


CR 2013/42 - Income tax: Associated Retailers Limited - ARL Equity Notes

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Class Ruling

Income tax: Associated Retailers Limited – ARL Equity Notes

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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 provisions identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provisions

2. The relevant provisions dealt with in this Ruling are:
- Section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Section 45B of the ITAA 1936;
 - Section 45C of the ITAA 1936;
 - Section 177EA of the ITAA 1936;
 - section 202-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - subsection 202-40(2) of the ITAA 1997; and
 - paragraph 204-30(3)(c) of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is investors (referred to as Note Holders) who acquired ARL Equity Notes (the Notes) issued by Associated Retailers Limited (ARL) and who:

- are residents of Australia (within the meaning of subsection 6(1) of the ITAA 1936);
- subscribed for their Notes on or after 1 August 2012 and on or before 30 June 2014;
- hold their Notes on capital account; and
- are not subject to the Taxation of Financial Arrangements rules in Division 230 of the ITAA 1997 in relation to financial arrangements under the scheme.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals unless they have made an election for it to apply to them).

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 40 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 2012 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 Minter Ellison on behalf of ARL as the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- the application for Class Ruling dated 1 October 2012;
- draft Terms of the ARL Equity Notes (Note Terms) dated 8 May 2013;
- draft Trust Deed relating to the ARL Equity Notes (Trust Deed) dated 19 September 2012; and
- additional correspondence received from Minter Ellison.

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. ARL is an unlisted public company which is an Australian resident under subsection 6(1) of the ITAA 1936.

11. ARL is the head company of the ARL tax consolidated group which consolidated effective from 1 July 2009.

12. ARL provides a range of services to independent retailers that are members of ARL. ARL's principal business activities are:

- (i) the sale and distribution of menswear, womenswear, footwear, homeware, sporting, leisure and lifestyle goods, toys and bicycles to members; and
- (ii) retailing and marketing services to members.

13. The members of ARL are a mix of individuals, companies, trusts and partnerships.

14. ARL has at least 650 members. Further, based on ARL's members register as at 30 June 2012 there does not appear to be any individual or up to 20 individuals who own between them, directly or indirectly, 75% of the voting rights in ARL.

15. As at 30 June 2012, the total issued share capital of ARL was approximately 29,960 Ordinary Shares and 41,050 Redeemable Preference Shares.

16. The approximate allocation of resident and non-resident shareholders of ARL is 93.18% resident and 6.82% non-resident. Approximately 3.74% of the Ordinary Shares on issue are held by members who are non-residents (being residents of New Zealand) and 7.34% of the Redeemable Preference Shares are held by members who are non-residents (being residents of New Zealand).

17. As at the date of issue of the Notes, ARL will not have any other class of shares on issue other than the Ordinary Shares and Redeemable Preference Shares, nor will it have on issue any options over any of its shares.

18. The purpose of the issue of the Notes is to raise capital.

19. The Notes will be issued between 1 July 2012 and 30 June 2014 for an Issue Price to be set by ARL. The Notes will not be quoted on any financial market.

20. The Notes will not be subject to any restrictions of their transfer; however, the directors of ARL have an absolute discretion to refuse to register any transfer of the Notes.

21. The Notes rank equally amongst themselves and with the claims of Equal Ranking Securities and ahead of the claims of Ordinary Shareholders and Redeemable Preference Shareholders.

22. ARL may redeem some or all of the Notes at its option after each of the first, second, third and fourth anniversaries of the Issue Date and at any time if a Change of Control Event, a Regulatory Event or a Tax Event has occurred. ARL must redeem the Notes on the Maturity Date.

23. The Maturity Date is to occur no later than 31 January 2019. This means the Notes will have a term of approximately five years.

24. The Notes will be redeemed for the Liquidation Amount and the Liquidation Amount is to be paid in cash to the Note Holders.

25. The Liquidation Amount is equal to the sum of any Note Distribution due and unpaid at Redemption plus the Principal Amount.

26. The Principal Amount in relation to a Note means the lesser of:

- (a) the Face Value of that Note plus the Redemption Premium; and
- (b) the amount calculated by ARL using the formula set out under the Note Terms.

27. The Liquidation Amount will therefore consist of the following components:

- (i) the Note Distributions due and unpaid at the time (being either the Realisation Date, the Maturity Date or the commencement of the winding up of ARL, each of which results in a Redemption); and
- (ii) the Principal Amount which will consist of:
 - (a) a component up to the issue price per Note at the time of Redemption, which may be less than the issue price depending upon movements in the parameters of the formula set out under the Note Terms (**Capital Redemption**); and
 - (b) a potential component in excess of the Capital Redemption amount (**Redemption Distribution**).

28. ARL will credit the proceeds from the issue of the Notes to a separate non-share capital account in its balance sheet. Upon Redemption, the Capital Redemption amount will be debited to this account.

29. It is expected that the Notes will be offered to existing members of ARL, however, there exists the possibility that other investors may acquire the Notes, which may for example include a complying superannuation fund of which the relevant ARL member is also a member. ARL will therefore consider applications to subscribe for the Notes from non-members.

30. If there are material commercial disadvantages in offering the Notes to non-resident members of ARL, with an address registered outside Australia (for example, New Zealand residents), there exists the potential that the offer will be limited only to the Australian public and to members of ARL who have a registered address in Australia.

31. Note Distributions to be paid to Note Holders in respect of a Distribution Period are to be determined in accordance with the formula set out in the Note Terms.

32. The Note Terms require Distributable Profits to be greater than \$100,000 before a Note Distribution is payable.

33. A Distribution Period in respect of a Note means:

- (i) for the first Distribution Period applicable to a Note issued before 1 July 2014, the Issue Date of the Note to (but excluding) the first Distribution Calculation Date in respect of that Note;

- (ii) for each subsequent Distribution Period in respect of a Note issued before 1 July 2014, the period from (and including) each Distribution Calculation Date of the Note on or after the first Distribution Calculation Date of the Note (but excluding) the immediately following Distribution Calculation Date of the Note;
- (iii) for the first Distribution Period applicable to a note issued on or after 1 July 2014, the Issue Date of the Note to (but excluding) the first Distribution Calculation Date after the Issue Date in respect of that Note; and
- (iv) for each subsequent Distribution Period applicable to a Note issued on or after 1 July 2014, the period from (and including) each Distribution Calculation Date on or after the first Distribution Calculation Date after the Issue Date to (but excluding) the immediately following Distribution Calculation Date.

34. Note Distributions will be made on the Notes once for each financial year ending 30 June and Note Distributions will be paid annually.

35. Note Distributions are to be paid in respect of Distribution Periods on the Distribution Calculation Date. The Distribution Calculation Date for each Distribution Period is:

- (i) in respect of the first Distribution Period, 30 June 2014;
- (ii) in respect of each subsequent Distribution Period, each 30 June until the Maturity Date;
- (iii) the Realisation Date; and
- (iv) the Maturity Date.

36. ARL must pay a Note Distribution in respect of each Distribution Period if each of the following conditions are satisfied:

- (i) the payment of the Note Distribution will not constitute or result in ARL becoming, or likely to become, insolvent for the purposes of the *Corporations Act 2001*; and
- (ii) the public announcement of Distributable Profits as set out in or derived from the audited or reviewed financial statements of ARL for that Distribution Period occurs. ARL is required to make this public announcement within 4 months of the Distribution Calculation Date; and
- (iii) the amount of Distributable Profits for the Distribution Period in respect of the Note Distribution is equal to or greater than \$100,000. This condition exists solely to ensure that ARL is not required to distribute an immaterial amount, where the administration costs would not warrant the making of the distribution.

37. The Distributable Profits in respect of:

- (i) a Distribution Period (other than the Final Distribution Period), means the profits, reserves and other accounts of ARL in respect of that Distribution Period (as assessed by the directors) out of which dividends may be paid as if the Note Distributions were dividends in respect of shares in ARL; or
- (ii) the Final Distribution Period, means the profits, reserves and other accounts of ARL in respect of the Distribution Period last occurring before the Final Distribution Period out of which dividends may be paid as if the Note Distributions were dividends in respect of shares in ARL.

38. The Note Distributions are non-cumulative. If all or part of a Note Distribution is not paid on a Distribution Date because the conditions to make the Note Distribution are not satisfied at the relevant time, ARL has no liability to pay the unpaid amount of the Note Distribution and Note Holders will not have any claim in respect of such non-payment.

39. ARL has not in recent times paid a dividend or made any other franked distributions and it does not expect to frank distributions on its shares (being, its Ordinary Shares and Redeemable Preference Shares) in the near future. However, it is not precluded under its Constitution from paying a dividend on either the Ordinary Shares or Redeemable Preference Shares on issue.

Other matters

40. This Ruling is made on the basis that:

- (a) the Notes are non-share equity interests in ARL pursuant to the definition of that term in subsection 995-1(1) of the ITAA 1997;
- (b) the Notes are not traditional securities for the purposes of sections 26BB and 70B of the ITAA 1936;
- (c) any Note Distribution or Redemption Distribution paid to Note Holders will be a non-share dividend pursuant to section 974-120 of the ITAA 1997;
- (d) immediately before the payment of a non-share dividend, ARL will have available frankable profits to pay the non-share dividend at least equal to the amount of the franked distribution; and
- (e) the terms and conditions under which the Notes were originally issued will not be altered in any material way during the period in which this Ruling applies.

Ruling

Frankable distributions

41. Any Note Distribution and Redemption Distribution will be a frankable distribution under subsection 202-40(2) of the ITAA 1997 and therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

Imputation benefits – streaming of imputation benefits

42. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of any imputation benefits received by a Note Holder in respect of a franked component of a Note Distribution or a Redemption Distribution.

Determination under paragraph 177EA(5)(b)

43. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received by a Note Holder in respect of a franked component of a Note Distribution or a Redemption Distribution.

Section 45A

44. The Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole or part of a Capital Redemption amount as an unfranked dividend in the hands of a Note Holder.

Section 45B

45. The Commissioner will not make a determination under subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole or part of a Capital Redemption amount as an unfranked dividend in the hands of a Note Holder.

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.*

Frankable distributions

46. The Notes are non-share equity interests pursuant to the definition of that term in subsection 995-1(1) of the ITAA 1997.

47. A Note Distribution or Redemption Distribution paid to Note Holders will be a non-share dividend pursuant to section 974-120 of the ITAA 1997.

48. Pursuant to subsection 202-5 of the ITAA 1997, an entity will be taken to have franked a distribution where the following conditions are satisfied:

- (a) the entity is a franking entity that satisfies the residency requirement when the distribution is made; and
- (b) the distribution is a frankable distribution; and
- (c) the entity allocates a franking credit to the distribution.

49. The term 'franking entity' is defined pursuant to section 202-15 of the ITAA 1997 and specifically includes a 'corporate tax entity'. The term 'corporate tax entity' is itself defined pursuant to section 960-115 of the ITAA 1997 to include companies.

50. The 'residency requirement' stipulated in paragraph 202-5(a) of the ITAA 1997 is set-out in section 202-20 of the ITAA 1997. Insofar as it applies to a company, it prescribes that the company must be an Australian resident when making a distribution.

51. On the basis of the information provided, ARL is a resident public company so will be both a corporate tax entity as defined in section 960-115 of the ITAA 1997 and will satisfy the residency requirement contained in section 202-20 of the ITAA 1997.

52. ARL will therefore satisfy the requirements of paragraph 202-5(a) of the ITAA 1997.

53. The term 'frankable distribution' is defined pursuant to section 202-40 of the ITAA 1997. It provides that a non-share dividend is a frankable distribution to the extent that is not unfrankable under section 202-45 of the ITAA 1997.

54. Any Note Distribution or Redemption Distribution paid to Note Holders will be a non-share dividend pursuant to section 974-120 of the ITAA 1997 (on the basis that neither amount will be sourced from or debited to ARL's non-share capital account or share capital account).

55. A distribution will be unfrankable if it falls within any of the circumstances listed in section 202-45 of the ITAA 1997. There is no specific circumstance listed within section 202-45 which would cause either a Note Distribution or a Redemption Distribution to be an unfrankable non-share dividend.

56. However, paragraph 202-45(f) of the ITAA 1997 provides that a distribution will be unfrankable if section 215-15 of the ITAA 1997 applies. Section 215-15 of the ITAA 1997 states that a non-share dividend will be unfrankable where a corporate tax entity pays a non-share dividend and immediately before the payment, the amount of the available frankable profits of the entity is nil or less than nil.

57. On the basis of the information provided, ARL will have available frankable profits to pay any non-share dividend at least equal to the amount of the franked distribution, immediately before the payment of the non-share dividend.

58. In these circumstances section 215-15 of the ITAA 1997 will not apply and consequently paragraph 202-45(f) of the ITAA 1997 should also not apply.

59. Therefore, any Note Distribution or Redemption Distribution will constitute a frankable distribution as defined under subsection 202-40(2) of the ITAA 1997 satisfying the requirements of paragraph 202-5(b) of the ITAA 1997.

60. Provided ARL allocates franking credits to a Note Distribution or a Redemption Distribution (pursuant to paragraph 202-5(c) of the ITAA 1997), such distributions will be capable of being franked in accordance with section 202-5 of the ITAA 1997.

Imputation benefits – streaming of imputation benefits

61. Subdivision 204-D of the ITAA 1997 enables the Commissioner to make a determination to either impose a franking debit or deny an imputation benefit where distributions with imputation benefits are streamed to a member of a corporate tax entity in preference to another member.

62. Section 204-30 of the ITAA 1997 prescribes the circumstances that are required to exist before the Commissioner may make such a determination. Section 204-30 of the ITAA 1997 applies where an entity 'streams' the payment of distributions in such a way that:

- an 'imputation benefit' is, or apart from section 204-30 of the ITAA 1997 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- the member (favoured member) would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); and

- the other member (disadvantaged member) of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c) of the ITAA 1997).

63. On the basis of the information provided, any Note Distribution or Redemption Distribution made to a Note Holder is expected to be fully franked. As such, a Note Holder will receive an imputation benefit as a result of receiving such distributions.

64. This is on the basis that any Australian resident Note Holder should receive the benefit of a tax offset (as set-out in paragraph 204-30(6)(a) of the ITAA 1997) or receive a franking credit to their franking account (as set-out in paragraph 204-30(6)(c) of the ITAA 1997) as a result of receiving a Note Distribution or a Redemption Distribution.

65. Any non-resident Note Holder should receive an imputation benefit in the form of an exemption from dividend withholding tax (as set-out in paragraph 204-30(6)(e) of the ITAA 1997).

66. Streaming is not defined for the purposes of Subdivision 204-D of the ITAA 1997. However, the Commissioner understands it to refer to a company 'selectively directing the flow of franked distributions to those members who can most benefit from imputation credits' (paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002).

67. Subsection 204-30(8) of the ITAA 1997 provides a non-exhaustive list (see subsection 204-30(7) of the ITAA 1997) of circumstances where a member of an entity will be considered to derive a greater benefit from franking credits than another member of the entity.

68. Paragraph 204-30(8)(a) of the ITAA 1997 states that a member derives a greater tax benefit from franking credits than another member of the entity where the other member is a foreign resident.

69. On the basis of the information provided, the Notes are going to be offered primarily to ARL's existing members. ARL's membership comprises at least 650 entities which is a mix of individuals, companies, trusts and partnerships. The majority of which (93.18%) are Australian resident entities. Consequently, it is clear that while the vast majority of existing members will be capable of effectively utilising the franking credits attached to Note Distributions or Redemption Distributions, the small portion (6.82%) of foreign residents will not.

70. However, from the information provided, a Note Holder will receive a fully franked Note Distribution or fully franked Redemption Distribution regardless of their tax attributes or their individual tax position.

71. Further, ARL's distribution policies in relation to the franking of dividends or distributions on ordinary share capital and its redeemable preference shares are not expected to change as a result of the issuance of the Notes.

72. As the Notes will be offered to existing ARL members (albeit there is the possibility of the Notes being offered to other investors outside the current ARL membership) it is expected that investors in the Notes will broadly reflect resident to non-resident ratio among ARL's current members.

73. Based on the information provided, the Commissioner has concluded that the requisite element of streaming does not exist in relation to any imputation benefits attached to a Note Distribution or a Redemption Distribution. Accordingly, the Commissioner will not make a determination under paragraph 230-30(3)(c) of the ITAA 1997 to deny imputation benefits to Note Holders.

Determination under paragraph 177EA(5)(b)

74. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies where one of the purposes (other than an incidental purpose) of a scheme is to enable a relevant taxpayer to obtain an imputation benefit.

75. Where such a purpose exists, paragraph 177EA(5)(b) of the ITAA 1936 enables the Commissioner to make a determination to deny the whole, or any part, of any imputation benefit on the distribution that flows directly or indirectly to the relevant taxpayer.

76. Pursuant to subsection 177EA(3) of the ITAA 1936, the provision applies if the following conditions are satisfied:

- (a) there is scheme for the disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in the membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for section 177EA of the ITAA 1936, the person (the relevant taxpayer) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and

- (e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

77. The term 'scheme for a disposition' as used in paragraph 177EA(3)(a) of the ITAA 1936 is defined pursuant to subsection 177EA(14) of the ITAA 1936. Here the term is defined widely and includes the issuing of a membership interest or creating an interest in a membership interest.

78. Paragraph 177EA(3)(a) of the ITAA 1936 refers to a disposition of a membership interest in a 'corporate tax entity'. Pursuant to section 960-115 of the ITAA 1997, a 'corporate tax entity' includes a company.

79. Further, subsection 177EA(12) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies to non-share equity interests, equity holders and non-share dividends in the same way as it applies to membership interests, members and distributions. The Notes constitute non-share equity interests, which for the purposes of section 177EA of the ITAA 1936 are to be treated in the same manner as membership interests. Consequently, the issuance of the Notes by ARL will represent a disposition of a membership interest.

80. On the basis of the information presented, the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, 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, did so for a more than merely incidental purpose of enabling a Note Holder to obtain an imputation benefit.

81. Circumstances which are relevant in determining whether any person had the requisite purpose include, but are not limited to, the factors listed in subsection 177EA(17) of the ITAA 1936.

82. The relevant circumstances listed encompass a range of circumstances which taken individually or collectively could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may or may not be present at any one time in relation to a particular scheme.

83. Based on the information presented, the Commissioner's consideration of all the relevant circumstances of the scheme would not, on balance, lead to a conclusion that the purpose of enabling Note Holders to obtain imputation benefits is more than incidental to ARL's purpose of raising capital.

84. Accordingly, the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or part, of any imputation benefit attaching to a Note Distribution or Redemption Distribution.

Section 45A

85. Section 45A of the ITAA 1936 applies in circumstances where a company streams the provision of capital benefits to certain shareholders who derive a greater benefit from the receipt of capital (the advantaged shareholders) and it is reasonable to assume that the other shareholders have received or will receive dividends (the disadvantaged shareholders).

86. The Commissioner may make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies. The effect of such a determination is that the capital benefit is taken to be an unfranked dividend.

87. Paragraph 43B(1)(a) of the ITAA 1936 stipulates that Subdivision D of Division 2 of the ITAA 1936 applies to a non-share equity interest in the same way it applies to a share.

88. Further, subsection 45A(3A) of the ITAA 1936 provides that for the purposes of section 45A of the ITAA 1936, a non-share distribution to an equity holder is taken to be the distribution to the equity holder of share capital to the extent to which it is a non-share capital return.

89. Consequently, section 45A of the ITAA 1936 can potentially apply to Note Holders in regards to the receipt of a Capital Redemption amount.

90. The Capital Redemption amount to be paid to Note Holders at the redemption of a Note is but one component of the Principal Amount. The second component of the Principal Amount is the Redemption Distribution. The Capital Redemption amount will be debited to ARL's non-share capital account and will not exceed the issue price of each Note. Any amounts exceeding the Capital Redemption amount constitute the Redemption Distribution which will be sourced from and debited to the current or retained profits of ARL and will be a frankable non-share dividend.

91. Therefore, a Capital Redemption amount will constitute the provision of a capital benefit as defined in paragraph 45A(3)(b) of the ITAA 1936.

92. Under the scheme set out in paragraphs 9 to 40 of this Ruling, the Capital Redemption amounts will be paid to all Note Holders in direct proportion to their individual holdings and all Capital Redemption amounts will be sourced from and debited to ARL's non-share capital account at the time of Redemption. Note holders will not be presented with a choice of receiving either a distribution of non-share capital or a distribution of profits dependant upon their tax profiles.

93. Accordingly, the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936, as section 45A of the ITAA 1936 is not applicable to the issuance of the Notes.

Section 45B

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

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

- 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);
- under the scheme, a taxpayer (the relevant 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
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

95. Paragraph 43B(1)(a) of the ITAA 1936 stipulates that Subdivision D of Division 2 of the ITAA 1936 applies to a non-share equity interest in the same way it applies to a share.

96. Further, subsection 45B(7) of the ITAA 1936 provides that, for the purposes of the application of section 45B of the ITAA 1936, a non-share distribution to an equity holder is taken to be a distribution to an equity holder of share capital to the extent to which it is a non-share capital return.

97. Consequently, section 45B of the ITAA 1936 can potentially apply to transactions which involve non-share capital returns.

Scheme

98. A 'scheme' for the purposes of section 45B of the ITAA 1936 is taken to have the same meaning as provided in subsection 177A(1) of the ITAA 1936. That definition is widely drawn and includes any agreement, arrangement, understanding, promise, undertaking, scheme, plan or proposal.

99. The payment of a Capital Redemption amount under the terms of the Notes would constitute a scheme for the purposes of paragraph 45B(2)(a) of the ITAA 1936.

Capital benefit

100. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936. It states that a person is provided with a capital benefit if:

- (a) an ownership interest in a company is issued to the person;
- (b) there is a distribution to the person of share capital; or
- (c) the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest (which may or may not be the same interest) held by that person.

101. ARL will debit any Capital Redemption amount payable on a Note to its non-share capital account. As such any Note Holder in receipt of such an amount will be provided with a capital benefit pursuant to paragraph 45B(5)(b) of the ITAA 1936.

Tax benefit

102. A taxpayer '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 had instead been a dividend.

103. On the basis of the information provided by ARL it is likely that Note Holders will obtain tax benefits from being provided a Capital Redemption payment, rather than a non-share dividend. A non-share dividend would generally be included in the assessable income of a resident Note Holder, or in the case of a non-resident Note Holder, be subject to dividend withholding tax under section 128B of the ITAA 1936.

104. However, generally, a return of non-share capital would be subject to the CGT provisions of the income tax law. Unless the amount of the return of non-share capital exceeds the cost base of the Notes, there will only be a cost base reduction under CGT event G1 (section 104-135 of the ITAA 1997). It is only to the extent (if any) that the return of non-share capital exceeds the cost base of the Notes that a capital gain arises.

105. Additionally, a capital gain may not arise at all for certain foreign resident Note Holders.

Relevant circumstances

106. Under paragraph 45B(2)(c) of the ITAA 1936, the Commissioner is required to consider the 'relevant circumstances' set out in subsection 45B(8) of the ITAA 1936 to determine whether any part of the scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

107. The list of relevant circumstances in subsection 45B(8) of the ITAA 1936 is not exhaustive and regard may be had to other circumstances on the basis of their relevance.

108. The test of purpose is an objective one. The question is whether it would be concluded that a person who entered into or carried out the scheme did so for the purpose of obtaining a tax benefit for the relevant taxpayer. This requisite purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

109. The purpose which causes section 45B of the ITAA 1936 to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is only concerned with the purpose of ARL. The Commissioner cannot at this juncture ascertain the purposes of each of the potential investors who are likely to take up the invitation to become Note Holders.

110. Nevertheless, in a case such as this, an objective conclusion as to the purpose of ARL should, generally speaking, not be inconsistent with an objective conclusion as to the purpose of potential Note Holders.

111. The relevant circumstances under subsection 45B(8) of the ITAA 1936 cover the circumstances of the company and the tax profile of Note Holders. On the basis of the information provided by ARL it is clear that the circumstances set-out in paragraphs 45B(8)(i) and 45B(8)(j) of the ITAA 1936 are not relevant to the distribution of any Capital Redemption amount.

112. Additionally, since the Capital Redemption amount will be paid to each Note Holder in respect of their Notes at the time of Redemption regardless of their individual tax circumstances, it is considered that paragraphs 45B(8)(c) to 45B(8)(f) of the ITAA 1936 will not be relevant in determining the objective purpose of ARL in entering into or carrying out the scheme.

113. Consequently, the relevant matters that need to be considered are those set-out in paragraphs 45B(8)(a), 45B(8)(b), 45B(8)(h) and 45B(8)(k) of the ITAA 1936.

114. Paragraph 45B(8)(a) of the ITAA 1936 refers to the extent to which the capital benefit is attributable to capital and profits (realised or unrealised) of the company or an associate of the company (within the meaning of section 318 of the ITAA 1936).

115. On the basis of the information presented, it should be reasonable to attribute any Capital Redemption amount payable on Redemption of a Note and debited to the non-share capital account, to the issue proceeds of the Note (example. the amount of non-share capital that was raised when the Note Holder subscribed for the Note).

116. The total amount of non-share capital to be returned by ARL upon Redemption of each Note will be debited to its non-share capital account and will not exceed the subscription proceeds from each Note issued.

117. As a result, this circumstance does not point towards a purpose of enabling a Note Holder to obtain a tax benefit through the disguising of a distribution of profits as a return of capital.

118. Paragraph 45B(8)(b) of the ITAA 1936 refers to the pattern of distributions made by a company or an associate of the company (within the meaning of section 318 of the ITAA 1936). ARL has not in recent times (at least the last 10 years) paid a dividend or made any other franked distributions and it does not expect to frank distributions on its shares (being its Ordinary Shares and its Redeemable Preference Shares) in the near future. The reason for this being, to allow ARL to reinvest profits with a view to offering larger discounts to its members. Thereby, providing members with greater buying and marketing power and enabling them to compete more effectively with larger retailers.

119. Under the scheme set out in paragraphs 9 to 40 of this Ruling, the Capital Redemption amounts will be paid to all Note Holders in direct proportion to their individual holdings and all Capital Redemption amounts will be sourced from and debited to ARL's non-share capital account at the time of Redemption.

120. Accordingly, this circumstance does not point towards a purpose of enabling a Note Holder to obtain a tax benefit.

121. Paragraph 45B(8)(h) seeks to determine the effect of a distribution upon the capital structure of the entity. Following the Redemption of the ARL Equity Notes all rights conferred or restrictions imposed by the relevant Notes will no longer have effect. Furthermore, the Notes which have been redeemed will be cancelled and may not be reissued, thereby altering the capital structure of ARL. This suggests that the redemption represents a genuine return of non-share capital rather than a disguised distribution of profits.

122. Paragraph 45B(8)(k) of the ITAA 1936 refers to the matters in subparagraphs 177D(b)(i) to 177D(b)(viii) of the ITAA 1936. These are matters by reference to which a scheme is able to be examined from a practical perspective in order to identify and compare its tax and non-tax objectives. The matters include the manner in which the scheme is carried out, its form and substance, and its financial implications for the parties involved.

123. From the facts presented to the Commissioner, both the form and substance of any payment of a Capital Redemption amount will be consistent with it being a distribution of non-share capital and not attributable to the profits of ARL. Nor will it be a payment made in substitution for a dividend.

124. Accordingly, it cannot be concluded that ARL or a Note Holder will enter into or carry out the relevant scheme for the purpose of enabling a Note Holder to obtain a tax benefit.

125. As such, 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 any part of any Capital Redemption amount.

Appendix 2 – Detailed contents list

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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Subject references:

- frankable distributions
- dividend streaming arrangements

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ATOlaw topic: Income Tax ~~ Assessable Income ~~ dividend, interest
and royalty income
Income Tax ~~ Entity specific matters ~~ franking of
dividends – company matters
Income Tax ~~ Tax integrity measures ~~ debt and equity
interests