

CR 2013/68 - Income tax: cancellation of shares in Tower Limited

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Class Ruling

Income tax: cancellation of shares in Tower 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; and
- section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997).

All subsequent 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 TOWER Limited (TOWER) who:

- are listed on the share register of TOWER as at the Record Date (5 April 2013);
- are residents of Australia as defined in subsection 6(1) on that date;
- are not temporary residents of Australia within the meaning of the term 'temporary resident' of Australia in subsection 995-1 of the ITAA 1997;
- hold their TOWER shares on capital account on the Record Date; and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their TOWER shares.

(Note – Division 230 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 8 to 26 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.

Date of effect

7. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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

8. 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:

- Class Ruling Application dated 12 April 2013 and correspondence provided to the ATO up to 22 July 2013;
- Timeline for the scheme of arrangement, including indicative timetable for the scheme of arrangement to effect the capital return;
- Ruling from the New Zealand Inland Revenue Department (IRD) as to the tax treatment of the arrangement, dated 22 February 2013;
- Extract from explanatory note to shareholders;
- Financial statements of TOWER for the year ended 30 September 2012;
- Financial statements of TOWER Health & Life (THL) for the year ended 31 December 2012;
- Interim Financial Statements for TOWER for the financial year ended 31 March 2013;
- The November Trial Balance for TOWER Medical Insurance Limited (TMIL);
- Draft note for the financial statements of TOWER for the half year ending 31 March 2013 to disclose the sale of TMIL;
- Dividend payment history; and
- Announcements to the ASX and NZX regarding approval of the arrangement by TOWER shareholders and the New Zealand High Court.

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

Background

9. TOWER is a public company listed on both the NZX and the ASX. It is incorporated in New Zealand and is a tax resident of New Zealand.

10. The ownership of TOWER is widely distributed with the largest shareholding being approximately 35%. The majority of shareholders are resident outside Australia (74%), with Australian shareholders holding approximately 26% of TOWER shares.

11. TOWER has one class of ordinary shares which rank equally in all respects.

12. In December 2012, TOWER made an application to the High Court of New Zealand seeking court approval of a scheme of arrangement under Part 15 of New Zealand's *Companies Act 1993* (Companies Act) for a capital reduction by way of a pro rata cancellation of all ordinary shares held in TOWER.

13. The scheme has been considered by the NZX and the ASX, and approved by TOWER shareholders by a special resolution and by an order of the New Zealand High Court.

14. Under New Zealand's *Insurance (Prudential Supervision) Act 2010*, insurers are required to have an approved financial strength rating. TOWER has been advised that its issuer credit rating will not be affected by the implementation of the scheme of arrangement.

15. The cancellation of the TOWER shares pursuant to the scheme was completed by 8 April 2013.

16. As at 30 November 2012, TOWER had 269,091,094 fully paid ordinary shares on issue.

17. As at 30 November 2012, there were 51,746 shareholders in TOWER. Of this number, approximately 80% of shareholders by number held 1,000 shares or fewer.

Return of Capital

18. In August 2009, TOWER raised NZ\$81.3 million through a renounceable rights issue of ordinary shares. The shares were offered at NZ\$1.34 per share. The capital was raised specifically for the purpose of giving TOWER the financial flexibility needed for any strategic opportunities that might have arisen.

19. Despite a thorough and diligent process to analyse and pursue acquisition opportunities, no acquisitions occurred, and the Board has determined that no suitable opportunities existed, or were likely to arise in the short to medium term. Of the NZ\$81.3 million raised, NZ\$17 million remains as surplus, with the rest used in general working capital and for the recapitalisation of TOWER Insurance Limited.

20. In November 2012, TOWER sold its health insurance business, TMIL for approximately NZ\$103.1 million. A strategic review of the TOWER business identified that it was preferable from an accounting, capital and administrative efficiency point of view to divest TMIL. At the accounting group level, the sale of TMIL resulted in a profit of approximately NZ\$18.8 million. The Board of TOWER considered the proceeds from the sale of TMIL, and NZ\$17 million remaining from the capital raised in 2009 to be surplus to TOWER's requirements.

21. Under the arrangement, approximately NZ\$120 million of excess capital was returned to all TOWER shareholders on a pro rata basis. This was undertaken as a cancellation of three shares for every 13 shares held by all TOWER shareholders. Some minimal rounding occurred where the number of shares held by a TOWER shareholder was not divisible by 13 to ensure that only whole shares were cancelled.

22. TOWER paid each TOWER shareholder NZ\$1.92 for each cancelled share registered in the name of that shareholder, being the volume weighted average price for the five trading days prior to 29 November 2012, being the date on which the return of capital was announced by TOWER. TOWER Australian Shareholders were paid in Australian dollars at the conversion rate applicable on the Record Date.

23. The amount returned to shareholders under the Arrangement was recorded by TOWER as a reduction to contributed equity. The journal entries giving effect to the return of capital were as follows:

DR Contributed equity \$119,227,499.52

CR Cash \$119,227,499.52

24. The actual amount paid on the share cancellation was \$119,227,499.52.

25. TOWER has advised that its share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

Other matters

26. TOWER has paid dividends each year since 2007. On 1 February 2013, TOWER paid a final dividend for the year ended 30 September 2012 of NZ\$0.06 per share.

Ruling

Distributions are not dividends for income tax purposes

27. The return of capital made to TOWER Australian shareholders will not be a dividend, as defined in subsection 6(1).

The application of section 45A, 45B and 45C to the return of capital

28. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole or any part of 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 (CGT) consequences

29. CGT event C2 (section 104-25 of the ITAA 1997) happened when a TOWER Australian Shareholder's share was cancelled under the Arrangement.

30. The capital proceeds received by a TOWER Australian Shareholder in respect of the cancellation of their TOWER share was NZ\$1.92 per share.

31. A TOWER Australian Shareholder made a capital gain if the capital proceeds for the cancellation of their TOWER share was more than the cost base of that share. The capital gain is equal to the amount of the excess.

32. A TOWER Australian Shareholder made a capital loss if the capital proceeds from the cancellation of their TOWER share was less than the reduced cost base of that share. The capital loss is equal to the amount of the difference.

Commissioner of Taxation

4 September 2013

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.*

Distributions are not dividends

33. 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).

34. The term 'dividend' is defined in subsection 6(1) and 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.

35. The term 'share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

36. The return of capital was recorded as a debit to TOWER's share capital account. Paragraph (d) of the definition of 'dividend' in subsection 6(1) will apply. Accordingly, the return of capital will not be a dividend, as defined in subsection 6(1).

Anti-avoidance provisions

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

Section 45A – streaming of dividends and capital benefits

38. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the receipt of capital than other shareholders (the Disadvantaged Shareholders), and these Disadvantaged Shareholders receive, or are likely to receive, dividends.

39. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) to include the distribution to the shareholder of share capital. TOWER provided TOWER Australian shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b) when TOWER paid the return of capital to TOWER Australian shareholders. The capital benefit was provided to all of its shareholders in the same proportion as their shareholdings.

40. Therefore, section 45A will not apply to the return of capital and 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 return of capital.

Section 45B – schemes to provide capital benefits

41. Section 45B applies where certain capital payments, including a return of capital, are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- under the scheme a 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)); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

Scheme

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

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

- an ownership interest in a company is issued to a person;
- there is a distribution to the person of share capital; or

- 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.

44. As the return of capital was debited wholly to TOWER's share capital account, TOWER has provided TOWER Australian shareholders with a capital benefit under paragraph 45B(5)(b) in the form of a distribution of share capital.

Tax benefit

45. A relevant taxpayer 'obtains a tax benefit' as defined in subsection 45B(9) 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, be less than the amount that:

- would have been payable; or
- would be payable at a later time than it would have been payable;

if the capital benefit had instead been a dividend.

46. The distribution to TOWER Australian Shareholders was a return of capital payment and therefore constitutes a capital benefit. Had the distribution been a dividend rather than a capital benefit, it is likely that the amount of tax payable by TOWER Australian Shareholders would have been greater.

47. Ordinarily, a share cancellation would be subject to the CGT provisions of the income tax law. It is only to the extent (if any) that the capital proceeds exceed the cost base of the shares that a capital gain arises. If the capital proceeds are less than the reduced cost base of the cancelled shares, a capital loss will arise. By contrast, a dividend would generally be included in the assessable income of a resident shareholder. Therefore, the receipt of the capital benefit by TOWER Australian Shareholders results in those shareholders obtaining a tax benefit.

Relevant circumstances

48. Paragraph 45B(2)(c) requires the Commissioner to consider the 'relevant circumstances' of the scheme as set out in subsection 45B(8). A consideration of these circumstances determines whether any part of the scheme was entered into for a purpose, other than an incidental purpose, of enabling the relevant taxpayer (that is TOWER Australian Shareholders) to obtain a tax benefit.

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

50. The purpose which causes section 45B to apply may be the purpose of any party to the scheme. In this case, however, the Commissioner is concerned only with the purpose of TOWER. The Commissioner cannot ascertain the purposes of TOWER's numerous shareholders, all of whom participated in the return of capital. Nevertheless, in a case such as this, an objective conclusion as to the purpose of the company, generally speaking, should not be inconsistent with an objective conclusion as to the purpose of the shareholders, in particular those shareholders who voted in favour of the payment.

51. Having regard to the relevant circumstances of the scheme, as listed under subsection 45B(8), it cannot be concluded that TOWER entered into or carried out the scheme for a more than incidental purpose of enabling the TOWER Australian Shareholders to obtain a tax benefit.

52. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the whole or a part of the return of capital.

Section 45C

53. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) in relation to the scheme as described, section 45C will not apply to deem any part of the return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or of the ITAA 1997.

Capital Gains Tax

54. CGT event C2 (section 104-25 of the ITAA 1997) occurred on the implementation date for the return of capital, being the date on which TOWER Australian Shareholders' shares were cancelled.

55. The capital proceeds for the share cancellation should be the amount received by TOWER Australian Shareholders from TOWER for each share that was cancelled (being NZ\$1.92).

56. A capital gain arises if the capital proceeds from the cancellation were more than the cost base of the asset. Conversely, a capital loss arises if the capital proceeds from the cancellation were less than the reduced cost base of the asset. Accordingly, a TOWER Australian Shareholder made a capital gain (or capital loss) if the amount received from TOWER for the share cancellation was more than (or less than) the cost base (or reduced cost base) of those shares.

Appendix 2 – Detailed contents list

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

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References

<i>Previous draft:</i>	- ITAA 1936 45B(2)(a)
Not previously issued as a draft	- ITAA 1936 45B(2)(c)
	- ITAA 1936 45B(3)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(5)
TR 2006/10	- ITAA 1936 45B(5)(b)
	- ITAA 1936 45B(8)
	- ITAA 1936 45B(9)
<i>Subject references:</i>	- ITAA 1936 45C
- cancellation of shares	- ITAA 1936 Pt IVA
	- ITAA 1936 177A(1)
<i>Legislative references:</i>	- ITAA 1997 104-25
- ITAA 1936 6(1)	- ITAA 1997 Div 230
- ITAA 1936 44(1)	- ITAA 1997 995-1
- ITAA 1936 45A	- ITAA 1997 975-300
- ITAA 1936 45A(2)	- TAA 1953
- ITAA 1936 45A(3)(b)	- Copyright Act 1968
- ITAA 1936 45B	

ATO references

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