----------------------|------------------------------------|
| - ITAA 1936 6(1) | - ITAA 1936 45B(8)(k) |
| - ITAA 1936 45A | - ITAA 1936 45B(9) |
| - ITAA 1936 45A(2) | - ITAA 1936 45C |
| - ITAA 1936 45B | - ITAA 1936 Pt III Div 9 |
| - ITAA 1936 45B(2) | - ITAA 1936 128B |
| - ITAA 1936 45B(2)(a) | - ITAA 1936 Pt IVA |
| - ITAA 1936 45B(2)(b) | - ITAA 1936 177A |
| - ITAA 1936 45B(2)(c) | - ITAA 1936 177C |
| - ITAA 1936 45B(3) | - ITAA 1936 177CA |
| - ITAA 1936 45B(5) | - ITAA 1936 177D |
| - ITAA 1936 45B(8) | - ITAA 1936 177D(b)(i) |
| - ITAA 1936 45B(8)(a) | - ITAA 1936 177D(b)(ii) |
| - ITAA 1936 45B(8)(b) | - ITAA 1936 177D(b)(iii) |
| - ITAA 1936 45B(8)(c) | - ITAA 1936 177D(b)(iv) |
| - ITAA 1936 45B(8)(d) | - ITAA 1936 177D(b)(v) |
| - ITAA 1936 45B(8)(e) | - ITAA 1936 177D(b)(vi) |
| - ITAA 1936 45B(8)(f) | - ITAA 1936 177D(b)(vii) |
| - ITAA 1936 45B(8)(h) | - ITAA 1936 177E |
| - ITAA 1936 45B(8)(i) | - ITAA 1936 177E(1) |
| - ITAA 1936 45B(8)(j) | - ITAA 1936 177F |
| | - ITAA 1936 177F(1) |
| | - ITAA 1936 177F(2A) |
| | - ITAA 1936 318 |
| | - ITAA 1997 |
| | - ITAA 1997 Div 125 |
| | - ITAA 1997 Div 197 |
| | - ITAA 1997 975-300 |
| | - ITAA 1997 975-300(3) |
| | - TAA 1953 |
| | - Co-operatives Act 1992 (NSW) |
| | - Co-operatives Act 1992 (NSW) 129 |
| | - Co-operatives Act 1992 (NSW) 289 |
| | - Copyright Act 1968 |
| | - Trade Practices Act |

ATO references

NO: 2009/3614

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Entity specific matters ~~ companies
Income Tax ~~ Tax integrity measures ~~ dividend streaming and demerger benefits