


CR 2010/2 - Income tax: proposed return of capital: Customers Limited

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Class Ruling

Income tax: proposed return of capital: Customers Limited

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 provisions 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);
 - section 104-135 of the ITAA 1997; and
 - section 855-10 of the ITAA 1997.

All legislative references are to the ITAA 1936 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies consists of the ordinary shareholders of Customers Limited (Customers) who:
- (a) are registered on the Customers share register on the Record Date; and
 - (b) hold their Customers shares on capital account.
4. In this Ruling, a person belonging to this class of entities is referred to as a 'Customers shareholder'.

Qualifications

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 9 to 25 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 1 July 2009 to 30 June 2010. The Ruling continues to apply after 30 June 2010 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will 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 this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant.

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

Background

10. Customers is an Australian resident public company which was incorporated in 1989 and is listed on the Australian Securities Exchange.

11. Customers primarily supplies ATMs and electronic payment system services in Australia and until recently has been in a 'start-up' phase, acquiring several ATM related businesses in Australia and focusing on growth in Asia.

12. Since its incorporation, Customers has raised capital for various reasons including funding for acquisitions, employees share plans, employee performance share rights, shares for payment to suppliers and share placements for working capital.

13. The financial statements of Customers as at 30 June 2009 show issued capital of \$203,731,000, reserves of \$1,315,000 and accumulated losses of \$29,925,000. As at 13 August 2009 Customers had 133,623,643 fully paid ordinary shares on issue. Customers has no other class of shares on issue.

14. The shareholders in Customers are a mixture of individuals, companies and superannuation funds, some of whom are foreign residents.

Acquisition and sale of Fintronics

15. On 12 September 2006, Customers announced the establishment of a 50/50 joint venture, Customers Asia Limited (CAL) to develop and provide ATM and related services throughout Asia. CAL is a company incorporated in Hong Kong and a tax resident of that country. On 15 November 2006, CAL subscribed for shares and convertible notes in Fintronics Holdings Company Limited (Fintronics) for approximately \$20,000,000. Fintronics is a company which is listed on the Hong Kong stock exchange and owns and operates an ATM independent service organisation in China. Customers funded its \$10,000,000 investment in CAL via the issue of 40,000,000 shares to the joint venturer at \$0.25 per share under an existing option agreement. On 28 May 2007, Customers acquired the remaining 50% interest in CAL from the joint venturer. As a result, CAL became a wholly owned subsidiary of Customers. The acquisition was settled in part by the issue of 93,322,176 Customers shares to the joint venturer with an approximate market value of \$19,568,000.

16. As a result of changes in legislation in China and concerns regarding corporate governance issues, a decision was taken to exit the investment in Fintronics and focus on Customers' core Australian and New Zealand businesses. Consequently, on 9 May 2008, CAL sold its investment in shares and convertible notes in Fintronics for approximately \$14,700,000. A loss was realised on disposal of Fintronics and the proceeds from this sale were used to repay debt.

Proposed return of capital

17. Following a recent review of its capital structure, Customers is proposing to make a return of capital of \$0.08 per share for all holders of shares in Customers on the Record Date. Customers has also implemented an on-market buy back programme of up to 10% of the company's shares.

18. Customers' primary purpose in making the return of capital is to achieve the commercial objective of increasing its gearing ratio towards target levels. Customers also expects this to have a positive effect on its share price and improve the efficiency of its capital structure.

19. There will be no change in either the number of ordinary shares held by each Customers shareholder or the proportionate interest of each shareholder in Customers as a result of the return of capital.

20. Customers will debit the whole of the proposed return of capital against its share capital account.

Other aspects

21. To date, no capital has been returned to shareholders, no bonus shares have been issued and no dividend has been declared or paid.

22. Customers has confirmed that its share capital account (as defined in section 975-300 of the ITAA 1997) is not tainted (within the meaning of Division 197 of the ITAA 1997).

23. Customers currently does not have an established dividend policy. No dividend has been declared or paid in the past 10 years to 30 June 2009.

24. The current business plans of the company do not require any of the capital proposed to be returned to fund any planned expansions or other capital expenditures.

25. Shares in Customers are not an 'indirect Australian real property interest' (as defined in section 855-25 of the ITAA 1997) for any foreign resident shareholder.

Ruling

Distribution is not a dividend

26. The proposed return of capital to Customers shareholders will not be a dividend, as defined in subsection 6(1).

Distribution will not be deemed a dividend under section 45C

27. The Commissioner will not make a determination under sections 45A or 45B that section 45C applies to the proposed return of capital. Accordingly, no part of the proposed return of capital will be taken to be a dividend for income tax purposes.

Capital gains tax

28. CGT event G1 (section 104-135 of the ITAA 1997) will happen when Customers pays the proposed return of capital to a Customers shareholder in respect of a Customers share that they own at the Record Date and continue to own at the payment date.

29. CGT event C2 (section 104-25 of ITAA 1997) will happen when Customers pays the proposed return of capital to a Customers shareholder in respect of a Customers share that they own at the Record Date but cease to own before the payment date.

Foreign resident shareholders

30. A foreign resident Customers shareholder who is paid the proposed return of capital disregards any capital gain made when CGT event G1 happens if their Customers shares are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

31. A foreign resident Customers shareholder who is paid the proposed return of capital disregards any capital gain or capital loss made when CGT event C2 happens if their right to receive the proposed return of capital is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Commissioner of Taxation

3 February 2010

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.*

Distribution is not a dividend

32. Subsection 44(1) includes in a shareholder's assessable income any dividends paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

33. The term 'dividend', defined in subsection 6(1) includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution from the meaning of 'dividend' if the amount of the distribution is debited against an amount standing to the credit of the company's share capital account.

34. The term 'share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital.

35. Subsection 975-300(3) of the ITAA 1997 states that an account is not a share capital account, except for certain limited purposes, if it is tainted. Section 197-50 of the ITAA 1997 states that a share capital account is tainted if an amount to which Division 197 of the ITAA 1997 applies is transferred to the account and the account is not already tainted.

36. The proposed return of capital will be recorded as a debit to Customers' share capital account. As the share capital account of Customers is not tainted within the meaning of Division 197 of the ITAA 1997, paragraph (d) of the definition of 'dividend' in subsection 6(1) applies. Accordingly the proposed return of capital will not be a dividend as defined in subsection 6(1).

Subsection 6(4)

37. The exclusion in paragraph (d) of the definition of dividend in subsection 6(1) is limited by subsection 6(4) which applies in circumstances where, under an arrangement:

- a company raises share capital, receiving either cash or property from a person or group of persons, crediting the amount of money or the value of the property to its share capital account; and
- returns the money or property to another person or group of persons, debiting the amount of the money or the value of the property to its share capital account.

38. In the present case, no arrangement exists under which Customers raised share capital from certain shareholders and then will distribute the capital raised to other shareholders. Accordingly, subsection 6(4) will have no application in respect of the proposed return of capital.

Anti-avoidance provisions***Sections 45A and 45B***

39. 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 paid by the company out of profits to the shareholder.

Section 45A – streaming of dividends and capital benefits

40. 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, or are likely to receive, dividends.

41. A reference to the 'provision of a capital benefit to a shareholder in a company' is defined in paragraph 45A(3)(b) to include a distribution to the shareholder of share capital. Customers will provide its shareholders with a 'capital benefit' as defined in paragraph 45A(3)(b). The capital benefit will be provided to all of its shareholders in the same proportion as their share holdings.

42. Therefore, section 45A will have no application in respect of the proposed return of capital. 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 capital benefit.

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

43. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. It allows the Commissioner to make a determination that section 45C applies to a capital benefit. The effect of such a determination is that all or part of the distribution of capital received by the shareholder under the return of capital is treated as an unfranked dividend.

44. In broad terms, section 45B 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 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)).

45. Under the present scheme, Customers proposes to make a distribution of \$0.08 in respect of each share held by Customers shareholders. This will constitute the provision of a capital benefit in accordance with paragraph 45B(5)(b).

46. Pursuant to subsection 45B(9), it is likely that each of the Customers shareholders to which 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.

47. However, having regard to the relevant circumstances of the scheme (defined to include the circumstances set out in subsection 45B(8)), it cannot be concluded that either Customers or the Customers shareholders will enter into or carry out the proposed scheme for the purpose of enabling the Customers shareholders to obtain a tax benefit. It cannot be said that the proposed return of capital is a disguised distribution of profits, nor does Customers' pattern of distributions indicate that the proposed return of capital is being made in substitution for dividends. Similarly, the manner in which the proposed scheme is to be carried out, and the form and substance of the proposed scheme, do not indicate that the proposed capital return will be made in substitution for dividends.

48. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the whole, or a part of the proposed return of capital.

49. As the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) in relation to the scheme as described, section 45C will not deem any part of the proposed return of capital to be an unfranked dividend for the purposes of the ITAA 1936 or of the ITAA 1997.

Capital gains tax

CGT event G1 – section 104-135

50. CGT event G1 will happen when Customers pays the proposed return of capital to a Customers shareholder in respect of a share that they own in Customers at the Record Date and continue to own at the payment date (section 104-135 of the ITAA 1997).

51. If the proposed return of capital (\$0.08 per share) is equal to or less than the cost base of the Customers share at the payment date, the cost base and reduced cost base of the share will be reduced by the amount of the payment (subsection 104-135(4) of the ITAA 1997).

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

53. If a Customers shareholder makes a capital gain when CGT event G1 happens, the cost base and reduced cost base of the Customers share is reduced to nil. A Customers shareholder cannot make a capital loss when CGT event G1 happens (subsection 104-135(3) of the ITAA 1997).

54. A capital gain made when CGT event G1 happens will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided that the Customers share was acquired at least 12 months before the payment of the proposed return of capital (subsection 115-25(1) of the ITAA 1997) and the other conditions of that Subdivision are satisfied.

CGT event C2 – section 104-25

55. The right to receive the proposed return of capital is one of the rights inherent in a Customers share at the Record Date. If, after the Record Date but before the payment date, a Customers shareholder ceases to own a Customers share, the right to receive the proposed return of capital in respect of that share will be retained by the shareholder and is a separate CGT asset.

56. CGT event C2 (section 104-25 of the ITAA 1997) will happen when the proposed return of capital is paid. The right to receive the payment (being an intangible CGT asset) will end by the right being discharged or satisfied when the payment is made.

57. A Customers shareholder will make a capital gain if the capital proceeds from the ending of the right are more than its cost base. The capital gain is equal to the amount of the excess. A Customers shareholder will make a capital loss if the capital proceeds from the ending of the right are less than its reduced cost base (subsection 104-25(3) of the ITAA 1997). The capital loss is equal to the amount of the difference.

58. In working out the capital gain or capital loss made when CGT event C2 happens, the capital proceeds will be the amount of the proposed return of capital (\$0.08 per share) (subsection 116-20(1) of the ITAA 1997).

59. The cost base of a Customers 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). The cost base of the right does not include the cost base or reduced cost base of the share previously owned by the Customers shareholder that has been applied in working out a capital gain or capital loss made when a CGT event happened to the share – for example, when the Customers shareholder disposed of the share after the Record Date.

60. Therefore, if the full cost base or reduced cost base of a Customers share has been previously applied in working out a capital gain or capital loss made when a CGT event happened to that share, the right to receive the proposed return of capital will have a nil cost base.

61. As the right to receive the proposed return of capital was inherent in the Customers share during the time it was owned, the right is considered to have been acquired at the time when the corresponding share was acquired (section 109-5 of the ITAA 1997). Accordingly, if the Customers share was acquired at least 12 months before the proposed return of capital, a capital gain made from the ending of the corresponding right will satisfy the requirements of section 115-25 of the ITAA 1997. Such a capital gain will be eligible to be treated as a discount capital gain under Subdivision 115-A of the ITAA 1997 provided the other conditions of that Subdivision are satisfied.

Foreign resident shareholders

62. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss made from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

63. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a gain or loss on ceasing to be an Australian resident).

64. Customers has advised that at the time CGT event G1 happens for any foreign resident Customers shareholder who is entitled to the proposed return of capital, a Customers share will not be an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997) as the interest will not pass the principal asset test in section 855-30 of the ITAA 1997 at that time.

65. Consequently, a foreign resident Customers shareholder, just before CGT event G1 happens, cannot disregard under subsection 855-10(1) of the ITAA 1997 a capital gain made if:

- (a) the Customers share has been used at any time by the foreign resident Customers shareholder in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- (b) the Customers share is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

66. A foreign resident Customers shareholder who has a right to the payment of the proposed return of capital, disregards any capital gain or capital loss made when CGT event C2 happens to that right because the right is not 'taxable Australian property' (section 855-10 of the ITAA 1997).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital benefit
- capital gains tax
- capital reductions
- CGT events C1-C3 – end of a CGT asset
- CGT events G1-G3 – shares
- dividends
- return of capital on shares
- share capital

Legislative references:

- ITAA 1936
 - ITAA 1936 6(1)
 - ITAA 1936 6(1)(d)
 - ITAA 1936 6(4)
 - ITAA 1936 44(1)
 - ITAA 1936 45A
 - ITAA 1936 45A(2)
 - 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)(b)
 - ITAA 1936 45B(8)
 - ITAA 1936 45B(9)
 - ITAA 1936 45C
 - ITAA 1997
 - ITAA 1997 104-25
 - ITAA 1997 104-25(3)
 - ITAA 1997 104-135
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 - ITAA 1997 Div 110
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 - ITAA 1997 115-25
 - ITAA 1997 115-25(1)
 - ITAA 1997 116-20(1)
 - ITAA 1997 Div 197
 - ITAA 1997 197-50
 - ITAA 1997 855-10
 - ITAA 1997 855-15
 - ITAA 1997 855-25
 - ITAA 1997 855-30
 - ITAA 1997 975-300
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 - ITAA 1997 995-1(1)
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ATO references

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