CR 2008/1 - Income tax: proposed return of capital: Globe International Limited

Class Ruling

Income tax: proposed return of capital: Globe International Limited

Contents Para

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. The relevant provisions dealt with in this 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 104-25 of the *Income Tax Assessment Act 1997* (ITAA 1997); and
- section 104-135 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Globe International Limited (GIL) who:

(a) are Australian resident ordinary shareholders of GIL on the record date (1 February 2008); and

(b) hold their GIL shares on capital account.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in the 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 14 to 25 of this Ruling.

6. This Ruling does not provide any guidance on the income tax implications for the foreign resident shareholders of GIL.

7. 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.

Date of effect

9. This Ruling will apply from 23 January 2008 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

10. 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.

11. If this 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)).

12. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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.

13. 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).

Scheme

14. The following description of the scheme is based on a number of documents provided to the Commissioner. These documents or relevant parts of them as the case may be, form part of and are to be read with this description. The documents include:

- application for Class Ruling from PricewaterhouseCoopers (PwC) dated 2 October 2007; and
- correspondence from PwC dated 7 November 2007, 5 December 2007 and 14 December 2007.

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

15. GIL is a public company incorporated in Australia and in May 2001 completed its initial public offering on the Australian Securities Exchange. GIL is a resident of Australia as defined in subsection 6(1).

Acquisition of KMI

16. In July 2002, GIL undertook an equity raising of A$80 million. The funds were raised to fund the acquisition of Kubic Marketing Inc (KMI) which included Skateboard World Industries (SWI).

17. On 3 July 2002, GIL acquired KMI, a leading US skate and snow hardware and apparel wholesale business for approximately A$68.594 million.

18. KMI through its wholly-owned subsidiaries SWI, Dwindle Inc (Dwindle) and Diaxis LLC (Diaxis) held a portfolio of brands and trademarks. The 'World Industries' trademark held by SWI, had a market value of approximately A$12.404 million at the time that GIL acquired KMI.

Write-off of intangibles

19. In 2003, as a result of a downturn in the skate industry and a decrease in sales, a write-off of A$33.152 million of goodwill and A$18.370 million of trademarks was recorded in GIL's consolidated accounts. Approximately A$9.316 million of this impairment was allocated to the World Industries trademark.

US rationalisation

20. In December 2006, GIL's US operations were rationalised. As part of this restructure, the shares in SWI, Dwindle and Diaxis were transferred by KMI to Osata Enterprises Inc (Osata), a US resident company wholly-owned by GIL, for market value consideration of US$11.25 million. It is estimated that at the time of the restructure, approximately A$14.170 million of the original capital contributed by GIL shareholders to fund the acquisition of KMI remained, taking into consideration the write-down adjustments to the value of goodwill and trademarks in 2003 and 2006.

Sale of World Industries assets

21. On 25 June 2007, SWI disposed of the World Industries trademark, related licences, a motor vehicle and other intellectual property (World Industries assets) to an unrelated third party for total consideration of A$9.5 million.

22. SWI intends to distribute the net cash proceeds from the sale of the World Industries assets to Osata which will in turn be passed on to GIL via a return of capital.

23. GIL then proposes to return A$8.6 million of these funds to its shareholders by way of a capital return. GIL will debit the whole of the return of capital against its share capital account. GIL's share capital account is not tainted within the meaning of Division 197 of the ITAA 1997.

24. The proposed return of capital will be $0.2074 per share and will be paid to all shareholders who hold GIL shares on the record date (1 February 2008).

25. GIL did not pay a dividend in the 2007 income year, having negative retained earnings of approximately A$53.666 million. GIL has also reported a loss of A$3.225 million for the income year ended 30 June 2007.

Ruling

Dividend

26. The payment of the proposed return of capital from GIL to its shareholders will not be a dividend, as defined in subsection 6(1).

Sections 45A and 45B

27. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to the whole, or any part, of the payment of the proposed return of capital to be received by GIL shareholders. Accordingly, no amount of the proposed return of capital will be taken to be an unfranked dividend pursuant to section 45C.

Capital gains tax

28. CGT event G1 in section 104-135 of the ITAA 1997 will happen when GIL pays the proposed return of capital in respect of a GIL share that a GIL shareholder owns at the time of the payment.

29. CGT event C2 in section 104-25 of the ITAA 1997 will happen when GIL pays the proposed return of capital to a GIL shareholder in respect of a GIL share they owned at the record date but which they cease to own before the time of the payment.

Commissioner of Taxation
16 January 2008

Appendix 1 – Explanation

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.

Dividend

30. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia).

31. The term 'dividend' in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, later paragraphs in this subsection exclude certain items from being a dividend for tax purposes.

32. Relevantly, paragraph (d) of subsection 6(1) specifically excludes from the definition of 'dividend':

> 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

33. As the proposed return of capital will be wholly debited against an amount standing to the credit of GIL's share capital account, paragraph (d) of the definition of 'dividend' in subsection 6(1) will apply and the return of capital will not constitute a dividend under subsection 6(1).

Anti-avoidance provisions

Sections 45A and 45B

34. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies to treat all or part of the return of capital amount received by the shareholders as an unfranked dividend.

Section 45A – streaming of dividends and capital benefits

35. Section 45A applies where capital benefits are streamed to some shareholders (the Advantaged Shareholders), who would derive a greater benefit from the capital benefits than other shareholders (the Disadvantaged Shareholders) and these Disadvantaged Shareholders receive dividends.

36. A reference to the provision of a capital benefit to a shareholder in a company is defined in subsection 45A(3) to include the distribution to the shareholder of share capital. The proposed return of share capital in the present case by GIL to its shareholders will constitute the provision of a capital benefit. However, as GIL will make a pro-rata return of capital to all of its shareholders in respect of their ordinary shares in GIL, there will be no streaming of capital benefits to some shareholders and not to others. Therefore, section 45A will have no application in respect of the return of capital.

37. Accordingly, the Commissioner will not make a determination under subsection 45A(2) that section 45C applies in relation to the whole, or a part, of the proposed return of capital.

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

38. Section 45B 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 (the 'relevant 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, who entered into the scheme or carried out the scheme or any part of the scheme did so for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

39. Under the present scheme, GIL will make a distribution of share capital to all of its ordinary shareholders, which will constitute the provision of a capital benefit.

40. Pursuant to subsection 45B(9), it is likely that each of the shareholders, to whom this ruling applies, will obtain a tax benefit due to the capital benefit being assessed at a later time via the CGT regime, rather than being assessed immediately under subsection 44(1) as a dividend.

41. However, under the present scheme, the requisite purpose of enabling the participating shareholder to obtain a tax benefit is not present. Having regard to the 'relevant circumstances' of the scheme, in particular paragraphs 45B(8)(a), (b) and (k), it is considered that none of the persons who enter into or carry out the scheme, or any part of it, will do so for the requisite purpose of enabling a participating shareholder to obtain a tax benefit.

42. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies in relation to the whole, or a part, of the capital benefit. As the Commissioner will not make a determination under subsection 45B(3) in relation to the capital benefit, section 45C will not deem the proposed return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

Capital gains tax

CGT event G1 – section 104-135

43. CGT event G1, in section 104-135 of the ITAA 1997, will happen when GIL pays the proposed return of capital in respect of a share that a GIL shareholder owns at the time of the payment, as the payment will not be a dividend as defined in subsection 995-1(1) of the ITAA 1997, nor an amount that is taken to be a dividend under section 47.

44. If the proposed return of capital amount of $0.2074 per share is equal to or less than the cost base of the GIL share at the time of the payment, the cost base and reduced cost base of that GIL share will be reduced (but not below nil) by that amount of the proposed return of capital (subsection 104-135(4) of the ITAA 1997).

45. A GIL shareholder will make a capital gain if the proposed return of capital amount is more than the cost base of their GIL share. The amount of the capital gain is equal to the excess (subsection 104-135(3) of the ITAA 1997).

46. If a GIL shareholder makes a capital gain, the cost base and reduced cost base of the GIL share is reduced to nil (subsection 104-135(3) of the ITAA 1997).

47. If the GIL share was acquired by the shareholder at least 12 months before the proposed payment of the return of capital, a capital gain from CGT event G1 happening 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).

48. A GIL shareholder cannot make a capital loss when CGT event G1 happens.

CGT event C2 – section 104-25

49. The right to receive the proposed return of capital is one of the rights inherent in the GIL share at the record date. If, after the record date but before the payment date of the proposed return of capital, a GIL shareholder ceases to own some or all of their GIL shares, the right to receive the proposed return of capital will be retained by the shareholder and is considered to be a separate CGT asset.

50. CGT event C2 in section 104-25 of the ITAA 1997 will happen when the return of capital is paid and the right to receive that payment ends.

51. The GIL shareholder will make a capital gain if the capital proceeds from the ending of the right are more than the cost base of the right (subsection 104-25(3) of the ITAA 1997). The capital proceeds will be the proposed return of capital amount (section 116-20 of the ITAA 1997).

52. The cost base of the GIL shareholder's right to receive the proposed return of capital is worked out under Division 110 of the ITAA 1997 (modified by Division 112 of the ITAA 1997). As the GIL shareholder will have paid nothing for the right, the cost base of the right is likely to be nil. Therefore, a capital gain equal to the proposed return of capital will arise.

53. As the right to receive the proposed return of capital amount was inherent in the GIL share during the time it was owned, the right is considered to have been acquired at the time the share was acquired (section 109-5 of the ITAA 1997).

54. Consequently, if the GIL share to which the payment relates was originally acquired by the former shareholder at least 12 months before the proposed payment of the return of capital, 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).

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Subject references:

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

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 44(1)
- 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(8)(a)
- ITAA 1936 45B(8)(b)
- ITAA 1936 45B(8)(k)
- ITAA 1936 45B(9)
- ITAA 1936 45C
- ITAA 1936 47
- ITAA 1997
- 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 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Subdiv 115-A
- ITAA 1997 115-25(1)
- ITAA 1997 116-20
- ITAA 1997 Div 197
- ITAA 1997 995-1(1)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

ATO references

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Income Tax ~~ Capital Gains Tax ~~ CGT events C1 to C3 - end of a CGT asset
Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3 - shares