



CR 2004/127 - Income tax: capital reduction: AAV Limited (formerly ISIS Communications Limited)

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Class Ruling

Income tax: capital reduction: AAV Limited (formerly ISIS Communications Limited)

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Preamble

*The number, subject heading, **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 laws dealt with in this Class Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 6D of the ITAA 1936;
 - Part IVA of the ITAA 1936;
 - section 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-135 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 are those persons registered as ordinary shareholders of ISIS Communications Limited (ISIS) at 5.00 pm on the 'record date' for payment of the capital reduction amount described in the Arrangement part of this Ruling. In this Ruling, persons within this class are referred to as participating shareholders.

4. The record date referred to in paragraph 3 is 23 October 2002 (that is, 5 days after the date of the ISIS General Meeting on 18 October 2002).

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 actually carried out is carried out in accordance with the arrangement described in paragraphs 11 to 21.

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

- 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
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies to the income years ended 30 June 2003, 30 June 2004 and 30 June 2005. However, this Ruling does not apply to taxpayers to the extent that it conflicts with terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 to 22 of Taxation Ruling TR 92/20). Furthermore this Ruling applies to the extent that the relevant tax laws are not amended.

Withdrawal

10. This Ruling is withdrawn and ceases to have effect after 30 June 2005. 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 entered into the specified arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

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

- the application for a Class Ruling dated 6 January 2004;
- the ISIS Notice of General Meeting dated 2 September 2002; and
- BDO Partners Pty Ltd letters dated 5 August 2004 and 13 September 2004.

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

13. AAV Australia Pty Ltd (AAV) and ISIS merged in October 2002 by ISIS acquiring all of the issued shares of AAV in exchange for its own scrip. Subsequently, ISIS changed its name to AAV Limited (AAV New). The resolution approving the acquisition of AAV was passed at the ISIS General Meeting of 18 October 2002, along with a number of other resolutions.

14. This Ruling concerns resolution 2 which involved the shareholders' approval of:

- an equal capital reduction under subsections 256B(1) and 256C(1) of the *Corporations Act 2001* to reduce the share capital of ISIS; and
- the issue by ISIS of 466,965,647 shares to AAV shareholders.

15. The capital reduction was designed to provide participating shareholders with the opportunity to retain the potential value of the ISIS educational businesses. The education businesses of ISIS comprised XSIQ (International) Pty Ltd and ISIS Education and Training Pty Ltd and their respective subsidiaries.

16. Under the capital reduction, AAV New would be required to pay to all participating shareholders:

- (a) 'net profits' (if any) derived by the education businesses for the period 1 July 2002 to 31 October 2004 and/or the 'net disposal proceeds' (if any) made on the disposal of the businesses; or

- (b) in the event that the education businesses were not disposed of by 31 October 2004, the fair market value of the businesses, as determined by an independent valuer.

17. The payments, which were not guaranteed by ISIS, were to be made conditional upon:

- (a) the payment not materially prejudicing the merged group's ability to pay its creditors during the 12 months following the date of calculation of the capital reduction amount; or
- (b) the calculation of 'net profit' derived by the businesses and/or 'net disposal proceeds' from their sale being a positive amount.

18. The education businesses were not profitable (no net profits were made by the education businesses for the years ended 30 June 2003 and 30 June 2004).

19. The shares in XSIQ (International) Pty Ltd and ISIS Education and Training Pty Ltd were sold on 28 January 2003 and 13 March 2003 respectively. The net proceeds from their disposal will be used to fund the return of capital to participating shareholders.

20. The return of capital will be approximately \$0.06 per share (the capital reduction amount). The aggregate capital reduction amount will be debited against an amount standing to the credit of the share capital account (as defined in section 6D of the ITAA 1936) of AAV New.

21. A participating shareholder retains their right to be paid the capital reduction amount if they disposed of their share after the record day – the entitlement to the payment does not pass with the transfer of an ordinary share.

Ruling

Payment not a dividend

22. The capital reduction amount paid to a participating shareholder under the arrangement will not be a dividend, as defined in subsection 6(1) of the ITAA 1936.

Capital gains tax consequences

23. CGT event G1 in section 104-135 of the ITAA 1997 will happen when AAV New pays the capital reduction amount in respect of a share which has been owned by a participating shareholder from the record date until the time when the capital reduction amount is paid.

24. The cost base and reduced cost base of each AAV New share in respect of which the payment is made will be reduced (but not below nil) by the capital reduction amount (subsections 104-135(3) and (4) of the ITAA 1997). A participating shareholder will make a capital gain from CGT event G1 happening to each share to the extent that the payment exceeds the share's cost base (subsection 104-135(3) of the ITAA 1997).

25. For a participating shareholder who disposed of their AAV New shares before the capital reduction amount is paid, CGT event C2 in section 104-25 of the ITAA 1997 will happen as a result of their right to receive the payment being satisfied by the payment.

26. A shareholder will make a capital gain from CGT event C2 to the extent that the capital reduction amount exceeds the cost base of their right to the payment. They will make a capital loss to the extent that the capital reduction amount is less than the right's reduced cost base (subsection 104-25(3) of the ITAA 1997).

Franking credit streaming

27. The Commissioner will not make a determination under section 204-30 of the ITAA 1997.

Part IVA of the ITAA 1936

28. As the capital reduction amount is not a dividend and, therefore, is not a frankable distribution, the anti-avoidance provisions in Part IVA of the ITAA 1936 will not apply to the capital reduction amount received by participating shareholders.

Explanation

Payment not a dividend

29. The capital reduction amount will be debited against an amount standing to the credit of the share capital account. Therefore, subject to subsection 6(4) of the ITAA 1936, it will not constitute a 'dividend' as defined in subsection 6(1) of the ITAA 1936 because of the exclusion in paragraph (d) of that definition.

30. Subsection 6(4) of the ITAA 1936 provides that the exclusion in paragraph (d) of the definition of 'dividend' in subsection 6(1) will not apply where, under an arrangement:

- a person pays or credits any money or gives property to the company and the company credits its share capital account with the amount of the money or the value of the property; and

- the company pays or credits any money or distributes property to another person, and debits its share capital account with the amount of the money or the value of property so paid, credited or distributed.

31. As the distribution under the arrangement is a return of capital funded from the sale of the education businesses, the money paid by AAV New to participating shareholders does not constitute a 'dividend' under subsection 6(1) of the ITAA 1936.

Capital gains tax consequences

32. The capital gains tax consequences resulting from the payment of the capital reduction amount will depend on whether, at the time the payment is made, the participating shareholder:

- (a) owns the shares in respect of which the amount is paid – in which case CGT event G1 will happen when the payment is made; or
- (b) had disposed of the shares in respect of which the amount is paid before payment of it is made – in which case CGT event C2 will happen when the payment is made.

Participating shareholder continues to own shares – G1 event

33. CGT event G1 will happen when AAV New pays the capital reduction amount in respect of a share that a shareholder owned in the company at the record time and continues to own at the time of payment.

34. If the capital reduction amount (approximately \$0.06 per share) is not more than the cost base of the AAV New share at the time of the payment, the cost base and reduced cost base of the share are reduced by the amount (subsection 104-135(4) of the ITAA 1997).

35. A participating shareholder will make a capital gain if the capital reduction amount is more than the cost base of their AAV New share. The amount of the capital gain is equal to this excess. If a shareholder makes a capital gain, the cost base and reduced cost base of the share are reduced to nil (subsection 104-135(3) of the ITAA 1997).

36. A participating shareholder cannot make a capital loss from the payment of the capital reduction amount.

Participating shareholder has disposed of shares – C2 event

37. If a participating shareholder has ceased to own some, or all, of their shares in AAV New in respect of which a capital reduction amount is paid, the right to the payment is considered to be a separate CGT asset. This is because the right to the payment has

been separated from the bundle of rights that once attached to the share.

38. A participating shareholder's right to receive the payment will be discharged or satisfied when the payment is made under the arrangement, causing CGT event C2 to happen.

39. In working out the capital gain or capital loss made from CGT event C2 happening, the capital proceeds from the event will be the capital reduction amount.

40. The cost base of the participating shareholder's right to receive a payment under the arrangement is worked out in accordance with Division 110 of the ITAA 1997. However, the cost base of the right will be nil if the full cost base (or reduced cost base) of the share previously held by the participating shareholder has been applied in working out a capital gain or loss when a CGT event happened to the share – for example, when the participating shareholder disposed of the share. In these cases, the participating shareholder will generally make a capital gain equal to the amount paid under the arrangement.

41. Because the right to the payment from AAV New was inherent in the share during the time it was owned then, for the purposes of Subdivision 109-A of the ITAA 1997, the right is considered to have been acquired at the time when the share was acquired.

42. Consequently, if the share to which the payment relates was originally acquired by a participating shareholder at least 12 months before the payment of the capital reduction amount, a capital gain from CGT event C2 happening to the right 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).

Franking credit streaming

43. As the Commissioner accepts that there is no favoured member or disadvantaged member he will not make a determination under section 204-30 of the ITAA 1997.

Part IVA of the ITAA 1936

44. In the circumstances of the Arrangement, as advised by AAV New and outlined in paragraphs 11 to 21, the Commissioner accepts that the aggregate capital reduction amount represents a return of capital. The capital reduction amount is not attributable to the profits of AAV New and the Commissioner accepts that it does not give the participating shareholders access to the value of the profits in a substitute form. The capital reduction, for reasons stated earlier, is not a dividend and therefore is not a frankable distribution. Accordingly, sections 177E and 177EA of the ITAA 1936 have no application. Part IVA of the ITAA 1936 will not apply to the Arrangement as described.

Detailed contents list

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Commissioner of Taxation17 November 2004

Previous draft:

Not previously issued as a draft

*Related Rulings/Determinations:*CR 2001/1; TR 92/1; TR 92/20;
TR 97/16*Subject references:*- capital gains tax
- capital reductions
- CGT cost base

- CGT events

- CGT events C1-C3 – end of a
CGT asset

- CGT events G1-G3 – shares

- CGT reduced cost base

Legislative references:

- TAA 1953 Pt IVAAA

- Copyright Act 1968

- ITAA 1936 6(1)

- ITAA 1936 6(4)

- ITAA 1936 6D
 - ITAA 1936 Pt IVA
 - ITAA 1936 177E
 - ITAA 1936 177EA
 - ITAA 1997 104-25
 - ITAA 1997 104-25(3)
 - ITAA 1997 104-135
 - ITAA 1997 104-135(3)
 - ITAA 1997 104-135(4)
 - ITAA 1997 Subdiv 109-A
 - ITAA 1997 Div 110
 - ITAA 1997 Subdiv 115-A
 - ITAA 1997 115-25(1)
 - ITAA 1997 204-30
 - Corporations Act 2001 256B(1)
 - Corporations Act 2001 256C(1)
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ATO references

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