



CR 2006/133 - Income tax: proposed return of capital by Village Roadshow Ltd

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Class Ruling

Income tax: proposed return of capital by Village Roadshow Ltd

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. This Ruling relates to the application of the following provisions:

- section 45B of the *Income Tax Assessment Act 1936* (ITAA 1936); and
- section 45C of the ITAA 1936.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders and class A preference shareholders of Village Roadshow Ltd (VRL).

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 13 to 40 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
 - this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme 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 - this Ruling may be withdrawn or modified.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 from 20 December 2006. 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. Furthermore, the Ruling only applies to the extent that:
 - it is not later withdrawn by notice in the *Gazette*; or
 - the relevant provisions are not amended.
9. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).
10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:
 - the income year or other period to which the rulings relate has not begun; and
 - the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

12. This Ruling is withdrawn and ceases to have effect after 30 June 2007. However, the Ruling continues to apply after its withdrawal in respect of the relevant provisions ruled upon, to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entity's involvement in the scheme.

Scheme

13. The scheme that is the subject of the Ruling is described below. The description is based on the following documents.

- Request for a Class Ruling from Shaddick & Spence on behalf of VRL dated 9 November 2006.
- VRL's Annual Report 2006.
- VRL's announcement to the Australian Stock Exchange (ASX) dated 13 November 2006.
- Information received from Shaddick and Spence on behalf of VRL on 28 November 2006.
- Notice of the General Meeting and Explanatory Information in relation to the proposed equal and selective reductions of capital received on 28 November 2006.

Note: certain information may have been provided on a commercial-in-confidence basis and will not be discussed or released under the Freedom of Information legislation

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

15. At the time of the scheme VRL is an Australian resident, listed public company. It was incorporated on 11 November 1986 as De Laurentiis Entertainment Ltd.

16. Over the past five years VRL has been restructuring its business and recently completed a divestment programme of foreign cinema interests. This resulted in VRL and its subsidiaries (VRL Group) holding \$176.2 million of cash and cash equivalents as at 30 June 2006, and realising a further \$61 million at the end of October 2006.

17. Following on from its business restructuring and the simplification of the group structure, VRL has announced significant capital management initiatives. As part of its Capital Management Programme, VRL has proposed the following initiatives:

- return of capital;
- payment of special dividends; and
- on-market share buy-backs.

18. VRL has two classes of shares: ordinary shares and class A preference shares (preference shares). The preference shares carry limited voting rights and have some degree of priority on the winding-up of the company. In addition, where a dividend is recommended, the dividend on each preference share is a minimum of 10.175 cents, or 3 cents above the dividend on the ordinary shares, whichever is the higher.

19. The directors of VRL believe that approximately 23% of the company's shareholders (predominately holders of the preference shares) are resident outside Australia.

20. VRL intends to make a return of capital of 15 cents per ordinary share and preference share. It is expected the proposed transaction would result in a return of capital of approximately \$39.3 million to both ordinary and preference shareholders.

21. The capital return of 15 cents per ordinary share will be debited to the ordinary share capital account.

22. The capital return of 15 cents per preference share will be debited to the preference share capital account.

23. The share capital accounts of VRL as at 30 June 2006 totalled some \$552.8 million and the proposed return of capital for both ordinary and preference shares will reduce the total of the share capital accounts by 7.1%.

24. The capital return will not reduce the number of shares on issue or create or increase any unpaid amount on shares, which will remain fully paid shares.

25. The return of capital is subject to the approval by ordinary and preference shareholders by way of a special resolution at a General Meeting to be held on 22 December 2006. If approved the shareholders are expected to be paid in early January 2007.

26. VRL also paid a fully franked interim dividend of 34 cents per ordinary share and 37 cents per preference share on 4 December 2006.

27. Both dividend payments cost a total of approximately \$92.4 million and were paid out of existing profits and reserves. The dividends were debited against VRL's retained earnings.

28. VRL's franking account balance as at 30 June 2006 was \$36.5 million, sufficient to frank dividends of \$85.2 million to 100%.

Additional franking credits generated during the year ended 30 June 2007 ensured that the dividend was able to be fully franked.

29. VRL suspended the regular payment of dividends for the ordinary and preference shares between 2002 and 2006. However, a special dividend of 7.175 cents per ordinary share and 10.175 cents per preference share was paid in November 2005, franked to 100%. VRL has been under pressure to re-establish the payment of dividends on a reasonably consistent basis.

30. VRL directors have approved an on-market buy back of up to 11 million preference shares, representing approximately 10% of the shares in that class. Based on the preference share price as of 10 November 2006, it is estimated that it will cost VRL \$26.4 million.

31. Directors also intend to commence an on-market buy-back of up to 15.2 million ordinary shares in VRL, representing 10% of the issued shares in that class. Based on the ordinary share price as of 10 November 2006, it is estimated that it will cost VRL \$39.5 million.

32. The on-market buy-back of preference shares and ordinary shares will continue for a maximum period of 12 months.

33. The buy-back of ordinary shares will be debited to the ordinary share capital account and the buy-back of preference shares will be debited to the preference share capital account.

34. Both share capital accounts are untainted for taxation purposes.

35. The buy-back of both classes of shares will leave VRL's total shares on issue at approximately 236 million. VRL believes that at this level of shares on issue, dividends can be paid more regularly and this should strengthen and enhance the value of VRL shares.

36. VRL has conducted on-market share buy backs in previous years. Approximately 140 million preference shares and 83 million ordinary shares were bought on market since July 2003. The preference shares were bought in March and May 2004 at a cost of \$169 million and the ordinary shares were bought back between July 2004 and December 2005 at a cost of \$185.5 million. The cost of these previous on-market share buy-backs was debited to VRL's share capital account.

37. The funding for the three proposed Capital Management Initiatives is coming from various sources which are addressed below.

38. On 10 November 2006 the Theme Parks division successfully signed a new \$350 million limited recourse debt facility which will be firstly be applied to repay the existing theme park debts (\$115 million) with the balance of \$235 million repaid to VRL. The \$235 million proceeds to be received by VRL will be used to retire in full VRL's core debt of \$90 million and the balance of \$145 million will be added to VRL's cash reserves. This will result in VRL having no material direct recourse external debt facilities with any financier.

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39. VRL will have available for these Capital Management Initiatives cash reserves of approximately \$230 million including proceeds from the sale of cinemas in Italy and the partial sell down of the company's investment in Austereo.

40. VRL anticipates that at the completion of the announced Capital Management Initiatives, it will be able to resume declaring annual dividends in the future.

Ruling

41. The Commissioner will not make a determination under section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole or any part of the return of capital received by the ordinary shareholders and preference shareholders of VRL. Accordingly, no part of the return of capital will be taken to be a dividend for income tax purposes.

Commissioner of Taxation

20 December 2006

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

42. Section 45B of the ITAA 1936 applies where certain capital payments 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)).

Each of these conditions is considered below.

43. A scheme for the purposes of section 45B of the ITAA 1936 is defined under subsection 177A(1) of the ITAA 1936 to include:

- any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable, by legal proceedings; and
- any scheme, plan, proposal, action, course of action or course of conduct.

44. The arrangement involving VRL's proposed return of capital to both its ordinary and preference shareholders will constitute a 'scheme' for the purposes of section 45B of the ITAA 1936.

45. The phrase 'provided with a capital benefit' is defined in subsection 45B(5) of the ITAA 1936. It states that a person is provided with a capital benefit if:

- an ownership interest in a company is issued to the person;
- there is a distribution to the person of share capital; or
- the company does something in relation to an ownership interest that has the effect of increasing the value of the ownership interest (which may or may not be the same interest) held by that person.

46. As VRL's return of capital will be recorded by means of a debit to the ordinary share capital account and the preference share capital account, its shareholders would be taken to have been provided with a capital benefit as defined under paragraph 45B(5)(b) of the ITAA 1936.

47. 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.

48. As discussed in paragraph 45 of this Ruling the distribution to the ordinary and preference shareholders will be a return of capital and constitute a capital benefit. In the event that the relevant distribution did represent a dividend rather than a capital benefit, it is likely that a shareholder would have incurred a greater tax liability. Consequently, the receipt of the capital benefit will represent a tax benefit.

49. For the purposes of paragraph 45B(2)(c) of the ITAA 1936 the Commissioner is required to consider the relevant circumstances set out in subsection 45B(8) of the ITAA 1936 to determine whether any part of the scheme would be entered into for a purpose, other than an incidental purpose, of enabling a relevant taxpayer to obtain a tax benefit.

50. The test for 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. The purpose does not have to be the dominant purpose but it must be more than an incidental purpose.

51. In this case the relevant taxpayers are the holders of ordinary shares and the preference shares in VRL and some of the relevant circumstances of this scheme are as follows:

- Paragraph 45B(8)(a) refers to the extent that 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. No part of the 15 cents per share return of capital is considered to be a distribution out of the current or previous year's profits. It is debited to the share capital account, and can be regarded as being funded from excess cash being generated from recent asset disposals, which will return both the share capital invested in the assets and a profit component for VRL. Further, the planned special dividend will distribute to shareholders the profits generated from the recent asset disposals.

- Paragraph 45B(8)(b) refers to the pattern of distribution made by a company or an associate of the company. In this case, VRL has not paid any ordinary dividends from 2002 to 2006. It did pay a special dividend on ordinary and preference shares in November 2005 which was fully franked. VRL hopes to resume to regular dividend payment in future upon completion of the Capital Management Initiatives. However, it should be noted that VRL has conducted on-market share buy-backs of ordinary and preference shares in recent years that were debited to the share capital account of VRL.
- Paragraphs 45B(8)(c) to 45B(8)(g) – VRL is an Australian resident company and 23% of its shareholders (mainly preference shareholders) are non-residents. In this instance, the 15 cents per share return of capital is made to all the ordinary and the preference shareholders of VRL regardless of their individual circumstances or residency. The same analogy is applied to the special dividend payments. However, the preference shareholders are entitled to an extra 3 cents per share dividend under the rights attached to that class of dividends. Further, as VRL was incorporated in 1986, none of the shares in the company was acquired before the enactment of the Capital Gains Tax legislation (20 September 1985).
- Paragraph 45B(8)(h) – the comparative rights and interests held by the shareholders after the proposed return of capital will be the same as those that would have been held as an equivalent dividend been paid instead of the capital benefit. The capital return will not reduce the number of shares on issue or create or increase any unpaid amount on shares.
- Paragraph 45B(8)(k) – this requires the Commissioner to consider the matters listed in subparagraphs 177D(b)(i) to (viii). In this context, it is considered that; having regard to the form and substance of the planned return of capital, associated with a special dividend payment and a planned on-market share buy-back; the planned return of capital of 15 cents per share represents a genuine return of capital.

52. Having regard to the relevant circumstances outlined in paragraph 51 of this Ruling, it is considered that the scheme as described will not be entered into for more than an incidental purpose of enabling a shareholder to obtain a tax benefit. As such, section 45B of the ITAA 1936 will have no application to the proposed return of capital.

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53. Accordingly, the Commissioner will not make a determination pursuant to subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the return of capital by VRL.

Appendix 2 – Detailed contents list

54. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Subject references:

- on-market share buy-back
- return of capital
- special dividend

Legislative references:

- 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(5)(b)
 - ITAA 1936 45B(8)
 - ITAA 1936 45B(8)(a)
 - ITAA 1936 45B(8)(b)
 - ITAA 1936 45B(8)(c)
 - ITAA 1936 45B(8)(d)
 - ITAA 1936 45B(8)(e)
 - ITAA 1936 45B(8)(f)
 - ITAA 1936 45B(8)(g)
 - ITAA 1936 45B(8)(h)
 - ITAA 1936 45B(8)(k)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1936 177A(1)
 - ITAA 1936 177D(b)(i)
 - ITAA 1936 177D(b)(ii)
 - ITAA 1936 177D(b)(iii)
 - ITAA 1936 177D(b)(iv)
 - ITAA 1936 177D(b)(v)
 - ITAA 1936 177D(b)(vi)
 - ITAA 1936 177D(b)(vii)
 - ITAA 1936 177D(b)(viii)
 - ITAA 1936 318
 - TAA 1953
 - TAA 1953 Sch 1 357-75(1)
 - Copyright Act 1968
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ATO references

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