


# ***CR 2017/67 - Income tax: SMS Management & Technology Limited - Scheme of Arrangement and Special Dividend***

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## Class Ruling

# Income tax: SMS Management & Technology Limited – Scheme of Arrangement and Special Dividend

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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.

## Summary – 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 provisions

2. The relevant provisions dealt with in this Ruling are:

- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subparagraph 44(1)(a)(i) of the ITAA 1936
- subparagraph 44(1)(b)(i) of the ITAA 1936
- subparagraph 44(1)(c)(i) of the ITAA 1936
- paragraph 128B(3)(ga) of the ITAA 1936
- subsection 128B(3E) of the ITAA 1936
- section 128D of the ITAA 1936
- former section 160APHM of the ITAA 1936
- former section 160APHN of the ITAA 1936

- section 177EA of the ITAA 1936
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 67-25 of the ITAA 1997
- subsection 104-10(1) of the ITAA 1997
- subsection 104-10(2) of the ITAA 1997
- paragraph 104-10(3)(b) of the ITAA 1997
- subsection 104-10(4) of the ITAA 1997
- Subdivision 115-A of the ITAA 1997
- paragraph 116-20(1)(a) of the ITAA 1997
- paragraph 116-20(1)(b) of the ITAA 1997
- section 204-30 of the ITAA 1997
- Division 207 of the ITAA 1997
- section 207-20 of the ITAA 1997
- subsection 207-35(1) of the ITAA 1997
- subsection 207-75(2) of the ITAA 1997
- section 207-145 of the ITAA 1997
- paragraph 207-145(1)(a) of the ITAA 1997
- section 855-10 of the ITAA 1997.

All subsequent legislative references in this Ruling are to provisions of the ITAA 1997 unless specified otherwise.

## **Class of entities**

3. The class of entities to which this Ruling applies is the shareholders of SMS Management & Technology Limited (SMS) who:

- participated in the scheme of arrangement under which ASG Group Limited (ASG) acquired 100% of the shares in SMS
- received the Special Dividend and Scheme Consideration
- held their shares in SMS on capital account, that is, the shares were neither held as revenue assets (as defined in section 977-50) nor as trading stock (as defined in subsection 995-1(1))
- acquired their SMS shares on, or after, 20 September 1985
- are not 'significant stakeholders' or 'common stakeholders' in relation to the scheme within the

meaning of these expressions in Subdivision 124-M, and

- were not subject to the taxation of financial arrangement rules in Division 230 in relation to gains and losses on their SMS shares.

**(Note:** Division 230 will generally not apply to individuals, unless they have made an election for the Division to apply to them.)

### **Qualifications**

4. The Commissioner makes this Ruling based on the precise scheme 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 8 to 22 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.

### **Date of effect**

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7. This Ruling applies from 1 July 2017 to 30 June 2018. The Ruling continues to apply after 30 June 2018 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**

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8. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them, form part of and are to be read with the description:

- the application for a class ruling dated 4 July 2017
- the Scheme Implementation Agreement (SIA), together with all schedules and annexures, dated 20 June 2017

- the Scheme Booklet lodged with the Australian Securities & Investments Commission (ASIC) on 27 July 2017, and
- additional information provided by the applicant between 4 July 2017 and 8 August 2017.

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

## Relevant Entities

### ***SMS Management & Technology Limited***

9. SMS is an Australian resident company that is listed on the Australian Securities Exchange (ASX).

10. The principal activities of SMS comprise of IT services including business advisory services, solutions, managed services and recruitment for specific enterprise, government and corporate markets in Australia and Asia.

11. As at 20 June 2017 SMS had 68,536,340 shares and 1,656,236 performance rights on issue. The performance rights will not convert to shares as part of the scheme.

12. As at 20 June 2017 over 55% of SMS shareholders had a registered address in Australia.

13. As at 31 December 2016, no non-residents, either alone or together with any associates, beneficially held more than 10% of the shares in SMS.

### ***ASG Group Limited***

14. ASG is a company incorporated in Australia which is a 100% subsidiary of Nomura Research Institute, Ltd which is an IT consulting and solutions provider based in Japan and listed on the Tokyo Stock Exchange.

## Scheme of Arrangement

15. On 20 June 2017 SMS announced that it had entered into a SIA under which ASG proposed to acquire 100% of the issued shares in SMS via a scheme of arrangement (SOA) under Part 5.1 of the *Corporations Act 2001*.

16. On 7 September 2017 the SOA was approved by order of the Supreme Court of Victoria.

17. The SIA was implemented on 26 September 2017 and each shareholder in SMS transferred each share they held in SMS to ASG in exchange for cash consideration of \$1.698 (\$1.80 minus the Special Dividend of \$0.102).

**Special Dividend**

18. On 1 September 2017 the Board of Directors of SMS declared a fully franked Special Dividend of \$0.102 per SMS share held by SMS shareholders on 11 September 2017 (Special Dividend Record Date).

19. The Special Dividend was permitted under the SIA which stated:

- the decision to pay the Special Dividend is entirely within the discretion of the Board of SMS and ASG had no right to influence that decision
- the SIA is not conditional on payment or otherwise of the Special Dividend
- the Special Dividend is to be paid entirely from SMS's accumulated/retained earnings reserve and must not be debited against the share capital account of SMS
- ASG must not in any way finance, assist or facilitate the payment of the Special Dividend
- the total amount distributed as a Special Dividend must not exceed \$7 million, and
- if the Special Dividend is paid by SMS, the cash consideration to be paid by ASG is reduced by the amount of the Special Dividend.

20. The Special Dividend was sourced entirely from the retained earnings of SMS and was not debited against the share capital account of SMS.

21. The Special Dividend was funded from existing cash reserves, working capital and/or existing financing facilities of SMS. ASG did not provide any funds to SMS to fund the Special Dividend.

22. The Special Dividend was paid to SMS shareholders on 18 September 2017 (Special Dividend Payment Date).

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**Ruling****Special Dividend**

23. The Special Dividend of \$0.102 paid to SMS shareholders constituted a 'dividend' as defined in subsection 6(1) of the ITAA 1936.

## ***Assessability and withholding tax***

### *Residents*

24. A resident SMS shareholder who received the fully franked Special Dividend is required to include the Special Dividend as assessable income (subparagraph 44(1)(a)(i) of the ITAA 1936).

### *Non-residents not carrying on business at or through a permanent establishment*

25. A non-resident SMS shareholder who received the fully franked Special Dividend (other than those carrying on business in Australia at or through a permanent establishment in Australia) is not required to include the dividend as assessable income under subsection 44(1) of the ITAA 1936 (section 128D of the ITAA 1936) and is not liable to Australian withholding tax in respect of the dividend (subparagraph 128B(3)(ga)(i) of the ITAA 1936).

### *Non-residents carrying on business at or through a permanent establishment*

26. A non-resident SMS shareholder who received the fully franked Special Dividend and is carrying on business in Australia at or through a permanent establishment in Australia, where the Special Dividend is attributable to the permanent establishment, is required to include the Special Dividend as assessable income (subparagraphs 44(1)(b)(i) and 44(1)(c)(i) of the ITAA 1936) and is not liable to Australian withholding tax in respect of the Special Dividend (subsection 128B(3E) of the ITAA 1936).

## ***Gross-up and tax offset***

27. A resident SMS shareholder and a non-resident SMS shareholder that is carrying on business in Australia at or through a permanent establishment in Australia, who received the fully franked Special Dividend:

- is required to include the amount of the franking credit attached to the Special Dividend in their assessable income, and
- is entitled to a tax offset equal to the amount of the franking credit

under section 207-20 and subsection 207-75(2), subject to being a qualified person in relation to the Special Dividend.

28. A SMS shareholder (not being an entity taxed as a corporate tax entity) that is the trustee of a trust (not being a complying superannuation entity) or a partnership is required to include the amount of the franking credit attached to the Special Dividend in its assessable income under subsection 207-35(1), subject to the trustee

or the partnership being a qualified person in relation to the Special Dividend.

#### *Qualified persons*

29. The payment of the Special Dividend is regarded as the making of a related payment for the purposes of paragraph 207-145(1)(a) and former section 160APHN of the ITAA 1936.

30. Therefore, a SMS shareholder will be a qualified person in relation to the Special Dividend if, from 29 July 2017 until 18 September 2017 inclusive, they continued to hold their SMS shares and did not have 'materially diminished risks of loss or opportunities for gain' (as defined under former section 160APHM of the ITAA 1936) in respect of their SMS shares for a continuous period of at least 45 days.

#### *Refundable tax offset*

31. The franking credit tax offset a SMS shareholder is entitled to under Division 207 in relation to the Special Dividend is subject to the refundable tax offset rules in Division 67. Certain trustees and corporate tax entities are excluded from the refundable tax offset rules pursuant to section 67-25.

32. A non-resident SMS shareholder that carries on business in Australia at or through a permanent establishment in Australia, where the Special Dividend is attributable to the permanent establishment, is excluded from the refundable tax offset rules (subsection 67-25(1DA) of the ITAA 1997).

### **Capital Gains Tax (CGT) consequences**

#### ***CGT event A1***

33. CGT event A1 happened to each SMS shareholder when they disposed of each share in SMS to ASG under the SIA (subsections 104-10(1) and 104-10(2)).

34. The time of CGT event A1 is 26 September 2017 (paragraph 104-10(3)(b)).

#### ***Capital proceeds***

35. The capital proceeds for CGT event A1 happening to a SMS shareholder is the money and market value of any property received or entitled to be received in respect of the event happening (paragraphs 116-20(1)(a) and 116-20(1)(b)).

36. The capital proceeds received by a SMS shareholder for each share they held in SMS was cash consideration of \$1.698.

37. The Special Dividend of \$0.102 is not included in the capital proceeds.

### ***Capital gain or capital loss***

38. A SMS shareholder will make a capital gain if the capital proceeds from the disposal of a SMS share exceed its cost base (subsection 104-10(4)). The capital gain is the amount of the excess.

39. A SMS shareholder will make a capital loss if the capital proceeds are less than the reduced cost base of the SMS share (subsection 104-10(4)). The capital loss is the amount of the difference.

### ***Discount capital gain***

40. If a SMS shareholder makes a capital gain from the disposal of a SMS share they will be eligible to treat the capital gain as a 'discount capital gain' provided that they satisfy the requirements of Subdivision 115-A.

### ***Non-resident shareholders***

41. A non-resident SMS shareholder who participated in the scheme may disregard any capital gain or capital loss made when CGT event A1 happened if the SMS share was not 'taxable Australian property' (section 855-10).

### **The anti-avoidance provisions**

#### ***Section 177EA***

42. Section 177EA of the ITAA 1936 will not apply in respect of the Special Dividend.

#### ***Section 204-30***

43. Section 204-30 will not apply in respect of the Special Dividend.

#### ***Section 207-145***

44. Section 207-145 will not apply to the whole, or any part, of the Special Dividend because the distribution is not made as part of a dividend stripping operation (paragraph 207-145(1)(d)).

## **Appendix 1 – Explanation**

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**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.*

### **Special Dividend**

45. The term 'dividend' is defined in subsection 6(1) of the ITAA 1936 and includes any distribution made by a company to any of its shareholders.

46. The payment of the Special Dividend was a distribution of money by SMS to its shareholders.

47. However, paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 excludes any:

... moneys paid or credited by a company to a shareholder ... where the amount of the moneys paid or credited, ... is debited against an amount standing to the credit of the share capital account of the company...

48. The Special Dividend was not debited against SMS's share capital account. Therefore, the exclusion in paragraph (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936 does not apply and the Special Dividend paid to SMS shareholders constitutes a 'dividend' for the purposes of subsection 6(1) of the ITAA 1936.

### **Assessability and withholding tax**

#### *Residents*

49. Subparagraph 44(1)(a)(i) of the ITAA 1936 includes in the assessable income of an Australian resident shareholder in a company:

...dividends (other than non-share dividends) that are paid to the shareholder by the company out of profits derived by it from any source.

50. As the Special Dividend was paid to SMS shareholders out of profits derived by SMS, SMS shareholders who are residents of Australia as defined in subsection 6(1) of the ITAA 1936 are required to include the Special Dividend in their assessable income under subparagraph 44(1)(a)(i) of the ITAA 1936.

#### *Non-residents not carrying on business at or through a permanent establishment*

51. Subparagraph 44(1)(b)(i) of the ITAA 1936 includes in the assessable income of a non-resident shareholder in a company:

... dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia.

52. However, subsection 44(1) of the ITAA 1936 does not apply to a dividend to the extent to which it is included in, or excluded from, assessable income by another provision that expressly deals with dividends in ITAA 1936 or the ITAA 1997.

53. Subsection 128B(1) of the ITAA 1936 imposes Australian withholding tax on income which:

- (a) is derived, on or after 1 January 1968, by a non-resident; and
- (b) consists of a dividend paid by a company that is a resident.

54. Subparagraph 128B(3)(ga)(i) of the ITAA 1936 excludes from subsection 128B(1) income derived by a non-resident that consists of the franked part of a dividend. As the Special Dividend was fully franked, it will not be subject to Australian withholding tax when derived by a non-resident SMS shareholder.

55. Section 128D of the ITAA 1936 operates to treat the Special Dividend as non-assessable non-exempt income.

56. Accordingly, non-resident SMS shareholders who received the fully franked Special Dividend (other than those shareholders who received the Special Dividend in carrying on business in Australia at or through a permanent establishment in Australia) are not required to include the dividend as assessable income pursuant to subparagraph 44(1)(b)(i) of the ITAA 1936 (section 128D of the ITAA 1936) and are not liable to Australian withholding tax in relation to the dividend (subparagraph 128B(3)(ga)(i) of the ITAA 1936).

*Non-residents carrying on business at or through a permanent establishment*

57. A non-resident's liability to withholding tax on dividend income received pursuant to subsection 128B(1) of the ITAA 1936 is subject to subsection 128B(3E) of the ITAA 1936. Subsection 128B(3E) of the ITAA 1936 states that section 128B of the ITAA 1936 does not apply to dividend income that:

- (a) is paid to a person who is a non-resident carrying on business in Australia at or through a permanent establishment of the person in Australia; and
- (b) is attributable to the permanent establishment; and
- (c) is not paid to the person in the person's capacity as a trustee.

58. Subparagraph 44(1)(b)(i) of the ITAA 1936 includes in the assessable income of a non-resident shareholder in a company:

... dividends (other than non-share dividends) paid to the shareholder by the company to the extent to which they are paid out of profits derived by it from sources in Australia.

59. Subparagraph 44(1)(c)(i) of the ITAA 1936 includes dividends in the assessable income of a non-resident shareholder of a resident

company, where the non-resident shareholder is carrying on business in Australia at or through a permanent establishment of the shareholder in Australia which:

... are attributable to the permanent establishment, to the extent to which they are paid out of profits derived by the company from sources outside Australia.

60. Accordingly, non-resident SMS shareholders that carry on business in Australia at or through a permanent establishment who received the fully franked Special Dividend are required to include the dividend as assessable income, to the extent to which the Special Dividend is attributable to the permanent establishment, pursuant to subparagraphs 44(1)(b)(i) and 44(1)(c)(i) of the ITAA 1936, and are not liable to Australian withholding tax in relation to the dividend.

### ***Gross-up and tax offset***

61. Section 207-20 provides:

- (1) If an entity makes a franked distribution to another entity, the assessable income of the receiving entity, for the income year in which the distribution is made, includes the amount of the franking credit on the distribution. This is in addition to another amount included in the receiving entity's assessable income in relation to the distribution under any other provision of this Act.
- (2) The receiving entity is entitled to a tax offset for the income year in which the distribution is made. The tax offset is equal to the franking credit on the distribution.

62. Therefore, subject to satisfying the qualified person rule, where the fully franked Special Dividend is received directly by a SMS shareholder and the SMS shareholder satisfies the residency requirements in section 207-75, the SMS shareholder:

- is required to include the amount of the franking credit attached to the Special Dividend in their assessable income, and
- is entitled to a tax offset equal to the amount of the franking credit.

63. If the fully franked Special Dividend was received by a SMS shareholder (not being an entity taxed as a corporate entity) that is a trustee of a trust (not being a complying superannuation fund) or a partnership, subsection 207-35(1) applies, subject to the trustee or partnership being a qualified person.

64. Subsection 207-35(1) provides:

If:

- (a) a franked distribution is made in an income year to an entity that is a partnership or the trustee of a trust; and

- (b) the entity is not a corporate tax entity when the distribution is made; and
- (c) if the entity is a trustee of a trust – the trust is not a complying superannuation entity when the distribution is made;

the assessable income of the partnership or trust for that income year includes the amount of the franking credit on the distribution.

65. Where a SMS shareholder that is a partnership or a trustee of a trust is a qualified person, the SMS shareholder is required to include the amount of the franking credit attached to the Special Dividend in the assessable income of the trust or partnership under subsection 207-35(1).

### *Qualified persons*

66. Paragraph 207-145(1)(a) provides that where a franked distribution is made to an entity, only a 'qualified' person in relation to the distribution for the purposes of Division 1A of former Part IIIAA of the ITAA 1936 is:

- required to include the amount of the franking credit in their assessable income, and
- entitled to a tax offset in respect of the franking credit attached to the franked distribution.

67. Former section 160APHU of the ITAA 1936 provides that a partner in a partnership or the beneficiary of a trust is not a 'qualified person' unless the partnership or the trustee of the trust is also a 'qualified person' in relation to the dividend.

68. The main test of what constitutes a 'qualified person' for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, which is known as the holding period rule, is set out in former subsection 160APHO(1) of the ITAA 1936 which states:

A taxpayer who has held shares or an interest in shares on which a dividend has been paid is a **qualified person** in relation to the dividend if:

- (a) where neither the taxpayer nor an associate of the taxpayer has made, or is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the primary qualification period in relation to the dividend; or
- (b) where the taxpayer or an associate of the taxpayer has made, is under an obligation to make, or is likely to make, a related payment in respect of the dividend – the taxpayer has satisfied subsection (2) in relation to the secondary qualification period in relation to the dividend.

69. Former subsection 160APHO(2) of the ITAA 1936 requires the taxpayer to hold the shares for at least 45 days if the shares are not

preference shares, or at least 90 days if the shares are preference shares.

70. Former subsection 160APHO(2) of the ITAA 1936 sets out the holding period requirement. Broadly, if a taxpayer is not under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer is required to satisfy the holding period requirement within the primary qualification period. If a taxpayer is under an obligation to make a related payment in relation to a dividend or distribution, the taxpayer is required to satisfy the holding period requirement within the secondary qualification period.

#### *Related payment rule*

71. In order to determine the relevant qualification period, it is necessary to determine whether a SMS shareholder has made, or is under an obligation to make, or is likely to make, a related payment in respect of any of the Special Dividend received.

72. Former section 160APHN of the ITAA 1936 sets out, for the purposes of Division 1A of former Part IIIAA of the ITAA 1936, non-definitive examples of what constitutes the making of a related payment.

73. Former subsection 160APHN(2) of the ITAA 1936 provides that a:

...taxpayer or associate is taken, for the purposes of this Division, to have made, to be under an obligation to make, or to be likely to make, a related payment in respect of the dividend or distribution if, under an arrangement, the taxpayer or associate has done, is under an obligation to do, or may reasonably be expected to do, as the case may be, anything having the effect of passing the benefit of the dividend or distribution to one or more other persons.

74. Former subsection 160APHN(3) of the ITAA 1936 contains examples of transactions that may have the effect of passing the benefit of the dividend or distribution to one or more other persons (for example, where an amount paid or credited is equal to the amount of the dividend or distribution or causing a payment or the transfer of property in accordance with the direction of another person or persons).

75. Former subsection 160APHN(4) of the ITAA 1936 outlines the circumstances of transactions referred to in former subsection 160APHN(3) of the ITAA 1936 that may have the effect of passing the benefit of the dividend or distribution to one or more other persons (for example, where an amount paid or credited is equal to the amount of the dividend or distribution).

76. The Commissioner considers that the circumstances surrounding the payment of the Special Dividend of \$0.102 per SMS share leads to the conclusion that the Special Dividend is a constituent element of the scheme. The payment of the Special Dividend is a 'permitted distribution' provided for in the SIA. Pursuant

to the SIA, if the Special Dividend is paid the cash component of the scheme consideration is reduced by the amount of the Special Dividend. Further, SMS shareholders, in approving the SIA and receiving the Special Dividend, were part of the scheme that caused the SMS shares ('property') to be transferred to ASG ('another person') for the purposes of former subsection 160APHN(3) of the ITAA 1936.

77. Therefore, it is considered that a SMS shareholder is taken to have made a related payment in respect of the Special Dividend.

### *Holding period requirement*

78. The holding period rule requires shareholders to hold their ordinary shares at-risk for a continuous period of not less than 45 days during the relevant qualification period.

79. As a SMS shareholder is considered to have made or be likely to make a related payment in respect of the Special Dividend, a SMS shareholder is required to satisfy the holding period requirement within the secondary qualification period pursuant to former paragraph 160APHO(1)(b) of the ITAA 1936.

80. The secondary qualification period is defined in former section 160APHD of the ITAA 1936 as:

...in relation to a taxpayer in relation to shares or an interest in shares, means:

- (a) if the shares are not preference shares – the period beginning on the 45<sup>th</sup> day before, and ending on the 45<sup>th</sup> day after, the day on which the shares or interest becomes *ex dividend*...

81. The concept of 'ex-dividend' is defined by former subsection 160APHE(1) of the ITAA 1936 as follows:

A share in respect of which a dividend is to be paid, or an interest (other than an interest as a beneficiary of a widely held trust) in such a share, becomes ex dividend on the day after the last day on which the acquisition by a person of the share will entitle the person to receive the dividend.

82. The eligibility for the Special Dividend was determined on the Special Dividend Record Date of 11 September 2017, being the last day on which acquisition by a person of a SMS share entitled the person to receive the Special Dividend as per former section 160APHE of the ITAA 1936. Accordingly, the ex-dividend date of a SMS share for the purposes of former subsection 160APHE(1) of the ITAA 1936 is 12 September 2017.

83. The secondary qualification period thus runs from 45 days before and ends on 45 days after the ex-dividend date of 12 September 2017. In practical terms, this means that the secondary qualification period runs from 29 July 2017 to 27 October 2017. However, pursuant to former subsection 160APHO(3) of the ITAA 1936, any days on which a taxpayer has materially diminished

risks of loss or opportunities for gain in respect of the SMS share is to be excluded. This would mean that the secondary qualification period would be from 29 July 2017 until the date that SMS shareholders are no longer at risk for the purposes of former Division 1A of Part III of the ITAA 1936.

84. Entitlement to participate in the SIA will be determined on the SIA Record Date (19 September 2017). SMS shareholders who dispose of their shares under the SIA will no longer be considered to hold their SMS shares at risk for the purposes of former Division 1A of Part IIIA of the ITAA 1936 as of 19 September 2017.

85. Accordingly, for a SMS shareholder who disposes of their shares under the SIA, the secondary qualification period will run for a period of 52 days from 29 July 2017 to 18 September 2017 (being the day prior to the SIA Record Date). A SMS shareholder who receives the Special Dividend will need to hold its shares at risk for continuous period of not less than 45 days during this period in order to be a qualified person for the purposes of former Division 1A of Part IIIA of the ITAA 1936. Further pursuant to former paragraph 160APHO(2)(a) of the ITAA 1936, neither the date of acquisition nor the date of disposal is included in the relevant 45 day period.

#### ***Refundable tax offset***

86. SMS shareholders who are entitled to a tax offset under subsection 207-20(2) in respect of the franking credit received (or entities entitled to a tax offset under section 207-45 equal to their share of the franking credit) will also be subject to the refundable tax offset rules in Division 67, unless specifically excluded under section 67-25.

87. Pursuant to section 67-25, certain taxpayers are specifically excluded from the operation of the refundable tax offset rules. The identified entities include:

- non-complying superannuation funds or non-complying approved deposit funds (subsection 67-25(1A))
- a trustee of a trust who is liable to be assessed under section 98 or 99A of the ITAA 1936 (paragraph 67-25(1B)(b))
- corporate tax entities, unless the entity is an exempt institution that is eligible for a refund, or a life insurance company that has received distributions on membership interests which were not held by the company on behalf of its shareholders (subsections 67-25(1C) and 67-25(1D)), and
- foreign resident entities carrying on business in Australia at or through a permanent establishment (subsection 67-25(1DA)).

88. SMS shareholders (or entities entitled to a tax offset under section 207-45) were entitled to the refundable tax offset unless specifically excluded pursuant to section 67-25.

## **CGT consequences**

### ***CGT event A1***

89. CGT event A1 happens when an entity disposes of a CGT asset (subsection 104-10(1)). This occurs when there is a change in the ownership of a CGT asset from one entity to another (subsection 104-10(2)). The time of CGT event A1 is when the disposing entity enters into a contract for the disposal, or if there is no contract, when the change of ownership occurs (subsection 104-10(3)).

90. The disposal of shares pursuant to the SIA is not under a contract (paragraph 9 of Taxation Determination TD 2002/4 *Income tax: capital gains: what is the first element of the cost base and reduced cost base of a share in a company you acquire in exchange for a share in another company in a takeover or merger?*).

91. CGT event A1 happened at the time when SMS shareholders disposed of their SMS shares pursuant to the SIA (subsections 104-10(1), 104-10(2) and 104-10(3)). The disposal happened on the scheme implementation date, being 26 September 2017 (paragraph 104-10(3)(b)).

92. The time when CGT event A1 happened determines the year of income in which a SMS shareholder made a capital gain or a capital loss, and may affect whether the shareholder is entitled to the CGT discount for any capital gain made.

93. A SMS shareholder made a capital gain when CGT event A1 happened if the capital proceeds from the disposal of their SMS shares were more than the cost base of the shares. A SMS shareholder made a capital loss if the capital proceeds were less than the reduced cost base of the SMS shares (subsection 104-10(4)).

### ***Capital Proceeds***

94. The capital proceeds received by a SMS shareholder from CGT event A1 happening to their SMS share under the SIA is the money and the market value of any property received or entitled to be received (worked out at the time of the event happening) in respect of the event happening (subsection 116-20(1)).

95. The term 'in respect of the event happening' in subsection 116-20(1) requires the relationship between the event and the receipt of the money, or the entitlement to receive the money, to be more than coincidental. An amount is not capital proceeds received or entitled to be received in respect of a CGT event merely because it is received in association with the CGT event (Taxation Ruling TR 2010/4 *Income tax: capital gains: when a dividend will be*

*included in the capital proceeds from a disposal of shares that happens under a contract or a scheme of arrangement).*

96. In this case, the Special Dividend was not paid in respect of the disposal of SMS shares under the Scheme. The determination to pay the Special Dividend was at the discretion of the SMS Board. ASG had no control over the decision of SMS to pay the Special Dividend. ASG had no control over the quantum of the Special Dividend (beyond the requirement that the total amount distributed as a Special Dividend must not exceed \$7 million in the SIA).

97. The payment of the Special Dividend was funded entirely from existing cash reserves, working capital and/or existing finance facilities of SMS. ASG did not provide any funds to SMS to fund the Special Dividend.

98. Therefore, the Commissioner considers that the Special Dividend was not received in respect of the disposal of SMS shares under the SIA. Accordingly, the Special Dividend did not form part of the capital proceeds which a SMS shareholder received in respect of CGT event A1 happening.

99. The capital proceeds that a SMS shareholder receives for the disposal of a SMS share is cash consideration of \$1.698.

#### ***Discount capital gain***

100. If a SMS shareholder made a capital gain from the disposal of their SMS share, the SMS shareholder may be eligible to treat the capital gain as a discount capital gain provided that all relevant requirements of Subdivision 115-A are met.

101. One of those requirements is that the capital gain must result from a CGT event happening to a CGT asset that was acquired by the entity making the capital gain at least 12 months before the CGT event (subsection 115-25(1)).

102. This means that a capital gain made by a SMS shareholder when they dispose of their SMS share is a discount capital gain if the shareholder acquired the SMS share at least 12 months before the date of disposal under the scheme, being 26 September 2017, and the other requirements in Subdivision 115-A are satisfied.

#### ***Non-resident SMS shareholders***

103. Under subsection 855-10(1), an entity disregards a capital gain or capital loss 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'.

104. The term 'taxable Australian property' is defined in the table in section 855-15. 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) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

105. Item 2 of the table in section 855-15 defines taxable Australian property to include an indirect Australian real property interest. An indirect Australian real property interest under section 855-25 is an interest held by an entity in another entity if it passes:

- the non-portfolio interest test under section 960-195, and
- the principal asset test in section 855-30.

106. The non-portfolio interest test under section 960-195 is as follows:

An interest held by an entity (the holding entity) in another entity (the test entity) passes the non-portfolio interest test at a time if the sum of the direct participation interests held by the holding entity and its associates in the test entity at that time is 10% or more.

107. A non-resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happens under the Scheme, cannot disregard under subsection 855-10(1) a capital gain or capital loss from CGT event A1 happening if their shares in SMS are indirect Australian real property interests (item 2 of the table in section 855-15).

108. On the basis that there were no non-residents, either alone or together with any associates, who beneficially hold more than 10% of the shares in SMS, none of the SMS shares disposed of as part of the scheme passes the non-portfolio interest test. Consequently, SMS shares held by non-residents do not constitute indirect Australian real property interests.

109. Since the first condition of an indirect Australian real property interest under section 855-25 is not satisfied, it is not necessary to consider the application of the principal asset test. The SMS shares do not constitute 'taxable Australian property' of non-resident shareholders.

## The anti-avoidance provisions

### **Section 177EA**

110. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes seeking to obtain a tax advantage in relation to imputation benefits. In essence, it applies to schemes for the disposition of shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares.

111. If section 177EA of the ITAA 1936 applies, the Commissioner may make a determination under subsection 177EA(5) of the ITAA 1936 that either a franking debit arises to the company in respect of each distribution paid to the relevant taxpayer (paragraph 177EA(5)(a) of the ITAA 1936) or, in the alternative, that no imputation benefit arises in respect of a distribution paid to the relevant taxpayer (paragraph 177EA(5)(b) of the ITAA 1936).

112. Subsection 177EA(3) of the ITAA 1936 provides that section 177EA of the ITAA 1936 applies if:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
  - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
  - (ii) a frankable distribution has flowed directly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the person (the **relevant taxpayer**) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) 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 the relevant taxpayer to obtain an imputation benefit.

### *Special Dividend*

113. SMS is a corporate tax entity. The sale of the ordinary shares in SMS pursuant to a SIA is a scheme for the disposition of membership interests. The fully franked Special Dividend is a frankable distribution that was paid to SMS shareholders (the relevant

taxpayers) as a part of this scheme and who could, therefore, reasonably be expected to receive imputation benefits.

114. In the present case, it is considered that the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme (as provided for in subsection 177EA(17) of the ITAA 1936), it would be concluded that, on the part of SMS, its shareholders or any other relevant party, there is a purpose, more than merely an incidental purpose, of conferring an imputation benefit under the scheme

115. In arriving at a conclusion, one must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of diverse matters which, taken individually or in conjunction with other matters, listed or not, could indicate the requisite purpose, that is, that the delivery of the imputation benefit is more than an incidental purpose of the scheme.

116. The relevant circumstances are that the disposition of the ordinary shares in SMS was made pursuant to a takeover by ASG by way of SIA under the *Corporations Act 2001* voted upon by SMS shareholders entitled to vote.

117. SMS's scheme of arrangement is a normal commercial transaction under which SMS is being acquired by ASG.

118. SMS shareholders are a mix of residents and non-residents. The fully franked Special Dividend was paid to all the existing shareholders of SMS in proportion to the number of shares that each shareholder held on the Special Dividend Record Date and irrespective of their ability to utilise the relevant franking credits. The Special Dividend allowed SMS shareholders to share in the accumulated profits of SMS.

119. In considering the manner, form and substance of the scheme, it is considered that the scheme is not being entered into by SMS or SMS shareholders for more than an incidental purpose of enabling SMS shareholders to obtain imputation benefits. The provision of imputation benefits to SMS shareholders remains incidental, in the sense of being subservient to, the purpose of transferring their shares to ASG.

120. Having regard to the relevant circumstances of the scheme, it cannot be concluded that SMS or SMS shareholders entered into or carried out the scheme for the purpose of enabling the SMS shareholders to obtain an imputation benefit.

121. As such, the Commissioner has come to the view that the requisite purpose is not present and accordingly the Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefit to be received in relation to the Special Dividend.

**Section 204-30**

122. Section 204-30 applies where a corporate tax entity streams the payment of dividends or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an \*imputation benefit is, or apart from this section would be, received by a \*member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a)), and
- (b) the member would \*derive a \*greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)), and
- (c) the other member of the entity will receive lesser imputation benefits, or will not receive any imputation benefits, whether or not the other member receives other benefits (paragraph 204-30(1)(c)).

123. Relevantly, if section 204-30 applies, the Commissioner has the discretionary powers under subsection 204-30(3) to make a written determination.

124. Subsection 204-30(3) provides:

The Commissioner may make one or more of these determinations:

- (a) that a specified \*franking debit arises in the \*franking account of the entity, for a specific \*distribution or other benefit to a disadvantaged member;
- (b) that a specified \*exempting debit arises in the \*exempting account of the entity, for a specified \*distribution or other benefit to a disadvantaged member;
- (c) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination.

A determination must be in writing.

125. 'Streaming' is not defined for the purposes of section 204-30. However, the Commissioner has understood it to refer to a company 'selectively directing the flow of franked distributions to those members who can most benefit from the imputation credits' (paragraph 3.28 of the Explanatory Memorandum to the New Business Tax System (Imputation) Bill 2002).

126. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from franking credits than another member of the entity. The words 'derive a greater benefit from franking credits' are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

127. Under the current arrangement, all SMS shareholders received an imputation benefit when the Special Dividend was paid. The imputation benefit for resident shareholders is in the form of a tax offset (paragraph 204-30(6)(a)), and for non-resident shareholders is in the form of not being liable to pay dividend withholding tax

(paragraph 204-30(6)(e)). The resident shareholders may derive a greater benefit from franking credits than the non-resident shareholders.

128. However, the Special Dividend was paid equally to all SMS shareholders and was fully franked regardless of their tax profiles. Accordingly, it cannot be said that SMS selectively directed the flow of franked distributions to those members who could most benefit from the franking credits.

129. As the conditions in subsection 204-30(1) have not been met, the Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole of, or any part of, the imputation benefit received by a SMS shareholder in relation to the Special Dividend.

## **Section 207-145**

130. Pursuant to subsection 207-145(1), gross-up and tax offset treatment under sections 207-20, 207-35 and 207-45 does not apply if an entity makes a franked distribution to another entity in one or more of the following circumstances:

- (a) the entity is not a qualified person in relation to the distribution for the purposes of Division 1A of former Part IIIAA of the *Income Tax Assessment Act 1936*;
- (b) the Commissioner has made a determination under paragraph 177EA(5)(b) of that Act that no imputation benefit (within the meaning of that section) is to arise in respect of the distribution for the entity;
- (c) the Commissioner has made a determination under paragraph 204-30(3)(c) of this Act that no imputation benefit is to arise in respect of the distribution for the entity;
- (d) the distribution is made as part of a dividend stripping operation
- (da) the distribution is one to which section 207-157 (which is about distribution washing) applies;

then, ...

131. Explanation of whether a SMS shareholder is a qualified person in relation to the Special Dividend for the purpose of the former Division 1A of the ITAA 1936 is contained in paragraphs 66 to 70.

132. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 or paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefit in relation to the Special Dividend.

133. Paragraph 207-145(1)(d) applies if a franked distribution is made as part of a dividend stripping operation. A distribution will be taken to be made as part of a dividend stripping operation, pursuant

to section 207-155, if the making of the distribution arose out of, or was made in the course of, a scheme that:

- (a) was by way of, or in the nature of, dividend stripping; or
- (b) had substantially the effect of a scheme by way of, or in the nature of, dividend stripping.

134. Having regard to the circumstances of the SIA under which SMS shareholders disposed of their SMS shares to ASG, the Commissioner considers that the payment of the Special Dividend to SMS shareholders was not made as part of a dividend stripping operation. Therefore, paragraph 207-145(1)(d) will not apply to the Special Dividend.

135. Consequently, section 207-145 will not apply to the Special Dividend received by the SMS shareholders.

## Appendix 2 – Detailed contents list

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