


CR 2005/39 - Income tax: Promina Group Limited - proposed capital reduction

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Class Ruling

Income tax: Promina Group Limited – proposed capital reduction

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax laws, 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 laws' 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 Ruling are:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) – definition of 'dividend';
 - section 45A of the ITAA 1936;
 - section 45B of the ITAA 1936;
 - section 45C of the ITAA 1936; and
 - section 104-135 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Class of persons

3. The class of persons to which this Ruling applies is the persons who hold ordinary shares in Promina Group Limited (Promina) and who are registered on the Promina Share Register on the Record Date, being the date for determining entitlements to participate in the proposed return of share capital (capital reduction). In this Ruling, this class of persons is referred to as ordinary shareholders.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. 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 10 to 16.
6. 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 - this Ruling may be withdrawn or modified.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

8. This Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) for an ordinary shareholder in which the capital reduction is received. The arrangement, as described in paragraphs 10 to 16, will be completed within that income year. For an ordinary shareholder that does not have a substituted accounting period, this will be the income year ending 30 June 2005. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:
 - it is not later withdrawn by *Gazette*;
 - it is not taken to be withdrawn by an inconsistent later public ruling; or
 - the relevant tax laws are not amended.

Withdrawal

9. 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

10. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- application for Class Ruling from KPMG dated 29 March 2005; and
- correspondence dated 30 March to 12 May 2005 from KPMG and Promina providing further particulars.

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

11. Promina is an Australian resident public company listed on the Australian Stock Exchange (ASX) and is the ultimate parent of the Promina group of companies. Promina listed on the ASX on 12 May 2003 as part of an Initial Public Offer.

12. Promina has determined that it has capital surplus to requirements (surplus capital) and proposes to return surplus capital of approximately \$244 million (equating to 23 cents per fully paid ordinary share) to ordinary shareholders by way of a capital reduction.

13. The capital reduction was approved at Promina's Annual General Meeting (AGM) held on 29 April 2005. Although holders of Reset Preference Shares (RPS) cannot participate in the capital reduction because of the terms of the RPS issue they were entitled to vote on this proposal at the AGM. All ordinary shareholders registered on the Record Date will be entitled to the capital reduction. The Record Date and date of payment of the capital reduction will be 9 June 2005 and 20 June 2005, respectively.

14. Promina will debit the capital reduction against its share capital account. Promina confirms that its share capital account, as defined in section 6D of the ITAA 1936, is not tainted as there have been no transfers to the share capital account from other accounts.

15. The source of funds for the capital reduction is ultimately a return of capital from a wholly-owned subsidiary of Promina.

16. The proposed capital reduction will be made in addition to the payment of interim and final dividends to ordinary shareholders anticipated by Promina in respect of the year ended 31 December 2005. Holders of RPS will not receive any additional dividend in connection with the capital reduction.

Ruling

Definition of 'dividend' as defined in subsection 6(1) of the ITAA 1936

17. The proposed capital reduction will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

Sections 45A, 45B and 45C of the ITAA 1936

18. Subject to the qualifications in paragraphs 4 to 6 of this Ruling, the Commissioner will not make a determination (under sections 45A or 45B of the ITAA 1936) that section 45C of the ITAA 1936 applies to the proposed capital reduction. Accordingly, no part of the proposed capital reduction will be taken to be a dividend for income tax purposes under section 45C.

CGT event G1 section 104-135 of the ITAA 1997

19. CGT event G1 in section 104-135 of the ITAA 1997 will happen when Promina makes the capital reduction of 23 cents per share to an ordinary shareholder.

20. Pursuant to subsections 104-135(3) and (4), the cost base and reduced cost base of each ordinary share will be reduced (not below nil) by the amount of the capital reduction. An ordinary shareholder will make a capital gain from CGT event G1 occurring to each share to the extent (if any) that the payment exceeds the share's cost base in accordance with subsection 104-135(3) of the ITAA 1997.

21. If the ordinary shareholder is not an Australian resident for income tax purposes, a CGT event G1 capital gain will not be made unless the shares have the necessary connection with Australia in terms of section 136-25 of the ITAA 1997.

Explanation

Definition of 'dividend' as defined in subsection 6(1) of the ITAA 1936

22. Subject to certain exceptions, the subsection 6(1) definition includes:

- (a) any distribution made by a company to any of its shareholders, whether in money or other property ...

The capital reduction will be a distribution made by Promina to all of its ordinary shareholders.

23. However, the exception in paragraph (d) of the definition excludes a distribution if the amount is debited against an amount standing to the credit of the share capital account of a company.

24. The capital reduction will be debited against Promina's untainted share capital account. Therefore, paragraph (d) of the definition of 'dividend' applies.

25. Paragraph (d) of the definition of 'dividend' is qualified by subsection 6(4) which, broadly, applies to certain arrangements where amounts provided by a person to a company and recorded as share capital are distributed to another person. In the present case, there is no 'arrangement' for the purposes of subsection 6(4). Accordingly, subsection 6(4) does not apply.

26. Therefore, the capital reduction will not be a dividend as defined in subsection 6(1).

Sections 45A and 45B of the ITAA 1936

27. Sections 45A and 45B of the ITAA 1936 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 unfrankable dividend that is paid by the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

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

29. By making the distribution, Promina will provide a 'capital benefit' in terms of paragraph 45A(3)(b) to all its ordinary shareholders and all those shareholders will receive the same amount of capital reduction per share. In this case, the threshold conditions of section 45A, namely an advantaged shareholder and a disadvantaged shareholder are not present. Accordingly, section 45A of the ITAA 1936 does not apply to the capital reduction.

Section 45B – schemes to provide capital benefits in substitution for dividends

30. Section 45B of the ITAA 1936 applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends.

31. Subsection 45B(2) sets out the conditions under which the Commissioner will 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;
- 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; 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.

Each of the conditions is considered below.

32. The capital reduction is a 'scheme' for the purposes of section 45B.

33. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936. Relevantly, it includes a distribution to a person of share capital. As Promina proposes to debit the capital reduction against its untainted share capital account, its ordinary shareholders will be provided with a capital benefit.

34. A taxpayer 'obtains a tax benefit', as defined in subsection 45B(9) of the ITAA 1936, where:

- the amount of tax payable;
- any other amount payable under the ITAA 1936 or the ITAA 1997;
- by the taxpayer would, apart from the operation of section 45B;
- 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.

35. A capital reduction, ordinarily, would be subject to the CGT provisions of the income tax law. Unless the amount of the distribution exceeds the cost base of the shares, 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 distribution exceeds the cost base of the shares that a capital gain arises. A capital gain may not arise at all for certain non-resident ordinary shareholders: see paragraph 47. By contrast a dividend would generally be included in the assessable income of a resident shareholder or in the case of a non-resident, subject to dividend withholding tax. Therefore, the ordinary shareholders will obtain tax benefits from the capital reduction.

36. The Commissioner is required to consider the circumstances set out under subsection 45B(8) of the ITAA 1936 to determine whether any part of the arrangement would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

37. 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 in respect of the capital benefit. The purpose does not have to be the most influential or prevailing purpose but it must be more than an incidental purpose.

38. The relevant circumstances under subsection 45B(8) cover the circumstances of the company and the tax profile of the shareholders. In this instance, as the capital reduction is made to all ordinary shareholders regardless of individual circumstances, paragraphs 45B(8)(c) to (h) do not incline for or against a conclusion as to purpose. The circumstances covered by paragraphs 45B(8)(i) and (j) pertaining to the provision of ownership interests and demerger benefits during a demerger are not relevant. So, in this case the relevant matters are those covered by the circumstances described in paragraphs 45B(8)(a), (b) and (k).

39. Paragraph 45B(8)(a) refers to the extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or an associate (within the meaning of section 318) of the company. In this case, the capital reduction is ultimately referable to a return of capital from a wholly-owned subsidiary of Promina. Therefore, the capital benefit is attributable to capital not profits, realised or unrealised.

40. Paragraph 45B(8)(b) refers to the pattern of distributions made by a company or an associate (within the meaning of section 318) of the company. Since listing Promina has paid dividends each year. The capital reduction will be made in addition to the payment of interim and final dividends anticipated by Promina in respect of the year ended 31 December 2005. In regard to its share capital Promina has not made any capital distributions. The company's pattern of distributions does not suggest that the capital reduction is made in substitution for a dividend.

41. Paragraph 45B(8)(k) refers to the matters in subparagraphs 177D(b)(i) to (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 and other implications for the parties involved. In this case, the practical implications of the scheme for Promina and its ordinary shareholders are consistent with its being, in form and substance, a distribution of share capital.

42. Therefore, having regard to the relevant circumstances (under subsection 45B(8) of the ITAA 1936) of the scheme, to return capital to the ordinary shareholders, as discussed in paragraphs 38 to 41, it would not be concluded that the parties who enter into or carry out the scheme do so for a more than incidental purpose of enabling those shareholders to obtain a tax benefit. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the capital reduction.

Section 45C of the ITAA 1936 – deeming dividends to be paid where determinations under section 45A or 45B are made

43. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 in relation to the arrangement as described, section 45C will not apply.

CGT event G1 section 104-135 of the ITAA 1997

44. CGT event G1 (section 104-135 of the ITAA 1997) occurs if a company makes a payment to a shareholder in respect of a share they own in a company and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997, or an amount that is taken to be a dividend under section 47 of the ITAA 1936.

45. Promina proposes to make a payment to its ordinary shareholders out of its untainted share capital account. This payment will not be a dividend as the term is defined in subsection 995-1(1) of the ITAA 1997. The provisions referred to in that definition are not applicable. Furthermore, the capital reduction will not be taken to be a dividend under section 47 of the ITAA 1936 which applies to distributions made by liquidators. Accordingly, CGT event G1 will occur.

46. Pursuant to subsections 104-135(3) and (4), the cost base and reduced cost base of each ordinary share will be reduced (not below nil) by the amount of the capital reduction. Capital gains can also arise from CGT event G1 but only to the extent (if any) that the payment exceeds the share's cost base: subsection 104-135(3).

47. If the ordinary shareholder is not an Australian resident for income tax purposes, a CGT event G1 capital gain cannot be made unless the shares have the necessary connection with Australia in terms of section 136-25 of ITAA 1997. Under item 5 of section 136-25 of the ITAA 1997, shares in public companies will not have the necessary connection with Australia, and a capital gain will not be made, where the non-resident ordinary shareholder and their associates beneficially own less than 10% by value of the shares in the company¹ during the 5 years before the CGT event.

Detailed contents list

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¹ This excludes shares that carried a right only to participate in a distribution of profits or capital to a limited extent.

Commissioner of Taxation

25 May 2005

<i>Previous draft:</i>	- ITAA 1936 45B(8)(c)
Not previously issued as a draft	- ITAA 1936 45B(8)(d)
	- ITAA 1936 45B(8)(e)
	- ITAA 1936 45B(8)(f)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(8)(g)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 45B(8)(h)
TR 97/16	- ITAA 1936 45B(8)(i)
	- ITAA 1936 45B(8)(j)
<i>Subject references:</i>	- ITAA 1936 45B(8)(k)
- capital benefit	- ITAA 1936 45B(9)
- dividend	- ITAA 1936 45C
- dividend substitution	- ITAA 1936 47
- return of capital	- ITAA 1936 177D(b)(i)
	- ITAA 1936 177D(b)(ii)
	- ITAA 1936 177D(b)(iii)
<i>Legislative references:</i>	- ITAA 1936 177D(b)(iv)
- ITAA 1936 6(1)	- ITAA 1936 177D(b)(v)
- ITAA 1936 6(4)	- ITAA 1936 177D(b)(vi)
- ITAA 1936 6D	- ITAA 1936 177D(b)(vii)
- ITAA 1936 45A	- ITAA 1936 177D(b)(viii)
- ITAA 1936 45A(2)	- ITAA 1936 318
- ITAA 1936 45A(3)	- ITAA 1997 104-135
- ITAA 1936 45A(3)(b)	- ITAA 1997 104-135(3)
- ITAA 1936 45B	- ITAA 1997 104-135(4)
- ITAA 1936 45B(2)	- ITAA 1997 136-25
- ITAA 1936 45B(3)	- ITAA 1997 995-1(1)
- ITAA 1936 45B(5)	- TAA 1953 Pt IVAAA
- ITAA 1936 45B(8)	- Copyright Act 1968
- ITAA 1936 45B(8)(a)	
- ITAA 1936 45B(8)(b)	

ATO references

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