


CR 2010/38 - Income tax: return of capital: Customers Limited

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Class Ruling

Income tax: return of capital: Customers 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);
- subsection 6(4) 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 104-165 of the ITAA 1997;
- section 104-135 of the ITAA 1997;
- section 115-25 of the ITAA 1997;

- section 855-10 of the ITAA 1997;
- section 855-15 of the ITAA 1997;
- section 855-30 of the ITAA 1997; and
- section 975-300 of the ITAA 1997.

All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies consists of the ordinary shareholders of Customers Limited (Customers) who:

- (a) are registered on the Customers share register on the Record Date; and
- (b) hold their Customers shares on capital account.

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

Qualifications

4. 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 10 to 33 of this Ruling.

5. 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

7. 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).

Previous Rulings

8. CR 2010/2 Income tax: proposed return of capital: Customers Limited.

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. Customers is an Australian resident public company which was incorporated in 1989 and is listed on the Australian Securities Exchange.

11. Customers primarily supplies ATMs and electronic payment system services in Australia and until recently has been in a 'start-up' phase, acquiring several ATM related businesses in Australia and focusing on growth in Asia.

12. Since its incorporation, Customers has raised capital for various reasons including funding for acquisitions, employees share plans, employee performance share rights, shares for payment to suppliers and share placements for working capital.

13. The financial statements of Customers as at 30 June 2009 show issued capital of \$203,731,000, reserves of \$1,315,000 and accumulated losses of \$29,925,000. At this time it had approximately 133,623,643 fully paid ordinary shares on issue.

14. The financial statements of Customers as at 31 December 2009, show issued capital of approximately \$215 million credited to its equity account.

15. At 26 February 2010 Customers had approximately 137.9 million ordinary shares on issue. These are the only shares on issue. The increase in the number of shares on issue is primarily attributable to the exercise of share options and rights.

16. Customers has implemented an on-market buy back programme of up to 10% of the company's shares, and has already purchased some of its shares on-market as part of this programme.

17. The shareholders in Customers are a mixture of individuals, companies and superannuation funds, some of whom are foreign residents.

Acquisition and sale of Fintronics

18. On 12 September 2006, Customers announced the establishment of a 50/50 joint venture, Customers Asia Limited (CAL), to develop and provide ATM and related services throughout Asia. CAL is a company incorporated in Hong Kong and a tax resident of that country. On 15 November 2006, CAL subscribed for shares and convertible notes in Fintronics Holdings Company Limited (Fintronics) for approximately \$20,000,000. Fintronics is a company which is listed on the Hong Kong stock exchange and owns and operates an ATM independent service organisation in China. Customers funded its \$10,000,000 investment in CAL via the issue of 40,000,000 shares to the joint venturer at \$0.25 per share under an existing option agreement. On 28 May 2007, Customers acquired the remaining 50% interest in CAL from the joint venturer. As a result, CAL became a wholly owned subsidiary of Customers. The acquisition was settled in part by the issue of 93,322,176 Customers shares to the joint venturer with an approximate market value of \$19,568,000.

19. As a result of changes in legislation in China and concerns regarding corporate governance issues, a decision was taken to exit the investment in Fintronics and focus on Customers' core Australian and New Zealand businesses. Consequently, on 9 May 2008, CAL sold its investment in shares and convertible notes in Fintronics for approximately \$14,700,000. A loss was realised on disposal of Fintronics and some of the proceeds from this sale were used to repay debt.

Return of capital

20. Until recently, Customers has been in a start-up phase, acquiring several ATM related businesses. It also had a strong Asian focus from its investment in Fintronics. During this start up phase, debt was either difficult to obtain or expensive. Accordingly, Customers relied to a material extent on share capital for both investment and working capital requirements (as reflected by the regular capital raisings).

21. Customers has now reached critical mass as a business and is benefiting from new Direct Charging arrangements in Australia. It has changed its business plan to concentrate on Australia and New Zealand. Its business is now producing strong cash flows.

22. Accordingly, Customers has reviewed its capital structure and the mix of equity and external debt. It has decided (in conjunction with its external lenders) that it should reduce its issued capital to give it optimal gearing. As such the following amounts are surplus to Customers needs:

- the remaining \$3.7 million of the proceeds from the disposal of Fintronics; and
- the \$10 million subsequently received by Customers from the exercise of the options. The additional \$1.279 million raised by the exercise of the other share options is also surplus.

23. Customers had sufficient funding for its business as at 30 June 2009, therefore it has no use for the capital raised by the exercise of the options during the 2010 financial year.

24. Customers proposes a return of capital to all of its shareholders of \$0.08 per share (approximately \$11 million). The company has also implemented an on-market buy back programme of up to 10% of the company's shares. The company has already purchased some of its shares on-market as part of this programme.

25. The Board of Directors sought and received approval for the return of capital from shareholders at an Extraordinary General Meeting which was held on 21 April 2010.

26. The return of capital of \$0.08 per share was made to all Customers shareholders registered on the Customers share register on the Record Date which was 14 May 2010. The return of capital was made by way of a cash distribution in proportion to the number of shares held on that date. The payment date was 28 May 2010.

27. The entire amount of the return of capital will be debited to Customers' share capital account as follows:

Dr	Share capital	
Cr		Cash

28. There will be no change in the number of shares on issue as a result of the return of capital.

29. A previous return of capital of \$0.08 per share relating to the sale of Fintronics (considered by the Australian Taxation Office in CR 2010/2) was made with a Record Date of 12 February 2010 and a Payment Date of 26 February 2010.

Other aspects

30. No dividend has been declared or paid in the past 10 years to 31 December 2009. However, when the half year results were announced the Board indicated it intends to introduce a sustainable dividend policy with the payout rate to be determined by the Board.

31. As at 31 December 2009, the franking account of Customers is nil.

32. Customers does not hold any direct or indirect interest in real property in Australia for the purposes of the principal asset test under section 855-30.

33. Customers has confirmed that its share capital account (as defined in section 975-300) is not tainted (within the meaning of Division 197).

Ruling

Distribution is not a dividend

34. The return of capital to Customers shareholders will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

Distribution will not be deemed a dividend under section 45C

35. The Commissioner will not make a determination under sections 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 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

36. CGT event G1 will happen when Customers pays the return of capital to a Customers shareholder in respect of a Customers share that they own at the Record Date and continue to own at the Payment Date (section 104-135).

37. CGT event C2 will happen when Customers pays the return of capital to a Customers shareholder in respect of a Customers share that they own at the Record Date but cease to own before the Payment Date (section 104-25).

Foreign resident shareholders

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

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

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

40. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

41. The term 'dividend', defined in subsection 6(1) of the ITAA 1936, includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution from the meaning of 'dividend' if the amount of the distribution is debited against an amount standing to the credit of the company's share capital account.

42. The term 'share capital account' is defined in section 975-300 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.

43. Subsection 975-300(3) states that an account is not a share capital account, except for certain limited purposes, if it is tainted. Section 197-50 states that a share capital account is tainted if an amount to which Division 197 applies is transferred to the account and the account is not already tainted.

44. The return of capital will be recorded as a debit to Customers' share capital account. As the share capital account of Customers 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 will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

Subsection 6(4)

45. The exclusion in paragraph (d) of the definition of dividend in subsection 6(1) of the ITAA 1936 is limited by subsection 6(4) of the ITAA 1936 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, crediting the amount of money or the value of the property to its share capital account; and
- returns the money or property to another person or group of persons, debiting the amount of the money or the value of the property to its share capital account.

46. In the present case, no arrangement exists under which Customers raised share capital from certain shareholders and then will distribute the capital raised to other shareholders. Accordingly, subsection 6(4) of the ITAA 1936 will have no application in respect of the return of capital.

Anti-avoidance provisions

Sections 45A and 45B

47. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies to treat all or part of the return of capital amount received by the shareholders as an unfranked dividend paid by the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

48. Section 45A of the ITAA 1936 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.

49. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) of the ITAA 1936 to include a distribution to the shareholder of share capital. Customers will provide its shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b) of the ITAA 1936. The capital benefit will be provided to all of its shareholders in the same proportion as their share holdings.

50. Therefore, section 45A of the ITAA 1936 will have no application in respect of the return of capital. Accordingly, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies in relation to the whole, or a part, of the capital benefit.

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

51. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C of the ITAA 1936 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.

52. In broad terms, section 45B of the ITAA 1936 applies where:
- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
 - (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) 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).
53. Under the present scheme, Customers made a distribution of \$0.08 in respect of each share held by Customers shareholders. This will constitute the provision of a capital benefit in accordance with paragraph 45B(5)(b) of the ITAA 1936.
54. Pursuant to subsection 45B(9) of the ITAA 1936, it is likely that each of the Customers 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) of the ITAA 1936 as a dividend.
55. However, having regard to the relevant circumstances of the scheme (defined to include the circumstances set out in subsection 45B(8) of the ITAA 1936), it cannot be concluded that either Customers or the Customers shareholders will enter into or carry out the scheme for the purpose of enabling the Customers shareholders to obtain a tax benefit. It cannot be said that the return of capital is a disguised distribution of profits, nor does Customers' pattern of distributions indicate that the return of capital is being made in substitution for dividends. Similarly, the manner in which the scheme is to be carried out, and the form and substance of the scheme, do not indicate that the capital return will be made in substitution for dividends.
56. 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 return of capital.
57. 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 return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or the ITAA 1997.

Capital gains tax

CGT event G1 – section 104-135

58. CGT event G1 happened when Customers paid the return of capital to a Customers shareholder in respect of a share that they own in Customers at the Record Date and continue to own at the Payment Date (section 104-135).

59. If the return of capital (\$0.08 per share) is equal to or less than the cost base of the Customers 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)).

60. A Customers shareholder will make a capital gain if the return of capital is more than the cost base of the Customers share (subsection 104-135(3)). The amount of the capital gain is equal to the excess amount.

61. If a Customers shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the Customers share is reduced to nil. A Customers shareholder cannot make a capital loss when CGT event G1 happens (subsection 104-135(3)).

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

CGT event C2 – section 104-25

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

64. CGT event C2 will happen when the return of capital is paid (section 104-25). 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.

65. A Customers 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. A Customers 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)). The capital loss is equal to the amount of the difference.

66. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the return of capital (\$0.08 per share) (subsection 116-20(1)).

67. The cost base of a Customers shareholder's right to receive the return of capital is worked out under Division 110 (modified by Division 112). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the Customers 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 Customers shareholder disposed of the share after the Record Date.

68. Therefore, if the full cost base or reduced cost base of a Customers 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 will have a nil cost base.

69. As the right to receive the return of capital was inherent in the Customers 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). Accordingly, if the Customers share was acquired at least 12 months before the return of capital, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25. Such a capital gain will be eligible to be treated as a discount capital gain under Subdivision 115-A provided the other conditions of that Subdivision are satisfied.

Foreign resident shareholders

70. 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', under subsection 855-10(1).

71. The term 'taxable Australian property' is defined in the table in section 855-15. 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) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

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

73. However, a foreign resident Customers shareholder, just before CGT event G1 happens, cannot disregard under subsection 855-10(1) a capital gain made if:

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

74. Customers has advised that at the time CGT event C2 happens to a foreign resident Customers shareholder who is entitled to the return of capital, a Customers right to payment will not be an indirect Australian real property interest (as defined in section 855-25) as the interest will not pass the principal asset test in section 855-30 at that time.

75. However, a foreign resident Customers shareholder, just before CGT event C2 happens, cannot disregard under subsection 855-10(1) a capital gain made if:

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

Appendix 2 – Detailed contents list

76. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Previous Rulings/Determinations:

CR 2010/2

Subject references:

- capital benefit
- capital gains tax
- capital reductions
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 – shares
- dividends
- return of capital on shares
- share capital

Legislative references:

- | | |
|-----------------------|--------------------------|
| - ITAA 1936 | - ITAA 1936 45B(2)(c) |
| - ITAA 1936 6(1) | - ITAA 1936 45B(3) |
| - ITAA 1936 6(4) | - ITAA 1936 45B(5)(b) |
| - ITAA 1936 44(1) | - ITAA 1936 45B(8) |
| - ITAA 1936 45A | - ITAA 1936 45B(9) |
| - ITAA 1936 45A(2) | - ITAA 1936 45C |
| - ITAA 1936 45A(3)(b) | - ITAA 1997 |
| - ITAA 1936 45B | - ITAA 1997 104-25 |
| - ITAA 1936 45B(2)(a) | - ITAA 1997 104-25(3) |
| - ITAA 1936 45B(2)(b) | - ITAA 1997 104-135 |
| | - ITAA 1997 104-135(3) |
| | - ITAA 1997 104-135(4) |
| | - ITAA 1997 104-165 |
| | - ITAA 1997 104-165(3) |
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| | - 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) |
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| | - ITAA 1997 197-50 |
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| | - ITAA 1997 855-15 |
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ATO references

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