


CR 2002/45W - Income tax: Selective Capital Reduction and Special Dividend

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Class Ruling

Income tax: Selective Capital Reduction and Special Dividend

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings** TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law(s) dealt with in this Class Ruling are:

- Section 45A of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 45B of the ITAA 1936;
- Section 177EA of the ITAA 1936;
- Section 104-25 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 116-30 of the ITAA 1997;
- Section 202-5 of the ITAA 1997;
- Section 202-40 of the ITAA 1997;
- Section 202-45 of the ITAA 1997; and
- Section 204-30 of the ITAA 1997

Class of persons

3. The class of persons to which this Ruling applies is the shareholders in George Weston Foods Limited ('GWFL') who are holders on the record date for the payment of the Special Dividend, as well as shareholders who participate in the Selective Capital Reduction, which together are referred to as the 'Arrangement' and are described in the Arrangement part of this Ruling.

4. It should be noted that this ruling does not address all the possible taxation consequences for all shareholders resulting from the Arrangement described below. Certain aspects of the ruling will cover shareholders in certain circumstances but will not cover all shareholders in all circumstances. In particular, in regard to the cancellation of shares under the Selective Capital Reduction, the Ruling does not cover shareholders who deal in shares in the ordinary course of their business.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 10 to 15 is carried out in accordance with the details of the arrangement provided in this Ruling.

7. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:

- (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled, and

- (b) this Ruling may be withdrawn or modified.

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Date of effect

9. This Class Ruling applies to the year of income ending 30 June 2003. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2003. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents:

- (a) The Class Ruling Application authored by Allens Arthur Robinson and dated 15 May 2002;
- (b) Information under covering letters from Allens Arthur Robinson and dated 30 May, 20 June & 3 July 2002.

12. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description.

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

13. GWFL is a public company listed on the ASX. As at 30 April 2002, there were 128.6 million GWFL shares quoted on the ASX, and 225,000 employee options outstanding. There were no other types of shares on issue.

14. For the last five years GFWL has generally maintained a constant annual dividend amount of 19 cents per share. It has also paid two special dividends of \$1.00 per share in the 1997 and 2001 years. In the current financial year GWFL declared an interim ordinary dividend of 9.5 cents per share fully franked, which was paid on 15 May 2002.

15. The shareholders' funds on GWFL's statement of financial position on a consolidated basis as at the half-year ended 31 January 2002 total \$679.944 million, consisting of retained profits of \$276.854 million, reserves of \$131.903 million and contributed equity of \$271.187 million. The balance of GWFL's franking account at this time was approximately \$190.4 million.

16. GWFL's shareholders are a mix of companies, trusts, superannuation funds and individuals and broadly consist of two groups, being the 'Majority Shareholder' and the 'Minority Shareholders'. Food Investments Pty Limited ('FIPL') is the Majority Shareholder and as at 27 September 2001 held approximately 81.25% of the shares in GWFL (60% of this interest was acquired prior to 20 September 1985). The Minority Shareholders consist of institutional investors, which held around 15% of the shares in GWFL as at 27 September 2001, and a diverse range of shareholders who held the balance of the shares on issue.

17. GWFL proposes to pay a Special Dividend of \$1.65 per share to all shareholders ('the Special Dividend Amount'), payment of which is conditional upon a Selective Capital Reduction being approved by shareholders. The Selective Capital Reduction will occur only in relation to the Minority Shareholders and will result in the payment of \$4.95 per share to each Minority Shareholder in return for the cancellation of their shares ('the Capital Reduction Amount'). Upon completion of the Arrangement FIPL will hold 100% of GWFL and will seek GWFL's delisting from the ASX.

18. The pricing of the Capital Reduction Amount is based on the expected market value of the shares at the time it is to be carried out on an ex dividend basis. The Special Dividend Amount was determined after reviewing GWFL's retained profits and franking credit surplus as at 31 January 2002.

19. The Special Dividend Amount will be debited entirely to retained profits and the Capital Reduction Amount will be debited entirely to the share capital account. GWFL will fund the arrangement itself and borrow from banks to meet any funding shortfall.

Ruling

The Special Dividend

20. The Special Dividend Amount of \$1.65 will constitute a frankable distribution pursuant to section 202-40 of the ITAA 1997, and therefore be capable of being franked in accordance with section 202-5 of the ITAA 1997.

21. The Commissioner will NOT make a determination pursuant to paragraph 204-30(3)(b) of the ITAA 1997 to deny the imputation benefits received in relation to the Special Dividend Amount by participating shareholders.

22. The Commissioner will NOT make a determination pursuant to paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the franking credit benefits received in relation to the Special Dividend Amount by participating shareholders.

Selective Capital Reduction

23. The Capital Reduction Amount of \$4.95 will be treated as the capital proceeds amount in relation to Capital Gains Tax (CGT) event C2 under section 104-25 of the ITAA 1997, which will occur at the time the relevant shares in GWFL are cancelled.

24. The amount by which the capital proceeds of \$4.95 exceeds the cost base of each share will be a capital gain to the shareholder which should be taken into account in calculating net capital gains or net capital losses to be included in the shareholder's assessable income.

25. Correspondingly, if the share's reduced cost base exceeds \$4.95 the difference will be a capital loss which should be taken into account in calculating net capital gains or net capital losses to be included in the shareholder's assessable income.

26. The Commissioner will NOT make a determination pursuant to sections 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole or any part of the Capital Reduction Amount to be received by minority shareholders.

Explanations

Special Dividend

27. GWFL is a 'franking entity' as defined in section 202-15 of the ITAA 1997, which also satisfies the residency requirement set out in section 202-20.

28. Subsection 6(1) of the ITAA 1936 provides that 'any distribution made by a company to any of its shareholders, whether in money or other property', would be treated as a dividend except where the distribution is debited against an amount standing to the credit of the share capital account of the company. Section 995-1 of the ITAA 1997 has a similar definition.

29. Paragraph 202-40(1) of the ITAA 1997 provides that a dividend within the meaning of the section 6 definition is a 'frankable

distribution' for the purposes of Part 3-6 of the ITAA 1997. No part of the distribution will be unfrankable under section 202-45 of the ITAA 1997.

30. The Special Dividend Amount will be a distribution made by GWFL to its shareholders which will be debited against its retained earnings account. Therefore the Special Dividend Amount will constitute a frankable distribution for the purposes of paragraph 202-40(1), and is capable of being franked in accordance with subsection 202-5 and subsection 202-60(1) of the ITAA 1997.

31. GWFL expects to fully frank the Special Dividend Amount, and therefore certain anti-avoidance provisions, in particular section 204-30 of the ITAA 1997 and section 177EA of the ITAA 1936, concerned with striking down arrangements which inappropriately provide franking credit benefits to a relevant taxpayer must be considered. These provisions allow the Commissioner to make a determination denying all or a part of a shareholder's entitlement to a franking credit, franking rebate, intercorporate dividend rebate or other such benefits. In this case, no determination will be made to deny franking credit/imputation benefits attaching to the Special Dividend Amount received by shareholders.

Section 204-30 of the ITAA 1997

32. Section 204-30 applies where a company streams the payment of franked distributions to its shareholders in such a way that the imputation benefits attaching to the distribution are received by those shareholders who derive a greater benefit from them and other shareholders receive lesser imputation benefits, or no imputation benefits.

33. For the section to apply, there must be some shareholders who receive lesser imputation benefits or no imputation benefits. However, under this Arrangement the Special Dividend is payable to all shareholders of GWFL with the result that imputation benefits are received by all shareholders regardless of their ability to use them. Accordingly, section 204-30 does not apply and the Commissioner will not make a determination under subsection 204-30(3)(b) of the ITAA 1997, that no imputation benefit is to arise in respect of the Special Dividend paid to the shareholders.

Section 177EA of the ITAA 1936

34. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes to obtain a tax advantage in relation to franking credits. In essence, it applies to schemes for the disposition of shares, or an interest in shares where a franked dividend is paid or payable in respect of the shares. This

would include the cancellation of shares under the Selective Capital Reduction.

35. Specifically, subsection 177EA(3) of the ITAA 1936 provides that the section applies where:

- (a) there is a scheme for a disposition of shares (or an interest in shares) in a company;
- (b) a frankable dividend has been paid or is payable or expected to be payable in respect of the shares;
- (c) the dividend or distribution was, or is expected to be, franked;
- (d) a person would receive, or could reasonably be expected to receive, franking credit benefits as a result of the dividend or 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 the purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a franking credit benefit.

36. In this case, whilst the conditions of paragraphs 177EA(3)(a) to (d) are satisfied, the requisite purpose of enabling the shareholder to obtain franking credit benefits is not present. In arriving at this conclusion the Commissioner had regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(19) of the ITAA 1936. In particular, the Commissioner had regard to the fact that GWFL has a history of making special dividend payments, that all the shareholders receive the Special Dividend in proportion to their shareholdings, that the amounts returned under the Arrangement are reflective of each shareholder's respective interests in GWFL, and that the form follows the substance of the Arrangement.

37. Accordingly, section 177EA of the ITAA 1936 does not apply and the Commissioner will not make a determination under paragraph 177EA(5)(a) of the ITAA 1936 that a franking debit arises in respect of the whole or part of the Special Dividend Amount paid to the shareholders.

The Selective Capital Reduction

38. The Selective Capital Reduction will result in those shares held by the Minority Shareholders being cancelled in return for \$4.95

per share. CGT Event C2 will occur when the shares in GWFL are cancelled after payment of the Capital Reduction Amount to shareholders. CGT Event C2 concerns cancellation, surrender and similar endings to CGT assets.

39. Subsection 116-30(2) of the ITAA 1997 provides for a deemed market value rule if the capital proceeds are more or less than market value of the CGT asset. In view of the calculation of the Capital Reduction Amount, it is accepted that the Capital Reduction Amount is the amount of the capital proceeds for CGT Event C2 purposes in relation to Minority Shareholders of GWFL.

40. The Capital Reduction Amount is treated as a distribution of share capital by the company to the shareholder and therefore the anti-avoidance provisions concerned with the provision of capital benefits to relevant taxpayers must be considered.

Sections 45A and 45B of the ITAA 1936

41. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C of the ITAA 1936 that all or part of the Capital Reduction Amount received by the Minority Shareholders is treated as an unfranked and non-rebatable dividend.

42. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed 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).

43. GWFL will be providing Minority Shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936). However, there is nothing in the circumstances of the Arrangement to indicate that there is a 'streaming' of capital benefits to some advantaged shareholders, being the Minority Shareholders, and dividends to other disadvantaged shareholders. Therefore section 45A of the ITAA 1936 has no application to the proposed share buy-back.

44. Section 45B of the ITAA 1936 applies where certain capital payments, including a return of capital, are made to shareholders in substitution for dividends. Specifically, the provision 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, 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

45. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) of the ITAA 1936 are met, the requisite purpose of enabling the shareholder to obtain a tax benefit – by way of a capital distribution – is not present.

46. Having regard to the relevant circumstances of the scheme – set out in subsection 45B(5) of the ITAA 1936 – it is apparent that the Capital Reduction Amount is reflective of the interests of the Minority Shareholders in GWFL. Further, the Capital Reduction Amount 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. Accordingly, section 45B of the ITAA 1936 will not apply to the Arrangement and the Commissioner will not make a determination pursuant to section 45C of the ITAA 1936.

Detailed contents list

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Commissioner of Taxation

24 July 2002

<i>Previous draft:</i>	– ITAA 1936 177EA
Not previously released in draft form	– ITAA 1936 177EA(3)
	– ITAA 1936 177EA(3)(a)
	– ITAA 1936 177EA(5)(a)
<i>Related Rulings/Determinations:</i>	– ITAA 1936 177EA(19)
CR 2001/1; TR 92/1; TR 92/20;	– ITAA 1997 Pt 3-6
TR 97/16; TR 94/12	– ITAA 1997 104-25
	– ITAA 1997 116-30
<i>Subject references:</i>	– ITAA 1997 116-30(2)
– capital Reductions	– ITAA 1997 202-5
– franked Distributions	– ITAA 1997 202-15
	– ITAA 1997 202-20
<i>Legislative references:</i>	– ITAA 1997 202-40
– TAA 1953 Pt IVA	– ITAA 1997 202-40(1)
– ITAA 1936 6(1)	– ITAA 1997 202-45
– ITAA 1936 45A	– ITAA 1997 202-60(1)
– ITAA 1936 45A(3)(b)	– ITAA 1997 204-30
– ITAA 1936 45B	– ITAA 1997 204-30(3)(b)
– ITAA 1936 45B(2)(a)	– ITAA 1997 995-1
– ITAA 1936 45B(2)(b)	– Copyright Act 1968
– ITAA 1936 45B(2)(c)	
– ITAA 1936 45B(5)	
– ITAA 1936 45C	

ATO References

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