


CR 2019/12 - Income tax: Phileo Australia Limited - selective capital reduction

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Class Ruling

Income tax: Phileo Australia Limited – selective capital reduction

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

This publication (excluding appendices) 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 provisions 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)
- subsection 44(1) of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- Division 16K of Part III (Division 16K) of the ITAA 1936
- Section 177EA of the ITAA 1936
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 8-1 of the ITAA 1997

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- Division 67 of the ITAA 1997
- section 104-25 of the ITAA 1997
- section 116-20 of the ITAA 1997
- section 118-20 of the ITAA 1997
- section 118-25 of the ITAA 1997
- section 202-40 of the ITAA 1997
- section 202-45 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-145 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Phileo Australia Limited (Phileo) who:

- participated in the selective capital reduction that is described in the Scheme part of this Ruling
- are residents of Australia as defined in subsection 6(1) of the ITAA 1936 at the record date
- held their ordinary shares in Phileo (Phileo shares) on the Record Date of 23 January 2019
- had their Phileo shares cancelled on the Implementation Date of 31 January 2019, and
- are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Phileo shares.

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

Phileo shareholders who satisfy these requirements are referred to as Participating Shareholders in this Ruling.

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 9 to 26 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

7. This Ruling applies from 1 July 2018 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 *Public Rulings*).

Scheme

8. 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

9. Phileo is an Australian incorporated company and has been listed on the Australian Securities Exchange (ASX) since 1987. Phileo is a property investment company with holdings in commercial real estate and development sites. Phileo generates revenue from the rental of its commercial property holdings and from the development and subsequent sale of its property holdings. The Phileo group of companies comprises Phileo and three wholly owned subsidiaries.

10. As at 30 June 2018, Phileo had 28,927,016 ordinary shares on issue of which the major shareholder held approximately 35.78%. The remaining ordinary shares were held by a mix of individuals, companies and superannuation funds, some of whom are residents of Australia and some of whom are non-residents of Australia.

11. Phileo has a single class share capital structure consisting of ordinary shares.

The selective capital reduction

12. On 5 October 2018, Phileo announced to the ASX its intention to seek shareholder approval to undertake a selective capital reduction in accordance with section 256B of the *Corporations Act 2001* (Corporations Act), by way of a cancellation of shares in Phileo. All shareholders in Phileo, other than the Major Shareholder and his controlled entities, would have the opportunity to participate in the share capital reduction. The selective capital reduction will provide commercial and financial benefits to Phileo as a whole and to the shareholders who choose to participate in the selective capital reduction (the Participating Shareholders).

13. The selective capital reduction was proposed to be undertaken for the following reasons:

- the low liquidity of Phileo shares
- Phileo not being able to access equity capital markets through its listing on the ASX
- Phileo considers that the selective capital reduction provides a better return for Exiting Shareholders than available alternatives, and
- the achievement of savings in administration and compliance costs.

14. Under the selective capital reduction proposal, a maximum of 10.5 million shares, representing approximately 36% of Phileo's current share capital, would be cancelled for cash consideration of \$12.66 for each share cancelled.

15. The top 10 largest Phileo shareholders own in excess of 90% of Phileo shares on issue.

16. It was proposed that the cash sum payable by Phileo to the shareholders who chose to participate in the selective capital reduction in consideration for the cancellation of their shares would be \$12.66 per share (the Cancellation Payment). As such, Phileo would be required to pay up to a maximum of approximately \$132.93 million in total to the Participating Shareholders.

17. The total Cancellation Payment under the selective capital reduction was funded primarily by way of the existing cash reserves of Phileo and from its ability to borrow further funds if necessary. Phileo has recently negotiated an increase in its existing debt facility with a bank to partly fund the Cancellation Payment.

18. The selective capital reduction was subject to shareholder approval and was approved via a special resolution passed at a general meeting of all Phileo shareholders on 20 December 2018 and via a special resolution at a special meeting of exiting and partially exiting shareholders held immediately after.

19. On 18 January 2019, Phileo applied to the ASX for a grant of a voluntary suspension in the trading of Phileo shares with effect from the close of trading at 4pm (Melbourne time) on Monday 21 January 2019. On 21 January 2019, Phileo shares were suspended from quotation on the ASX.

20. Subsequent to this:

- Phileo implemented the selective capital reduction on 31 January 2019 with Phileo shares representing approximately 32.81% of its issued shares being cancelled
- the final price for the Cancellation Payment was \$12.66 per share, and
- Phileo debited \$1.21 per share of the Cancellation Payment to its share capital account and debited the balance of \$11.45 per share to its retained earnings account.

Phileo made an application to be delisted from the ASX with effect from 1 February 2019.

Other matters

21. As at 30 June 2018, the financial statements of Phileo disclose \$19,910,650 in share capital and \$187,908,508 in retained earnings.

22. As at 30 June 2018, Phileo had existing cash reserves of approximately \$152,687,000.

23. As at 28 August 2018, the estimated franking account balance of Phileo was \$19,422,567.

24. Under the selective capital reduction the Dividend Component will be partially franked.

25. Phileo has paid a yearly dividend of between \$0.02 and \$0.10 cents per share fully franked in each of the last ten years.

26. Phileo's share capital account, as defined in subsection 995-1(1) of the ITAA 1997 by reference to section 975-300 of the ITAA 1997, is not tainted for the purposes of Division 197 of the ITAA 1997.

Ruling

Division 16K

27. The selective capital reduction will not be a share buy-back for the purposes of Division 16K of the ITAA 1936.

The Dividend and Capital Components

28. The amount proposed to be paid by Phileo to Participating Shareholders in respect of the cancellation of a share under the selective capital reduction will be a distribution made by the company to its shareholders. The distribution will be a dividend for tax purposes to the extent that it is not debited to Phileo's share capital account (paragraphs (a) and (d) of the definition of 'dividend' in subsection 6(1) of the ITAA 1936). As \$1.21 of the consideration will be debited against Phileo's share capital account (the Capital Component), the Participating Shareholder will receive a dividend for tax purposes of \$11.45 (the Dividend Component) for each Phileo share cancelled.

Franking of the Dividend Component

29. The Dividend Component will be a frankable distribution pursuant to subsection 202-40(1), and will not be rendered unfrankable by section 202-45.

Assessability of the Dividend Component for Participating Shareholders

30. The Dividend Component will be included in the assessable income of resident shareholders who participate in the selective capital reduction under subparagraph 44(1)(a) of the ITAA 1936.

Shares held on revenue account

31. Where the shares are held as revenue assets, the amount by which the Capital Component (\$1.21 per share) exceeds the cost of each share will be included in the resident Participating Shareholder's assessable income under section 6-5. Correspondingly, if the cost exceeds the Capital Component of \$1.21 per share the difference will be an allowable deduction under section 8-1.

Shares held as trading stock

32. Where the shares are held as trading stock, the Capital Component of \$1.21 per share will be included in the resident Participating Shareholder's assessable income under section 6-5.

Gross-up and tax offset

33. An amount equal to the franking credit on the Dividend Component (gross-up) will be included in the assessable income of Participating Shareholders under subsection 207-20(1).

34. Participating Shareholders will be entitled to a tax offset under subsection 207-20(2) equal to the amount of the franking credit on the

Dividend Component (tax offset), subject to being a 'qualified person': see paragraph 207-145(1)(a).

Qualified persons

35. For the purposes of Division 1A of former Part IIIAA, Participating Shareholders are considered to have satisfied the holding period rule under former section 160APHO and therefore be qualified persons (as long as the related payments rule is also met) in relation to the Dividend Component under the selective capital reduction if:

- the shares were acquired no less than 45 days prior to the date of cancellation of the shares under the selective capital reduction, not counting the date of acquisition and the date of disposal
- the Participating Shareholder has no other positions (for example, an option) in relation to the shares cancelled under the selective capital reduction, and
- the Participating Shareholder or an associate of the Participating Shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

Refundable tax offset

36. The tax offsets will be subject to the refundable tax offset rules in Division 67. Certain trustees and corporate tax entities are not entitled to a refundable tax offset because of subsections 67-25(1A) to (1DA).

Capital gains tax consequences

37. CGT event C2 happens when a Participating Shareholder's Phileo share is cancelled under the selective capital reduction (paragraph 104-25(1)(a) and subsection 104-25(2)).

38. The capital proceeds received by a Participating Shareholder in respect of the cancellation of their Phileo share are the Cancellation Payment of \$12.66 per share (subsection 116-20(1)).

39. A Participating Shareholder makes a capital gain if the capital proceeds for the cancellation of their Phileo share is more than the cost base of that share. The capital gain is equal to the amount of the excess (subsection 104-25(3)).

40. A Participating Shareholder makes a capital loss if the capital proceeds from the cancellation of their Phileo share are less than the reduced cost base of that share. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

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41. Any capital gain made by a Participating Shareholder when CGT event C2 happens is reduced (but not below zero) by the amount of the gain that is included in the assessable income of the shareholder under section 6-5 or as a dividend under subsection 44(1) of the ITAA 1936 (subsections 118-20(2) and 118-20(3)).

42. A Participating Shareholder disregards a capital gain or capital loss made from the cancellation of their Phileo share if, at the time of the cancellation, the share is trading stock (subsection 118-25(1)).

The anti-avoidance provisions

Sections 45A and 45B

43. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Component of the Cancellation Payment received by Participating Shareholders.

Section 177EA

44. 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 benefits received in relation to the Dividend Component received under the selective capital reduction by Participating Shareholders.

Section 204-30

45. The Commissioner will not make a determination under paragraph 204-30(3)(c) to deny the whole, or any part, of the imputation benefits received in relation to the Dividend Component received under the selective capital reduction by Participating Shareholders.

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.*

Division 16K

46. Division 16K of the ITAA 1936 provides for the taxation treatment of share buy-backs. A share buy-back is defined as having the meaning given by paragraph 159GZZZK(a) of the ITAA 1936, which provides that a particular share purchase is a buy-back where it involves the company buying a share in itself from a shareholder in the company.

47. Phileo will not be buying back its shares from its shareholders. Instead they will be cancelled in accordance with section 256B of the *Corporations Act 2001*. Therefore, the selective capital reduction will not be treated as a buy-back for the purposes of Division 16K of the ITAA 1936.

The Dividend and Capital Components

48. The Cancellation Payment received by Participating Shareholders for each share cancelled under the selective capital reduction comprises two elements:

- a Dividend Component, and
- a Capital Component.

49. The amount of these components is determined in accordance with the definition of 'dividend' in subsection 6(1) of the ITAA 1936, having regard to how the company accounts for the selective capital reduction as outlined in paragraph 18 of this Ruling.

Assessability of the Dividend Component for Participating Shareholders

50. Subsection 44(1) of the ITAA 1936 includes in a shareholder's assessable income any dividends, as defined in subsection 6(1) of the ITAA 1936, paid to the shareholder out of profits derived by the company from any source (if the shareholder is a resident of Australia) or from an Australian source (if the shareholder is a foreign resident of Australia).

51. The definition of 'dividend' in subsection 6(1) of the ITAA 1936 has the effect that any distribution made by the company to any of its shareholders, whether in money or property, is a dividend except where the distribution is debited against an amount standing to the credit of the share capital account of the company (paragraphs (a) and (d) of the definition).

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52. 'Share capital account' is defined in subsection 975-300(1) 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.

53. Subsection 975-300(3) states that an account is taken not to be a share capital account if it is tainted. Subsection 197-50(1) states that a share capital account is tainted if an amount to which Division 197 applies, is transferred to the account and the account is not already tainted.

54. The Cancellation Payment of \$12.66 per share is a distribution made by Phileo to its Participating Shareholders. \$1.21 of the Cancellation Payment will be debited to Phileo's untainted 'share capital account' (Capital Component). As such it will not constitute a dividend as defined in subsection 6(1) of the ITAA 1936.

55. As the remainder of the Cancellation Payment will be debited to Phileo's retained earnings, Participating Shareholders will receive a dividend of \$11.45 per share (Dividend Component) for tax purposes.

Shares held on revenue account

56. Where the Phileo shares are held as revenue assets by Participating Shareholders, the amount by which the Capital Component (\$1.21 per share) exceeds the cost of each share is included in the shareholder's assessable income under section 6-5. Correspondingly, if the cost exceeds the Capital Component (\$1.21 per share), the difference is an allowable deduction under section 8-1.

Shares held as trading stock

57. Where the Phileo shares are held as trading stock by Participating Shareholders, the Capital Component (\$1.21 per share) will be included in the shareholder's assessable income under section 6-5.

Gross-up and tax offset

58. For Participating Shareholders, the Dividend Component will constitute a frankable distribution for the purposes of subsection 202-40(1), and is capable of being franked in accordance with section 202-5. Further, the Dividend Component will not be rendered an unfrankable distribution pursuant to the operation of section 202-45.

59. An amount equal to the franking credit on the Dividend Component should be included in the assessable income of Participating Shareholders in the year in which the distribution is made under subsection 207-20(1).

60. Participating Shareholders should be entitled to a tax offset under subsection 207-20(2) for the income year in which the

distribution is made. The tax offset is equal to the amount of the franking credit on the Dividend Component, subject to the Participating Shareholder being a 'qualified person' as per paragraph 207-145(1)(a).

Qualified persons

61. Paragraph 207-145(1)(a) provides that an entity that is not a 'qualified person' in relation to a franked distribution for the purposes of Division 1A of former Part IIIAA is denied a gross-up and a tax offset. Broadly speaking, to be a 'qualified person' in relation to the dividend paid under the selective capital reduction, the shareholder must satisfy the holding period rule for the appropriate qualification period. The relevant qualification period may be affected by the application of the related payments rule.

62. Broadly, a Participating Shareholder will not satisfy the related payments rule if the Participating Shareholder, or an associate of the Participating Shareholder, is under an obligation to make, or makes, a payment in respect of the dividend, which effectively passes on the economic benefit of the dividend to another person. In the present circumstances, participation in the selective capital reduction, in and of itself, would not constitute the making of a related payment by a Participating Shareholder.

63. The holding period rule requires shareholders to hold the shares, or the interest in the shares, on which the dividend is paid at risk for a continuous period of at least 45 days that includes the date upon which a dividend is paid. In determining whether a shareholder has satisfied the holding period rule, any days during which there is a materially diminished risk in relation to the relevant shares are not counted. The day of acquisition and the day of disposal of the relevant shares are also not counted.

64. Under former subsection 160APHM(2), a shareholder is taken to have materially diminished the risks of loss and opportunities for gain with respect to shares or interests in shares if the 'net position' of the shareholder results in the shareholder having less than 30% of the risks and opportunities relating to the shares or interest in the shares.

65. A Participating Shareholder will be a qualified person in relation to the Dividend Component of the selective capital reduction amount if the shares were acquired not less than 45 days prior to the date of cancellation of the shares under the selective capital reduction, not counting the date of acquisition and the date of disposal and the eligible shareholder has no other positions in relation to the shares cancelled under the selective capital reduction.

66. A Participating Shareholder who acquired shares that are subsequently cancelled under the selective capital reduction less than 45 days prior to the date of cancellation of the shares under the selective capital reduction will not be a qualified person under former

section 160APHO in relation to the dividend paid under the selective capital reduction for the purposes of Division 1A of former Part IIIAA.

Refundable tax offset

67. The tax offsets will be subject to the refundable tax offset rules in Division 67. Certain trustees and corporate tax entities would not be entitled to a refundable tax offset because of subsections 67-25(1A) to (1DA).

Capital gains tax consequences

CGT event C2 – section 104-25

68. Under paragraph 104-25(1)(a), CGT event C2 happens when an entity's ownership of an intangible CGT asset, such as a Phileo share, ends by the asset being redeemed or cancelled.

Time of the CGT event

69. The time of CGT event C2 is when the entity enters into the contract that results in the asset ending or, if there is no contract, when the asset ends (subsection 104-25(2)).

70. The cancellation of the shares under the selective capital reduction does not happen under a contract. Accordingly, CGT event C2 happens when a Phileo share ends by being cancelled under the selective capital reduction.

Capital proceeds

71. The capital proceeds from a CGT event are determined under Division 116.

72. Subsection 116-20(1) provides that the capital proceeds from a CGT event are the total of the money received, or entitled to be received, and the market value of any property received, or entitled to be received, in respect of the CGT event happening.

73. The capital proceeds for the cancellation of a Phileo share are the Cancellation Payment, being \$12.66 that a Participating Shareholder receives or will be entitled to receive in respect of the cancellation of their Phileo share.

Capital gain or loss

74. A Participating Shareholder makes a capital gain if the capital proceeds from the cancellation of their Phileo share are more than the share's cost base. A Participating Shareholder makes a capital loss if the capital proceeds from the cancellation are less than the reduced cost base of the share (subsection 104-25(3)).

Section 118-20

75. Under subsection 118-20(1), a capital gain made from a CGT event is reduced if, because of the event, a provision of the income tax legislation outside Part 3-1 includes an amount (for any income year) in an entity's assessable income. The capital gain is reduced by the amount included, but not below zero (subsections 118-20(2) and (3)).

76. Accordingly, a capital gain made by a participating shareholder from CGT event C2 is reduced by the amount that is included in their assessable income under section 6-5, as ordinary income (except where the shares were held as trading stock), or under subsection 44(1) of the ITAA 1936, as a dividend.

CGT consequences for shares held as trading stock

77. A capital gain or capital loss made by an entity from a CGT asset is disregarded if, at the time of the CGT event, the asset is held as the entity's trading stock (subsection 118-25(1)).

78. Accordingly, a capital gain or capital loss made by a Participating Shareholder from CGT event C2 is disregarded if, at the time of the cancellation of their Phileo share, the share is held as their trading stock.

The anti-avoidance provisions**Section 45A**

79. Sections 45A of the ITAA 1936 is an anti-avoidance provision which, if it applies, allows the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of such a determination is that all or part of the distribution of capital received by the shareholder under the selective capital reduction is treated as an unfranked dividend.

80. Section 45A of the ITAA 1936 applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders), who derive a greater benefit from the receipt of share capital, and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

81. Although there will have been a 'provision of capital benefit' (as defined in subsection 45A(3) of the ITAA 1936) to shareholders under the selective capital reduction, the circumstances of the selective capital reduction indicate that there will be no streaming of capital benefits to some shareholders and of dividends to other shareholders. Accordingly, section 45A of the ITAA 1936 does not apply.

Section 45B

82. Section 45B of the ITAA 1936 applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, section 45B of the ITAA 1936 applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936)
- (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) of the ITAA 1936), 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) of the ITAA 1936).

83. In the case of the selective capital reduction, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 will have been met, the requisite purpose of enabling the Participating Shareholders to obtain a tax benefit – by way of capital distribution – will not be present.

84. Having regard to the relevant circumstances of the scheme, set out in subsection 45B(8) of the ITAA 1936, it is apparent that the inclusion of a capital element in the consideration for the selective capital reduction will be appropriate. Further, the Capital Component of the Cancellation Payment cannot be said to be attributable to the profits of the company, nor does the pattern of distributions indicate that it will be paid in substitution for a dividend. Accordingly, section 45B of the ITAA 1936 does not apply.

Section 177EA

85. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes 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 in circumstances where the provision of the imputation benefits is a more than incidental purpose of the scheme.

86. Specifically, subsection 177EA(3) of the ITAA 1936 provides that section 177EA 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 indirectly, 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.

87. In the present case 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, it would be concluded that, on the part of Phileo, its shareholders or any other person, there is a more than incidental purpose of conferring an imputation benefit under the scheme. Under this scheme the relevant taxpayer is a Participating Shareholder and the scheme comprises the circumstances surrounding the Phileo selective capital reduction.

88. In arriving at a conclusion the Commissioner 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 encompass a range of circumstances which, taken individually or collectively, could indicate the requisite purpose. Due to the diverse nature of these circumstances, some may not be present at any one time in any one scheme.

89. The commercial objectives of the selective capital reduction in this case from Phileo's perspective are outlined in paragraph 14. Having regard to these objectives, and the relevant circumstances of the scheme, the Commissioner has come to the view that the requisite purpose is not present and accordingly will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936.

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Section 204-30

90. 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:

- an imputation benefit is, or apart from that section would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a))
- the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)), and
- 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)).

91. Relevantly, if section 204-30 applies the Commissioner is vested with a discretion under subsection 204-30(3) to make a determination in writing either:

- that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a)), or
- that no imputation benefit is to arise in respect of any streamed distributions made to a favoured member and specified in the determination (paragraph 204-30(3)(c)).

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

93. Under the selective capital reduction, Participating Shareholders will receive an imputation benefit as a result of the Dividend Component; in the form of a tax offset (paragraph 204-30(6)(a)). As the Dividend Component will be franked to the same extent and paid to all Participating Shareholders and having regard to the profile of Phileo's shareholders, it is concluded that Phileo has not directed the flow of distributions in such a manner as to ensure that imputation benefits are derived by members who derive greater benefit from franking credits, while other members receive lesser or no imputation benefits.

94. Having regard to all of the relevant circumstances the Commissioner has formed the view that section 204-30 does not apply to the selective capital reduction.

Appendix 2 – Detailed contents list

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

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NO: 1-G97SJL

ISSN: 2205-5517

ATOlaw topic: Income tax ~~ Capital management ~~ Returning capital
~~ Share capital return

BSL: PGH

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