


CR 2009/25 - Income tax: share capital reduction: Artist & Entertainment Group Limited

 This cover sheet is provided for information only. It does not form part of *CR 2009/25 - Income tax: share capital reduction: Artist & Entertainment Group Limited*



Class Ruling

Income tax: share capital reduction: Artist & Entertainment Group Limited

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	8
Scheme	9
Ruling	23
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	28
Appendix 2:	
Detailed contents list	58

① 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 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; and
- section 855-10 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies consists of the ordinary shareholders of Artist & Entertainment Group Limited (AEM), who:

- (a) are registered on the AEM share register on 3 November 2008 (the Record Date); and
- (b) held their AEM shares on capital account.

In this Ruling, a person belonging to this class of entities is referred to as an 'AEM shareholder'.

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 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.

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 2009. The Ruling continues to apply after 30 June 2009 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.

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. AEM is a resident public company incorporated in 2001 and listed on the Australian Securities Exchange (ASX) on 9 December 2004 after an initial public offer.

11. AEM operated two divisions: an extra-curricular performing arts program for children (Brightstars) and a talent agency.

12. Brightstars was involved in the development of a training institution with more than 50 school locations in several states, 5,000 students, 200 staff and the conduct of thousands of classes each week following a comprehensive curriculum. To support these activities Brightstars owned various items of intellectual property, buildings and equipment.

13. On 5 August 2008, AEM announced to the ASX that it had entered into a binding agreement to sell its business for \$11.125 million (Brightstars Sale).

14. The Brightstars Sale, which was completed on 17 October 2008, was structured as an asset sale and did not involve the sale of AEM shares.

15. At the time of the distribution to which this Ruling relates AEM had invested approximately \$11.3 million of its share capital in Brightstars.

16. Given that AEM had disposed of its main business undertaking and the directors were uncertain about the company's future business direction, the directors decided to return the surplus share capital released from the sale to shareholders.

17. On 17 November 2008 (the payment date), the directors distributed an amount of 4 cents per share (\$7,528,640 in total), pursuant to section 256B of the *Corporations Act 2001*.

18. As at 30 June 2008, the accumulated losses of AEM totalled \$11,379,280.

19. From its date of incorporation AEM has not paid a dividend to its shareholders.

20. The directors confirm that the money paid to the AEM shareholders has been debited against the share capital account of AEM.

21. The share capital account is not a tainted share capital account for the purposes of Division 197 of the ITAA 1997.

22. AEM does not hold any interest, either directly or indirectly, in any Australian real property.

Ruling

Distribution is not a dividend for income tax purposes

23. The return of capital to the AEM shareholders was not a dividend, as defined in subsection 6(1).

The application of sections 45B and 45C to the return of capital

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

Capital gains tax

25. CGT event G1 (section 104-135 of the ITAA 1997) happened when AEM paid the return of capital to an AEM shareholder in respect of an AEM share that they owned at the Record Date and continue to own at the payment date.

26. CGT event C2 (section 104-25 of the ITAA 1997) happened when AEM paid the return of capital to an AEM shareholder in respect of an AEM share that they owned at the Record Date but ceased to own before the payment date.

Foreign resident shareholders

27. For a foreign resident AEM shareholder, the payment of the return of capital only has CGT consequences if their AEM shares are 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

13 May 2009

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

28. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholders 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).

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

30. 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.

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

32. The return of capital is recorded as a debit to AEM's share capital account. As the share capital account of AEM 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 return of capital does not constitute a dividend.

Anti-avoidance provision

33. Section 45B is an anti-avoidance provision which, if it applies, allows 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 45B

34. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. The effect of such a determination is that all or part of the distribution of capital received by the shareholder under the return of capital is treated as an unfranked dividend.

35. In broad terms, section 45B applies where:
- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
 - (b) under the scheme, a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
 - (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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).
36. In the case of the capital return, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, having regard to the relevant circumstances of the scheme as set out in subsection 45B(8), it could not 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, other than a merely incidental purpose of enabling a taxpayer to obtain a tax benefit.
37. The share capital invested in the Brightstars business and released by the Brightstars Sale has been returned to shareholders, as it is excess to AEM's current funding needs.
38. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the return of capital.

Section 45C

39. As section 45B will not apply to the capital return, the Commissioner will not make a determination under section 45C.
40. No part of the capital return will be taken to be an unfranked dividend in the hands of AEM shareholders.

Capital gains tax

CGT event G1 – section 104-135

41. CGT event G1 (section 104-135 of the ITAA 1997) happened when AEM paid the return of capital to an AEM shareholder in respect of a share that they owned in AEM at the Record Date and continued to own at the payment date, as the return of capital is not a dividend (as defined in subsection 995-1(1) of the ITAA 1997) or a deemed dividend under section 47 of the ITAA 1936.

42. If the return of capital (4 cents per share) is equal to or less than the cost base of the AEM share at the payment date, the cost base and reduced cost base of the share will be reduced by the amount of the return of capital (subsection 104-135(4) of the ITAA 1997).

43. An AEM shareholder made a capital gain if the return of capital was more than the cost base of the AEM share (subsection 104-135(3) of the ITAA 1997). The amount of the capital gain is equal to the excess.

44. If an AEM shareholder made a capital gain from CGT event G1 happening, the cost base and reduced cost base of the AEM share is reduced to nil. An AEM shareholder cannot make a capital loss from CGT event G1 happening (subsection 104-135(3) of the ITAA 1997).

45. A capital gain from CGT event G1 happening will be a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the AEM share was acquired at least 12 months before the payment (subsection 115-25(1) of the ITAA 1997) and the other conditions in that Subdivision are satisfied.

CGT event C2 – section 104-25

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

47. CGT event C2 (section 104-25 of the ITAA 1997) happened when the return of capital was paid. The right to receive the payment (being an intangible CGT asset) ended by the right being discharged or satisfied when the payment was made.

48. An AEM shareholder made a capital gain if the capital proceeds from the ending of the right is more than the cost base of the right. An AEM shareholder will make a capital loss if the capital proceeds from the ending of the right is 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, the capital proceeds will be the amount of the return of capital (subsection 116-20(1) of the ITAA 1997).

50. The cost base of an AEM shareholder's right to receive the return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the AEM shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share – for example, when the AEM shareholder disposed of the share after the Record Date.

51. Therefore, if the full cost base or reduced cost base of an AEM share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share, the right to receive the return of capital had a nil cost base.

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

53. If the AEM share to which the return of capital relates was originally acquired by an AEM 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.

Foreign resident shareholders

54. A foreign resident disregards a capital gain or capital loss made 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).

55. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997 and covers five categories of CGT assets:

- (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 a permanent establishment in Australia, and 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 covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident).

56. Accordingly, a foreign AEM shareholder disregards a capital gain made from CGT event G1 happening if the AEM shares were not 'taxable Australian property' (section 855-10 of the ITAA 1997).

57. A foreign AEM shareholder disregards a capital gain or capital loss made from CGT event C2 happening to their right to receive the return of capital because the right was not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

58. 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
Ruling	23
Distribution is not a dividend for income tax purposes	23
The application of sections 45B and 45C to the return of capital	24
Capital gains tax	25
Foreign resident shareholders	27
Appendix 1 – Explanation	28
Dividend	28
Anti-avoidance provision	33
Section 45B	34
Section 45C	39
Capital gains tax	41
<i>CGT event G1 – section 104-135</i>	41
<i>CGT event C2 – section 104-25</i>	46
Foreign resident shareholders	54
Appendix 2 – Detailed contents list	58

References

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- arrangement
- capital benefit
- capital reductions
- CGT events
- CGT events C1-C3 - end of a CGT asset
- CGT events G1-G3 - shares
- return of capital on shares

Legislative references:

- | | |
|--|--|
| <ul style="list-style-type: none">- ITAA 1936 6(1)- ITAA 1936 44(1)- ITAA 1936 45B- ITAA 1936 45B(2)(a)- ITAA 1936 45B(2)(b)- ITAA 1936 45B(2)(c)- ITAA 1936 45B(3)- ITAA 1936 45B(8) | <ul style="list-style-type: none">- ITAA 1936 45C- ITAA 1936 47- ITAA 1997 104-25- ITAA 1997 104-25(3)- ITAA 1997 104-135- ITAA 1997 104-135(3)- ITAA 1997 104-135(4)- ITAA 1997 104-165(3)- ITAA 1997 109-5- ITAA 1997 Div 110- ITAA 1997 Div 112- ITAA 1997 Subdiv 115-A- ITAA 1997 115-25(1)- ITAA 1997 116-20(1)- ITAA 1997 Div 197- ITAA 1997 855-10- ITAA 1997 855-15- ITAA 1997 975-300- ITAA 1997 975-300(3)- ITAA 1997 995-1(1)- TAA 1953- Copyright Act 1968- Corporations Act 2001 256B |
|--|--|
-

ATO references

NO: 2009/4077

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Entity specific matters ~~ share buy-backs