


CR 2015/110 - Income tax: The Village Building Co Limited - conversion of shares, variation of rights and selective capital reduction

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Class Ruling

Income tax: The Village Building Co Limited – conversion of shares, variation of rights and selective capital reduction

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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 provisions 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:

- section 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 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997)

- section 115-25 of the ITAA 1997, and
- Division 725 of the 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 are the holders of ordinary shares in The Village Building Co Limited (Village) who:

- held their Village ordinary shares on 23 November 2015 (Record Date) and were entitled to participate in the share conversion to Class B ordinary shares under the arrangement described in paragraphs 7 to 19
- held those Village shares on capital account
- are residents of Australia for tax purposes as defined in subsection 6(1), 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 Village shares.

(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)

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

Qualifications

4. The class of entities defined in this Ruling may rely on this Ruling provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 7 to 19 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.

Date of effect

6. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

7. 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.

Share capital of Village

8. Village is an Australian unlisted public company, limited by shares.

9. Village had two classes of shares on issue. As at 31 December 2014, the classes consisted of:

- 34,606,046 fully paid ordinary shares, and
- 15,720,000 convertible redeemable preference shares (CRPS).

10. The CRPS hold no voting rights until they are converted into ordinary shares.

11. Ordinary shares entitle the holder to a vote at a general meeting of the company and participate in dividends in proportion to the number of shares held.

Conversion of shares

12. Under an arrangement (the Scheme), Village has taken steps to convert the Village ordinary shares into Class A and Class B ordinary shares, vary the rights attaching to the Class B ordinary shares and amend the Constitution.

13. The steps taken in the Scheme at an Annual General Meeting of shareholders held on 23 November 2015 were:

- a special resolution was passed by the Village ordinary shareholders in accordance with section 246B of the *Corporations Act 2001* to:
 - divide the ordinary shares into Class A ordinary Shares and Class B ordinary Shares
 - create a new class of non-voting ordinary shares and conversion of certain existing ordinary shares held by accepting smaller shareholders to non-voting ordinary shares
 - amend the Constitution.
- a second special resolution was passed by all shareholders other than smaller shareholders in accordance with section 246B of the *Corporations Act 2001*, to create a new class of non-voting ordinary shares and conversion of certain existing ordinary shares to non-voting ordinary shares.

Return of capital

14. A special resolution was passed by Village Class A ordinary shareholders in accordance with section 256B and section 256C of the *Corporations Act 2001* to approve a selective capital reduction (return of capital).

15. On 11 December 2015 (Payment Date), participating Village shareholders received payment of \$0.12 per Class B ordinary share held, as consideration for converting their ordinary shares to Class B ordinary shares and therefore relinquishing their voting rights.

16. The share conversion and return of capital was undertaken for the following reasons:

- to reduce the number of holders of ordinary voting shares below 100 so the company ceases to be a disclosing entity pursuant to Part 1.2A of the *Corporations Act 2001*, and
- a reduction in administration and compliance costs.

Other matters

17. The share capital account of Village is not tainted within the meaning of section 197-50 of the ITAA 1997.

18. The return of capital was debited against Village's share capital account.

19. There is no single shareholder (or group of associated shareholders) that control at least 40% of rights in relation to the voting, dividend and capital distributions of Village.

Ruling

Return of capital is not a dividend

20. The return of capital paid to shareholders will not be a dividend, as defined in subsection 6(1).

The application of sections 45A, 45B and 45C

21. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the return of capital.

Capital gains tax

CGT event G1

22. CGT event G1 (section 104-135 of the ITAA 1997) will happen when Village pays the return of capital of \$0.12 to a participating Village shareholder in respect of a Village Class B ordinary share they own at the Record Date and continue to own at the Payment Date.

Value shifting

23. The conversion of shares and the variation of share rights will not have any direct value shifting consequences for participating Village shareholders because section 725-50 of the ITAA 1997 is not satisfied.

Commissioner of Taxation

16 December 2015

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.*

Return of capital is not a dividend

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

25. As the return of capital will be recorded as being wholly debited to Village's share capital account, and the account is not tainted, the return of capital of \$0.12 per share will not be a dividend.

Anti-avoidance provisions will not apply

26. 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.

Section 45A

27. 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.

28. Although there has been a 'provision of capital benefit' (as defined in subsection 45A(3)) to participating shareholders under the return of capital, the capital benefit would be provided to all participating Village shareholders in the same proportion as their shareholding. In addition the final dividend for the year ended 30 June 2015 will be paid equally to Class A ordinary shareholders and participating Village shareholders in the same proportion as their shareholding. Therefore, the circumstances of the return of capital indicate that there will be no streaming of capital benefits to some shareholders and of dividends to other shareholders.

29. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies.

Section 45B

30. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. 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)).

31. In the case of the return of capital, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, the requisite purpose of enabling the participating shareholder to obtain a tax benefit – by way of a capital distribution – is not present.

32. Having regard to the relevant circumstances of the scheme, set out in subsection 45B(8), it is apparent that the return of capital paid to participating Village shareholders is appropriate. Further, the return of capital cannot be said to be attributable to the profits of the company, nor does the pattern of distributions indicate that it is being paid in substitution for a dividend.

33. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies.

Section 45C

34. As the Commissioner will not make a determination under section 45A or 45B in relation to the scheme as described, section 45C will not apply to treat any part of the return of capital as an unfranked dividend for the purposes of the ITAA 1936 or the ITAA 1997.

Capital gains tax***Conversion of shares***

35. The conversion of the Village ordinary shares into Class B ordinary shares results in a variation of rights.

36. Shares are comprised of a bundle of rights, however, those rights are not separate pieces of property capable of being divided out and held separately. Accordingly, for CGT purposes, the rights attaching to shares do not constitute individual assets as defined in section 108-5 of the ITAA 1997, but rather combine to make up the ultimate asset, being the share (refer to Taxation Ruling TR 94/30).

Return of capital

CGT event G1 – section 104-135 of the ITAA 1997

37. CGT event G1 happens when a company makes a payment to a shareholder in respect of a share they own and some or all of the payment (the non-assessable part) is not a dividend or an amount that is taken to be a dividend under section 47.

38. Accordingly, CGT event G1 will happen when Village pays the return of capital to a participating Village shareholder in respect of a Village share that they own at the Record Date and continue to own at the Payment Date.

39. A participating Village shareholder will make a capital gain if the return of capital amount is more than the cost base of the shareholder's Village share. The amount of the capital gain is equal to that excess (subsection 104-135(3) of the ITAA 1997).

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

41. If the return of capital amount is equal to or less than the cost base of the Village share at the Payment Date, the cost base and reduced cost base of the ordinary share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

42. If the Village share was originally acquired by a participating Village shareholder at least 12 months before the payment of the return of capital, a capital gain from CGT event G1 may qualify as a discount capital gain under subsection 115-25(1) of the ITAA 1997, provided the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

Value shifting

43. Division 725 of the ITAA 1997 may apply where there is a direct value shift under a scheme involving equity interests in an entity. For Division 725 of the ITAA 1997 to have any possible consequences, paragraph 725-50(b) of the ITAA 1997 requires that a 'controlling entity test' be satisfied.

44. The 'controlling entity test' is satisfied for value shifting purposes if an entity (the controller) controls the target entity at some time starting when the scheme is entered into and ending when the scheme has been carried out (section 725-55 of the ITAA 1997).

45. Subdivision 727-E of the ITAA 1997 sets out the circumstances in which an entity will be regarded as controlling an entity for value shifting purposes. Section 727-355 of the ITAA 1997 contains the relevant tests for whether an entity controls a company. On the basis of the information provided, there are no shareholders who, individually or combined with their associates, control at least 40% of the dividend, voting or capital distribution rights in Village.

46. Accordingly, the 'control test' would not be satisfied and there are no direct value shifting consequences in respect of the transaction.

Appendix 2 – Detailed contents list

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

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References

- Previous draft:*
- ITAA 1997 Div 230
- Not previously issued as a draft
- ITAA 1997 104-135
 - ITAA 1997 104-135(3)
- Related Rulings/Determinations:*
- ITAA 1997 104-135(4)
 - ITAA 1997 108-5
 - ITAA 1997 197-50
 - ITAA 1997 Subdiv 115-A
- TR 94/30; TR 2006/10
- Legislative references:*
- ITAA 1936
 - ITAA 1936 6(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)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(3)
 - ITAA 1936 45B(8)
 - ITAA 1936 45C
 - ITAA 1936 47
 - ITAA 1997
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 - ITAA 1997 Div 725
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 - ITAA 1997 725-50(b)
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ATO references

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