



CR 2005/51 - Income tax: return of capital: Aristocrat Leisure Limited

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Class Ruling

Income tax: return of capital: Aristocrat Leisure 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 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 Class Ruling are:
- section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 45B of the ITAA 1936;
 - section 45C 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 136-10 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies are the persons who hold ordinary shares in Aristocrat Leisure Limited ('ALL') and who are registered on the ALL share register on the Record Date, being the date for determining entitlements to participate in the proposed return of share capital ('Capital Return') described in paragraphs 10 to 21 of this Ruling. In this Ruling, this class of persons are referred to as 'Participating 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 21.
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 - this Ruling may be withdrawn or modified.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 Class Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) for a Participating Shareholder in which that shareholder receives the Capital Return. The arrangement, as described in paragraphs 10 to 21, will be completed within that income year. For Participating Shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2006. 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 Class Ruling is withdrawn and ceases to have effect after 30 June 2006. 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

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

- (a) The class ruling application provided by Ernst & Young dated 28 February 2005 and accompanying financial statements; and
- (b) further correspondence from Ernst and Young dated 7 March 2005, 7 April 2005, 20 April 2005, 30 April 2005, 20 May 2005, 31 May 2005 and 1 June 2005.

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

11. The documents referred to above, or relevant parts of them, as the case may be, form part of and are to be read with this description.

12. ALL is an Australian resident public company listed on the Australian Stock Exchange (ASX) and the ultimate holding company of the Aristocrat group. The group has been manufacturing, distributing and marketing electronic gaming machines in Australia for over 50 years. The group also supplies gaming systems and other gaming related products and services to casinos, clubs and hotels in Australia, the Americas, Japan, Europe and other overseas regions. The group acquired subsidiaries in the United States in 2001.

13. On 22 February 2005 ALL announced its intention to make a pro-rata Capital Return of 21 cents per ordinary share. Based on the number of shares on issue as at 5 February 2005 of 477,048,378 shares, this should result in a Capital Return of approximately \$100.2 million.

14. The Capital Return will be applied equally to each holder of fully paid ordinary shares, the only shares on issue, in proportion to the number of shares held.

15. No shares will be cancelled as a result of the Capital Return and there will be no dilution in the shareholdings in ALL.

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16. The proposed Capital Return was approved by shareholders at ALL's Annual General Meeting on 3 May 2005. In accordance with that approval, ALL's Board of Directors determined that:

- the amount of the Capital Return will be \$0.21 per ordinary share held by shareholders on the register at 5 pm on Friday 1 July 2005 ('the Record Date');
- payment of the Capital Return to shareholders is to be effected on 15 July 2005 ('the Payment Date'); and
- shares will trade ex-entitlement to the Capital Return from Monday 27 June 2005.

17. ALL considers that the Capital Return is an integral part of an appropriate capital management strategy.

18. ALL will debit the Capital Return against its share capital account. ALL confirms that its share capital account, as defined in section 6D of the ITAA 1936, is untainted, as there have been no transfers to the share capital account from other accounts.

19. ALL's dividend history and other financial information are as follows:

Years		2000	2001	2002	2003	2004
Interim Dividend	cps	4.0	4.5	5.5	3.0	4.0
Franked		100%	100%	100%	100%	0%
Final Dividend	cps	7.0	7.5	6.5	3.0	4.0
Franked		100%	100%	100%	40%	0%
Total Dividend	cps	11.0	12.0	12.0	6.0	8.0
Accounting Net Profit (Consolidated)	\$m	64.8	86.0	80.0	(106.0)	174
Retained Profits (Consolidated)	\$m	86.1	117.7	143.2	23.0	136.0

20. Subject to the extraordinary losses incurred in the year ended 31 December 2003, ALL has been progressively increasing its dividends on a cents per share basis over time. ALL has advised that the proposed Capital Return will be made in addition to the payment of interim and final dividends declared by the Board in respect of the year ending 31 December 2005.

21. It is expected that the Capital Return will be funded using general working capital and/or existing cash reserves. The source of capital to be returned is identified excess contributed equity from ALL's dividend reinvestment scheme and employee share scheme, the sale of assets and equity previously invested in subsidiaries that has been repaid to ALL. ALL has advised that none of the repayments from the subsidiaries were made from profits.

Ruling

Specific anti-avoidance provisions do not apply

22. The Commissioner will not make a determination under either subsections 45A(2) or 45B(3) that section 45C applies to the whole, or any part, of the Capital Return received by the Participating Shareholders.

Capital Gains

23. CGT event G1, in section 104-135 of the ITAA 1997, will happen when ALL pays the Capital Return to Participating Shareholders in respect of a share they own at the Payment Date.

24. 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 Return. A Participating 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.

25. CGT Event C2, in section 104-25 of the ITAA 1997, will happen when ALL pays the Capital Return to Participating Shareholders in respect of a share they own at the Record Date but disposed of before the Payment Date.

26. If CGT event C2 happens in respect of a Participating Shareholder's right to the payment it will make a capital gain to the extent the payment exceeds the cost base of the right. A Participating Shareholder will make a capital loss to the extent the payment is less than the right's reduced cost base: see subsection 104-25(3) of the ITAA 1997.

27. A non-resident Participating Shareholder that receives the Capital Return will only make a capital gain if their share has the necessary connection with Australia (section 136-25 of the ITAA 1997). An ALL share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the Capital Return, the non-resident Participating Shareholder, together with their associates, owned 10% or more by value of the issued shares in ALL.

Explanation

Sections 45A and 45B of the ITAA 1936

28. 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.

Section 45A – streaming of dividends and capital benefit

29. Section 45A of the ITAA 1936 applies in circumstances where capital benefits and dividends 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 (the disadvantaged shareholders) have received or would receive dividends.

30. Although ALL will provide all of its Participating Shareholders with a 'capital benefit' (as defined in paragraph 45A(3) of the ITAA 1936), the circumstances of the Arrangement do not indicate that there is a streaming of capital benefits to advantaged shareholders and dividends to disadvantaged shareholders. Therefore, section 45A of the ITAA 1936 does not apply to the return of capital.

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

31. Section 45B of the ITAA 1936 applies where certain capital payments are made to Participating 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, who entered into the scheme 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)).

32. In the circumstances of the arrangement, the conditions of paragraphs 45B(2)(a) and (b) are satisfied. The proposed payment of the Capital Return will provide Participating Shareholders with a capital benefit (as defined in subsection 45B(5)) and the shareholders will generally pay less tax on the Capital Return than they would on an equivalent amount of dividend (a 'tax benefit' as defined in subsection 45B(9)).

33. For the purposes of paragraph 45B(2)(c), the Commissioner is required to consider the circumstances set out under subsection 45B(8) 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.

34. 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.

35. In this regard, the relevant taxpayers are the Participating Shareholders of ALL. The relevant circumstances of this arrangement are:

- ALL is able to demonstrate capital in excess of its requirements and has identified the amount of the Capital Return as being attributable to recent equity issuances under ALL's dividend reinvestment scheme and employee share schemes, the sale of assets and equity previously invested in subsidiaries that has been repaid to ALL. ALL has advised that none of the repayments from the subsidiaries were made from profits. It is expected that the Capital Return will be funded using cash reserves. This is supportive of a conclusion that no part of the Capital Return will be attributable to specific profits, realised or unrealised, of ALL or any of its subsidiaries (paragraph 45B(8)(a));
- subject to the extraordinary losses incurred in the year ended 31 December 2003, ALL has been progressively increasing its dividends on a cents per share basis over time. The proposed Capital Return will be made in addition to the payment of interim and final dividends declared by the Board in respect of the year ending 31 December 2005. These factors are supportive of a conclusion that the Capital Return is not in substitution for a dividend (paragraph 45B(8)(b)); and

- the matters referred to in paragraph 45B(8)(k) are the relevant circumstances listed in paragraph 177D(b)(i) to (viii) in relation to the arrangement for the purpose of determining whether a scheme was entered into to obtain a tax benefit under Part IVA. In the present circumstances, the Capital Return does not lead to a view that the arrangement was entered into for the purpose of obtaining a tax benefit.

36. Having regard to the circumstances outlined in paragraph 35, it is considered that the arrangement as described will not be entered into for the purpose, not being an incidental purpose, of enabling a Participating Shareholder of ALL to obtain a tax benefit. Although a tax benefit would be provided to the shareholders of ALL, any benefit is merely incidental. It is accepted the purpose of the proposed Capital Return is to return capital surplus to ALL's present requirements to its shareholders.

37. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C applies to the Capital Return.

38. As the Commissioner will not make a determination pursuant to subsection 45B(3) in relation to the arrangement as described, section 45C will not deem the Capital Return provided to be an unfranked dividend paid out of the profits of the company.

CGT event G1 section 104-135

39. CGT event G1 will happen when ALL pays the Capital Return amount in respect of a share that a Participating Shareholder owned at the Record Date and continues to own at the payment time and some or all of the payment is not a dividend as defined in subsection 995-1(1) of the ITAA 1997.

40. ALL proposes to make the payment to its Participating Shareholders out of its share capital account. This payment will not be a dividend as defined. If the Capital Return amount (\$0.21 per share) is not more than the cost base of the ALL 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).

41. A Participating Shareholder will make a capital gain if the return of capital amount is more than the cost base of their ALL share. The amount of the capital gain is equal to this excess.

42. If a Participating 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).

43. A Participating Shareholder cannot make a capital loss under CGT event G1.

Participating shareholder has disposed of shares – C2 event

44. If a Participating Shareholder has ceased to own some, or all, of their shares in ALL in respect of which the Capital Return 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.

45. 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.

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

47. 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.

48. Because the right to a payment such as the Capital Return 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.

49. 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 Return 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).

Non-resident shareholders: Division 136

50. Pursuant to section 136-10 of the ITAA 1997, a non-resident Participating Shareholder will make a capital gain from the Capital Return only if their ALL share has the necessary connection with Australia. Under category 5 of the table in section 136-25 of the ITAA 1997, an ALL share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the Capital Return, the Participating Shareholder together with their associates owned 10% or more by value of the issued shares in ALL.

Detailed contents list

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Commissioner of Taxation

22 June 2005

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 reduction
- reduction of share capital
- return of share capital
- share capital

Legislative references:

- TAA 1953 Pt IVAAA
- Copyright Act 1968
- 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(5)
- ITAA 1936 45B(8)

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|---------------------------|--------------------------|
| - ITAA 1936 45B(8)(a) | - ITAA 1997 104-25 |
| - ITAA 1936 45B(8)(b) | - ITAA 1997 104-135 |
| - ITAA 1936 45B(8)(k) | - ITAA 1997 104-135(3) |
| - ITAA 1936 45B(9) | - ITAA 1997 104-135(4) |
| - ITAA 1936 45C | - ITAA 1997 Subdiv 109-A |
| - ITAA 1936 177D(b)(i) | - ITAA 1997 Div 110 |
| - ITAA 1936 177D(b)(ii) | - ITAA 1997 Subdiv 115-A |
| - ITAA 1936 177D(b)(iii) | - ITAA 1997 115-25(1) |
| - ITAA 1936 177D(b)(iv) | - ITAA 1997 Div 136 |
| - ITAA 1936 177D(b)(v) | - ITAA 1997 136-10 |
| - ITAA 1936 177D(b)(vi) | - ITAA 1997 136-25 |
| - ITAA 1936 177D(b)(vii) | - ITAA 1997 995-1(1) |
| - ITAA 1936 177D(b)(viii) | |
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ATO references

NO: 2005/8552

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 – shares

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