



# ***CR 2005/78 - Income tax: AEP Financial Services Holdings Pty Limited offer to acquire shares in Baycorp Advantage Limited: return of capital***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2005*



## Class Ruling

### Income tax: AEP Financial Services Holdings Pty Limited offer to acquire shares in Baycorp Advantage Limited: return of capital

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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

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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:

- subsection 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); and
- section 136-25 of the ITAA 1997.

#### **Class of persons**

3. The class of persons to which this Ruling applies is the holders of ordinary shares in Baycorp Advantage Limited (BAL) who hold those shares on capital account and who are to receive a return of capital under the Arrangement described in paragraphs 10 to 18 of this Ruling.

## 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 18.
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

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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 18, 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

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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

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

- The application letter from Johnson Winter & Slattery requesting a Class Ruling dated 9 June 2005 and accompanying:
  - 2001 Annual Report for Data Advantage Limited;
  - 2002 Annual Report for Baycorp Advantage Limited;
  - 2003 Annual Report for Baycorp Advantage Limited;
  - 2004 Annual Report for Baycorp Advantage Limited;
  - 2004 Notice of Annual General Meeting of Baycorp Advantage Limited;
  - December 2004 Interim Results Summary and Appendix 4D Financial Report of Baycorp Advantage Limited released to the Australian Stock Exchange in February 2005; and
  - The draft Bidder's Statement prepared by Johnson Winter & Slattery; and
- Further correspondences from Johnson Winter & Slattery dated 29 June 2005, 30 June 2005, 1 July 2005, 26 July 2005, 18 August 2005, 19 September 2005 and 20 September 2005.

**Note:** Information received from Johnson Winter & Slattery has been provided on a commercial-in-confidence basis, and will not be disclosed or released under the Freedom of Information legislation.

11. BAL is an Australian resident public company listed on the Australian Stock Exchange.

12. Allco Equity Partners Limited (AEP) has incorporated Allco Equity Partners Financial Services Holdings Pty Limited (AEPFS), a wholly owned subsidiary, to make an offer to acquire 50% of each shareholder's shares in BAL for cash (the Offer). The Offer was made on 16 August 2005. An amended offer increasing the consideration for the purchase of BAL shares was made on 16 September 2005. One condition of the Offer is that AEPFS is successful in acquiring sufficient shares in BAL so that AEPFS's holding of BAL shares is not less than 50.1% of the total number of shares in BAL. This condition may be waived by AEPFS.

13. AEPFS has indicated that it will seek to implement a more efficient capital structure for BAL. This includes a proposed return of capital to shareholders of \$269 million, or approximately \$1.18 per share, based on 228,101,183 BAL shares on issue (the Capital Return). The exact amount of the Capital Return will ultimately be determined by the board of BAL.

14. The Capital Return will be funded by third party debt. It is proposed that the Capital Return will take place before 30 June 2006. AEP has secured a conditional offer of funding for BAL for up to \$275 million. Some of those funds may also be used to pay down BAL's existing debt facility.

15. All BAL shareholders, including AEPFS, will participate equally in the Capital Return.

16. All shareholders will hold the same number of shares before and after the Capital Return.

17. BAL has a substantial number of non-resident shareholders.

18. BAL's share capital account is untainted.

## Ruling

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19. The Capital Return will not be a dividend as defined in subsection 6(1) of the ITAA 1936.

20. The Commissioner will not make a determination (under sections 45A and 45B of the ITAA 1936) that section 45C of the ITAA 1936 applies to the Capital Return. That is, no part of the Capital Return will be taken to be a dividend for income tax purposes under section 45C of the ITAA 1936.

21. CGT event G1 will happen when BAL makes the Capital Return to its shareholders for each of their BAL shares (section 104-135 of the ITAA 1997).

22. The cost base and reduced cost base of each BAL share will be reduced (but not below nil) by the amount of the Capital Return (subsections 104-135(3) and (4) of the ITAA 1997).

23. A shareholder will make a capital gain from CGT event G1 happening to the extent (if any) that the Capital Return in respect of each share exceeds the share's cost base (subsection 104-135(3) of the ITAA 1997).

24. A shareholder who is not a resident of Australia and receives the Capital Return will only make a capital gain from CGT event G1 if their BAL shares have the necessary connection with Australia (sections 136-10 and 136-25 of the ITAA 1997).

## Explanation

### The Distribution is not a dividend

25. A dividend is defined in subsection 6(1) of the ITAA 1936 to include any distribution made by a company to any of its shareholders. However, this broad definition is confined by later paragraphs in the definition which expressly exclude certain items from being a dividend for income tax purposes. One specific exclusion is paragraph (d) of the definition of dividend which provides:

moneys paid or credited by a company to a shareholder or any other property distributed by a company to shareholders (not being moneys or other property to which this paragraph, by reason of subsection (4), does not apply or moneys paid or credited, or property distributed for the redemption or cancellation of a redeemable preference share), where the amount of the moneys paid or credited, or the amount of the value of the property, is debited against an amount standing to the credit of the share capital account of the company.

26. As the return of capital will be debited against the Company's share capital account, paragraph (d) of the definition of dividend applies to exclude the distribution from falling within the definition of dividend. Accordingly, the return of capital will not be regarded as a dividend unless some other more specific provision (including section 45B of the ITAA 1936) in either the ITAA 1936 or the ITAA 1997 operates to make it a dividend.

27. The exemption in paragraph 6(1)(d) of the ITAA 1936 is qualified by subsection 6(4). Subsection 6(4) of the ITAA 1936 provides that:

Paragraph (d) of the definition of dividend in subsection (1) does not apply if, under an arrangement:

- a) 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
- b) 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 the property so paid, credited or distributed.

28. In the current case, BAL's share capital account is untainted, therefore the qualification to paragraph 6(1)(d) contained in subsection 6(4) does not apply.

## **Anti-avoidance provisions**

29. 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 return of capital amount received by the shareholders is treated as an unfranked dividend.

### ***Section 45A of the ITAA 1936***

30. 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 would receive dividends (the disadvantaged shareholders).

31. BAL will provide 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 return of capital to indicate that there is a 'streaming' of capital benefits to some shareholders who are advantaged shareholders, and dividends to other shareholders, being disadvantaged shareholders, as all shareholders will receive a return of capital.

32. Therefore, section 45A of the ITAA 1936 has no application to the return of capital.

### ***Section 45B of the ITAA 1936***

33. Section 45B of the ITAA 1936 is applied where certain capital payments, including a return of capital, are made to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- 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
- 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)).

34. Each of these conditions is considered below.

35. The phrase '*provided with a capital benefit*' is defined in subsection 45B(5) of the ITAA 1936 and includes a distribution to a person of share capital. As it is proposed to debit the return of capital against BAL's untainted share capital account, BAL's shareholders will be provided with a capital benefit.

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

- the amount of tax payable; or
- 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.

37. Under the current arrangement, the distribution to shareholders is, *prima facie*, capital in nature and only to the extent, if any, that it exceeds the cost base of the shares will it give rise to a capital gain. Also, a capital gain may not arise at all for some non-resident shareholders. However, if a dividend had been paid instead, it would have been included in the assessable income of a resident shareholder or been subject to dividend withholding tax for non-resident shareholders. Therefore, some BAL shareholders would obtain a tax benefit as defined in subsection 45B(9) under the capital return arrangement.

38. The conditions of paragraph 45B(2)(a) and (b) are satisfied as there is a scheme under which the proposed payment of the return of capital will provide BAL shareholders with a capital benefit and tax benefit.

39. 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 scheme would be entered into for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit.

40. The purpose test is an objective one, it does not have to be the most influential or prevailing purpose but must be more than an incidental purpose. 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.

41. In the present case, the quantum of the return of capital is well in excess of the accumulated profits of BAL. It is clear that BAL does not have sufficient profits (realised and unrealised) to support the payment of a dividend of a similar amount in place of the capital return.



42. As BAL has, up until the 2004 income year incurred substantial accumulated losses, the capital return does not appear to be attributable to profits or in substitution for dividends.

43. Furthermore, the capital return is to be funded by third party debt which has been obtained specifically for that purpose. This suggests there is little connection between BAL's dividend distributions and the proposed capital return.

44. After consideration of all the relevant circumstances (as outlined in subsection 45B(8)), the Commissioner has formed the view that the capital reduction represents a genuine return of capital to BAL's shareholders. The purpose of the return of capital from BAL's perspective is to appropriately restructure BAL's capital, that is, to significantly increase the debt-to-equity ratio on BAL's balance sheet, to lower its weighted average cost of capital and to increase the return on the residual equity.

45. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) that section 45C of the ITAA 1936 applies to the return of capital because there is no purpose of obtaining a tax benefit.

## Capital Gains Tax

46. CGT event G1 happens if a company makes a payment to a shareholder in respect of the shares in the company and some or all of that payment is not a dividend or an amount that is taken to be a dividend under section 47 of the ITAA 1936 (non-assessable part) (subsection 104-135(1) of the ITAA 1997).

47. CGT event G1 happens when the company makes the payment of the non-assessable part (subsection 104-135(2) of the ITAA 1997).

48. A shareholder will make a capital gain if the non-assessable part is more than the share's cost base. If a capital gain is made, the share's cost base and reduced cost base are reduced to nil (subsection 104-135(3) of the ITAA 1997).

49. However, if the amount of the non-assessable part is not more than the share's cost base, the share's cost base and reduced cost base are reduced by the amount of the non-assessable part (subsection 104-135(4) of the ITAA 1997).

50. CGT event G1 will happen when BAL pays the Capital Return of approximately \$1.18 per share to its shareholders. The cost base and reduced cost base of each BAL share will be reduced (but not below nil) by \$1.18 (subsections 104-135(3) and (4) of the ITAA 1997). CGT event G1 will result in a capital gain being made to the extent that the share's cost base is less than \$1.18 (subsection 104-135(3) of the ITAA 1997).

***Non-residents***

51. A non-resident makes a capital gain or loss if a CGT event happens to a CGT asset that has the necessary connection with Australia (section 136-10 of the ITAA 1997).

52. As BAL is an Australian resident company, a BAL share will have the necessary connection with Australia if, at any time during the 5 years before the payment of the Capital Return, the shareholder together with their associates owned 10% or more by value of the issued shares in BAL (item 5 of the table in section 136-25 of the ITAA 1997).

53. Therefore, a non-resident shareholder will not make a capital gain under CGT event G1 if their BAL shares do not have the necessary connection with Australia (section 136-10 of the ITAA 1997).

**Detailed contents list**

54. Below is a detailed contents list for this Class Ruling:

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# CR 2005/78

*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 92/1; TR 92/20; TR 97/16;  
CR 2001/1

*Subject references:*

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

*Legislative references:*

- Copyright Act 1968
- ITAA 1936 6(1)
- ITAA 1936 6(1)(d)
- ITAA 1936 6(4)
- ITAA 1936 45A
- ITAA 1936 45A(3)(b)

- 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)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1997 104-135
- ITAA 1997 104-135(1)
- ITAA 1997 104-135(2)
- ITAA 1997 104-135(3)
- ITAA 1997 104-135(4)
- ITAA 1997 136-10
- ITAA 1997 136-25
- ITAA 1997 995-1(1)
- TAA 1953 Pt IVA

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ATO references

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