


CR 2009/54 - Income tax: proposed return of capital: Eircom Holdings Limited

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Class Ruling

Income tax: proposed return of capital: Eircom Holdings 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, 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 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-135 of the ITAA 1997; and
- Division 855 of the ITAA 1997.

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 is the ordinary shareholders of Eircom Holdings Limited (ERC), formerly Babcock and Brown Capital Limited, who:

- (a) are registered on the ERC share register on the Record Date, being the date for determining entitlements under the proposed return of capital as described in paragraphs 9 to 23 of this Ruling; and
- (b) hold their shares on capital account.

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 23 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 1 July 2009 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:

- application for Class Ruling dated 31 July 2009, together with its appendices;
- ERC's Australian Securities Exchange (ASX) Release dated 31 July 2009;
- ERC's ASX Release dated 27 February 2009; and
- ERC's Annual Reports for the year ended 30 June 2008 and 2009.

10. ERC is an Australian resident public company. ERC listed on the ASX on 14 February 2005 after a successful public offering (IPO) to raise equity of \$1 billion. ERC was previously named Babcock and Brown Capital Limited (BCM) and changed its name to eircom Holdings Limited on 27 April 2009.

11. To date ERC has made two investments:

- On 18 August 2006 ERC acquired a 57.1% interest in eircom Group Limited (eircom). As at 30 June 2009, ERC's 57.1% investment in eircom has been written down to \$67.1 million on the ERC balance sheet.
- In July 2007 ERC acquired 100% of Golden Pages for an enterprise value of \$150 million. Due to a potential sale, a non-cash loss of \$129.8 million was recognised on the reclassification of the Golden Pages investment as a non-current asset held for sale in the year ended 30 June 2009.

12. ERC invested a substantial proportion of the capital raised in the IPO in the eircom and Golden Pages investments. Following refinancing of these investments, some of this initial capital invested was returned to ERC. The cash resources which ERC currently has are attributable to the initial capital raised on listing.

13. On 28 August 2007, ERC announced an on-market buy-back program. As at 30 June 2008, a total of 32,095,086 shares had been bought back on-market representing 16.05% of the original issued share capital. The on market buy-back program was terminated as per the ASX announcement dated 10 November 2008.

14. On 17 March 2009, \$100.7 million (60 cents per share) was returned to shareholders as a proportionate return of capital on all issued ordinary shares.

15. On 31 July 2009, ERC announced that a further proposed return of capital is to be considered by shareholders at a General Meeting to be held on 15 September 2009. The proposed return of capital is expected to result in \$134,323,931 being returned to shareholders (equating to 80 cents per ordinary share).

16. The return of capital will result in ERC retaining approximately \$40 million as reserves to satisfy ongoing operating costs.

17. The return of capital will be funded from available cash reserves, which are attributable to the capital raised from the IPO.

18. The funds for the return of capital will not be sourced from profits. ERC has not received any dividends from subsidiaries subsequent to its IPO. Further, at 30 June 2009, ERC as a stand alone entity had accumulated losses of \$565.2 million.

19. ERC has never declared a dividend to shareholders. ERC intends to retain and reinvest its capital unless the board of directors forms the view that the capital cannot be employed in further investments at a rate of return consistent with ERC's investment objectives.

20. As at 30 June 2009, ERC had available franking credits of \$7.2 million.

21. As of 31 July 2009, ERC had 167,904,914 shares on issue.

22. ERC's share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

23. Shares in ERC are not an 'indirect Australian real property interest' (as defined in section 855-25 of the ITAA 1997) for any non-resident shareholder.

Ruling

Distribution is not a dividend for income tax purposes

24. The proposed return of capital to ERC shareholders 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

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

Capital gains tax

26. CGT event G1 (section 104-135 of the ITAA 1997) will happen when ERC pays the proposed return of capital to an ERC shareholder in respect of an ERC share that they own at the Record Date and continue to own at the payment date.

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

Foreign resident shareholders

28. A foreign resident ERC shareholder who is paid the proposed return of capital disregards any capital gain made when CGT event G1 happens if their ERC shares are not 'taxable Australian property' (section 855-10 of ITAA 1997).

29. A foreign resident ERC shareholder who is paid the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens if their right to receive the proposed return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation23 September 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.*

Distribution is not a dividend

30. 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).

31. The term 'dividend' is defined in subsection 6(1) and includes any distribution made by a company to any of its shareholders. However, this broad definition is confined by later paragraphs in the definition which expressly excludes certain items from being a dividend for income tax purposes.

32. Paragraph (d) of the definition 'dividend' in section 6(1) specifically excludes from the definition:

...moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share) where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

33. The proposed return of capital will be wholly debited against the untainted share capital account of ERC. Therefore, paragraph (d) of the definition of 'dividend' applies and the proposed return of capital will not be a dividend as defined in subsection 6(1).

Subsection 6(4)

34. The exclusion in paragraph (d) of the definition of dividend is limited by subsection 6(4) which applies in circumstances where, under an arrangement:

- a company raises share capital, receiving either cash or property from a person or group of persons and crediting it to its share capital account; and
- returns it to another person or group of persons, giving them either cash or property and debiting it to its share capital account.

35. In the present case, no arrangement exists under which ERC raised share capital from certain shareholders and then distributed the capital raised to other shareholders. Accordingly, subsection 6(4) will have no application in respect of the proposed return of capital.

Anti-avoidance provisions

Sections 45A and 45B

36. 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

37. Section 45A applies 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.

38. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in subsection 45A(3) to include the distribution to the shareholder of share capital. The proposed return of share capital in the present case by ERC to its shareholders will constitute the provision of a capital benefit. However, as ERC will make the return of capital to all of its shareholders in respect of their ordinary shares it is considered that there will be no streaming of capital benefits to some shareholders and not to others.

39. Therefore, section 45A will have no application in respect of the proposed return of capital. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the capital benefit.

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

40. 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.

41. 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)).
42. Under the present scheme, ERC proposes to make a distribution of share capital to all of the ERC shareholders, which will constitute the provision of a capital benefit in accordance with paragraph 45B(5)(b).
43. Pursuant to subsection 45B(9), it is likely that each of the ERC shareholders, to which this Ruling applies, will obtain a tax benefit due to the capital benefit being assessed at a later time via the CGT regime, rather than being assessed immediately under subsection 44(1) as a dividend.
44. However, having regard to the relevant circumstances of the scheme, it cannot be concluded that either ERC or the ERC shareholders will enter into or carry out the proposed scheme for the purpose of enabling the ERC shareholders to obtain a tax benefit. It cannot be said that the return of capital is attributable to profits of ERC. The manner in which the proposed scheme is to be carried out, and the form and substance of the proposed scheme, do not indicate that the proposed capital return will be made in substitution for dividends.
45. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or a part of the proposed return of capital.
46. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 in relation to the arrangement 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 of the ITAA 1997.

Capital gains tax

CGT event G1 – section 104-135

47. CGT event G1 will happen when ERC pays the proposed return of capital to an ERC shareholder in respect of a share that they own in ERC at the Record Date and continue to own at the payment date (section 104-135 of the ITAA 1997).

48. If the proposed return of capital (80 cents per share) is equal to or less than the cost base of the ERC share at the payment date, the cost base and reduced cost base of the share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

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

50. If an ERC shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the ERC share is reduced to nil. An ERC shareholder cannot make a capital loss when CGT event G1 happens (subsection 104-135(3) of the ITAA 1997).

51. A capital gain made when CGT event G1 happens will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the ERC share was acquired at least 12 months before the payment (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Subdivision are satisfied.

CGT event C2 – section 104-25

52. The right to receive the proposed return of capital is one of the rights inherent in an ERC share at the Record Date. If, after the Record Date but before the payment date, an ERC shareholder ceases to own an ERC share, the right to receive the proposed return of capital in respect of that share will be retained by the shareholder and is a separate CGT asset.

53. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the proposed return of capital is paid. The right to receive the payment (being an intangible CGT asset) will end by the right being discharged or satisfied when the payment is made.

54. An ERC shareholder will make a capital gain if the capital proceeds from the ending of the right are more than its cost base. The capital gain is equal to the amount of the excess. An ERC shareholder will make a capital loss if the capital proceeds from the ending of the right are less than its reduced cost base (subsection 104-25(3) of the ITAA 1997). The capital loss is equal to the amount of the difference.

55. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the proposed return of capital (subsection 116-20(1) of the ITAA 1997).

56. The cost base of an ERC 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). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the ERC 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 ERC shareholder disposed of the share after the Record Date.

57. Therefore, if the full cost base or reduced cost base of an ERC 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 proposed return of capital will have a nil cost base.

58. As the right to receive the proposed return of capital was inherent in the ERC share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997). Accordingly, if the ERC share was acquired at least 12 months before the proposed return of capital, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided the other conditions of that Subdivision are satisfied.

Foreign resident shareholders

59. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss made from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

60. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a gain or loss on ceasing to be an Australian resident).

61. ERC has advised that at the time CGT event G1 happens for any foreign resident ERC shareholder who is entitled to the proposed return of capital, an ERC share will not be an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997) as the interest will not pass the principal asset test in section 855-30 of the ITAA 1997 at that time.

62. Consequently, a foreign resident ERC shareholder, just before CGT event G1 happens, cannot disregard under subsection 855-10(1) of the ITAA 1997 a capital gain made if:

- (a) the ERC share has been used at any time by the foreign resident ERC shareholder in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- (b) the ERC share is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

63. A foreign resident ERC shareholder who has a right to the payment of the proposed return of capital, disregards any capital gain or capital loss made when CGT event C2 happens to that right because the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains tax
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 – shares
- distributions
- dividend income
- dividend streaming arrangements
- return of capital on shares
- share capital

Legislative references:

- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 6(4)
 - ITAA 1936 44(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - ITAA 1936 45A(3)
 - ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
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 - ITAA 1936 45B(3)
 - ITAA 1936 45B(5)(b)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1997
 - 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
 - ITAA 1997 115-25(1)
 - ITAA 1997 116-20(1)
 - ITAA 1997 Div 197
 - ITAA 1997 Div 855
 - ITAA 1997 855-10
 - ITAA 1997 855-10(1)
 - ITAA 1997 855-15
 - ITAA 1997 855-25
 - ITAA 1997 855-30
 - TAA 1953
 - Copyright Act 1968
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ATO references`

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 Income Tax ~~ Entity specific matters ~~ companies
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