PS LA 2008/10 - Application of section 45B of the Income Tax Assessment Act 1936 to share capital reductions

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Retrospective tax law changes have effect for a period before the date of enactment once the legislation is passed. See Administrative treatment of retrospective legislation.

This document has changed over time. This version was published on *19 October 2012*

Australian Government
Australian Taxation Office

Practice Statement Law Administration

PS LA 2008/10

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FOI status: may be released

This practice statement is issued under the authority of the Commissioner of Taxation and must be read in conjunction with Law Administration Practice Statement PS LA 1998/1. It must be followed by tax officers unless doing so creates unintended consequences or where it is considered incorrect. Where this occurs, tax officers must follow their business line's escalation process.

SUBJECT: **Application of section 45B of the *Income Tax Assessment Act 1936* to share capital reductions**

PURPOSE: **To provide instruction and practical guidance to tax officers on the application of section 45B of the *Income Tax Assessment Act 1936* to a share capital reduction by a company (or certain unit trusts treated as a company or head company for consolidation purposes), including a non-share distribution to the extent to which it is a non-share capital return**

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HOW TO USE THIS LAW ADMINISTRATION PRACTICE STATEMENT

1. This practice statement should be followed by tax officers who are considering whether or not section 45B of the *Income Tax Assessment Act 1936* (ITAA 1936),[1] will apply to an arrangement or proposed arrangement that is, or includes, a share capital reduction, including a non-share distribution to the extent to which it is a non-share capital return.

2. The practice statement follows the broad outline of section 45B covering scheme, capital benefit, obtaining a tax benefit, purpose and determinations.

3. The practice statement provides administrative and technical guidance on applying these elements of the section, and where appropriate includes further explanations or interpretations drawn from cited case law and Explanatory Memoranda. This practice statement documents what our practice has been in this area of the law since 1 July 1998.

ESCALATION PROCEDURE

4. Engagement of tax technical officers in Law and Practice on section 45B issues should be determined in accordance with PS LA 2012/1 *Guide to managing high risk technical issues and engagement of tax technical officers in Law and Practice*. In accordance with this practice statement, given the anti-avoidance nature of section 45B, where a decision to apply section 45B is made or is unable to be reached, engagement of tax technical officers in Law and Practice will be mandatory in order to determine whether the issue should be referred to the General Anti-Avoidance Panel for consideration.[2] However, if a business line determines that a section 45B issue is of sufficient risk to warrant Law engagement, tax technical officers in Law and Practice should also be engaged, regardless of the decision made by the business line to apply or not apply section 45B.

STATEMENT

Share capital reductions

5. A company may wish to reduce its issued share capital for various reasons, however this practice statement is concerned with the kind of reduction commonly referred to as a return of paid up share capital where the capital is surplus to needs or is replaced with debt. A company's share capital is the total amount of money representing what members, or persons proposing to be members of the company, have provided, or contractually bound themselves to provide, to the company, in cash or other value, for the company to use in its undertaking. The amount is provided in their capacity as members or intending members and not as creditors.[3]

6. A company cannot return share capital to members before a winding up except in accordance with the permitted processes set out in the *Corporations Act 2001* (the Corporations Act). Under the Corporations Act a transaction under which share capital is distributed to a shareholder (and is therefore reduced) other than in the case of a winding up is called a share capital reduction. The

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[1] All subsequent legislative references in this practice statement are to the ITAA 1936 unless otherwise specified.

[2] See PS LA 2005/24 *Application of General Anti Avoidance Rules* for details on the role and operation of this Panel.

[3] Ford H.A.J., Austin R.P., and Ramsay I.M., 2003, *Ford's Principles of Corporations Law* (11th ed) LexisNexis Butterworths, Sydney at paragraph [17.100].

Corporations Act specifies the circumstances in which a company may reduce its share capital, and the procedures which must be followed.

7. Share capital reductions not otherwise authorised under specific provisions of the Corporations Act are provided for in Division 1 of Part 2J.1 of the Corporations Act. Under section 256B of the Corporations Act a share capital reduction may be an equal or selective reduction and may or may not be accompanied by a cancellation of shares. Equal reductions relate only to ordinary shares, apply in proportion to the number of ordinary shares held and the terms of the reduction must be the same for each holder of ordinary shares.[4] Any reduction which does not meet these requirements is treated as a selective reduction for the purposes of the Corporations Act. Equal and selective reductions have different shareholder approval and notice requirements.

8. The tax consequences of a share capital reduction differ depending on whether it involves a share cancellation or not. In both cases however, to the extent that the distribution is debited against the share capital account it is not a dividend under subsection 6(1).[5] If the reduction does not involve a cancellation of shares, the distribution of share capital reduces the shareholder's cost base for the share under Capital Gains Tax (CGT) event G1.[6] To the extent that the distribution is in excess of the cost base of the share it will give rise to a capital gain under CGT event G1.[7]

9. In contrast, if the reduction does involve a cancellation of shares, the cancellation will result in CGT event C2[8] happening and, as a result, the shareholder may make a capital gain or capital loss depending on the amount of the distribution received and the cost base (or reduced cost base) of the share.

Share buy-backs

10. It should be noted that share buy-backs may involve a reduction in share capital. Share buy-backs are regulated by a different set of procedures in the Corporations Act,[9] and are identified as a separate type of transaction affecting share capital. Share buy-backs are also subject to specific tax treatment under Division 16K of Part III, which provides for tax consequences that are different from those arising from an equal or selective reduction, even if it includes a cancellation of shares. In particular, although a capital reduction can involve a dividend (to the extent the distribution exceeds the amount debited to the share capital account) and double tax on the dividend and capital gain is avoided by the application of section 118-20 of the *Income Tax Assessment Act 1997* (ITAA 1997), there is no possibility of a capital loss being generated by the application of the anti-overlap rules. In contrast to a share capital reduction, the share buy-back rules under Division 16K of Part III reduce the consideration on disposal of the share by reference to the dividend component, and a loss may result.

[4] Subsection 256B(2) of the Corporations Act.

[5] To the extent that a distribution in consideration for the cancellation of a share is not debited against share capital it will be received as a dividend under subsection 6(1), unless it comes within the exception in subsection 6(4), and would ordinarily be received as income.

[6] Section 104-135 of the ITAA 1997.

[7] Subsection 104-135(3) of the ITAA 1997.

[8] Section 104-25 of the ITAA 1997.

[9] Division 2 of Part 2J.1, being sections 257A to 257J of the Corporations Act.

11. The separate legislative approach in both the Corporations Act and the ITAA 1936 gives recognition in part to the commercial viewpoint of a share buy-back as a sale of the share as an item of property, even though this is contrary to the principle that the company is unable to own a claim against itself.[10] Ordinarily, what distinguishes a share buy-back from other forms of share capital reduction is that the shareholder to whom the company makes an offer to buy back may decide whether or not to 'sell'. In contrast, under other forms of share capital reduction the company can deprive shareholders of their shares without consent.[11] For these reasons, an arrangement which is a share buy-back within the meaning of section 159GZZZK is outside the scope of this practice statement.[12]

12. The Corporations Act also provides for other circumstances which may involve a reduction in share capital.[13] For instance, a company may cancel shares that have been forfeited under the terms on which the shares are on issue. A company may also reduce its share capital by cancelling any paid up share capital that is lost or is not represented by available assets as long as the company does not also cancel shares.

13. A reduction in share capital may also occur when there is redemption of redeemable preference shares out of the proceeds of a new issue of shares made for the purpose of the redemption under section 254K of the Corporations Act. It should be noted that this is subject to the definition of a 'dividend' in paragraph 6(1)(e). The definition provides that the redemption proceeds will be treated as a return of capital only to the extent that the proceeds represent a return of share capital attributable to that share, and if the company provides the relevant notice to the holder of the redeemable preference share. A reduction in share capital in the circumstances described in this and the preceding paragraph is also outside the scope of this practice statement.

Demergers

14. The demerger of a company may also involve a reduction in share capital. Demergers that involve a reduction in share capital that occur on or after 1 July 2002 and fall within the definition of 'demerger' in section 125-70 of the ITAA 1997 are outside the scope of this practice statement.[14] This practice statement is relevant to demerger arrangements that involve reductions of share capital that occur before 1 July 2002, or otherwise do not satisfy the section 125-70 of the ITAA 1997 definition.

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[10] This is despite the fact that section 257H of the Corporations Act provides that entry into an agreement to buy back a share will trigger the suspension of all rights attaching to the share and once bought back the share is cancelled immediately after its transfer to the company is registered.

[11] For instance, under an equal share capital reduction once approved by ordinary resolution of members all shareholders will be proportionately affected, whether they voted for it or not.

[12] The tax implications of share buy-backs are covered by Law Administration Practice Statement PS LA 2007/9 Share Buy-Backs, which includes a discussion on section 45B.

[13] Division 3 of Part 2J.1, being sections 258A to 258F of the Corporations Act.

[14] The application of section 45B of the ITAA 1936 to demergers within the meaning of Division 125 of the ITAA 1997 is covered by Law Administration Practice Statement PS LA 2005/21 Application of Section 45B of the Income Tax Assessment Act 1936 to demergers.

Unit trusts

15. As a consequence of the consolidation rules in Division 713 of the ITAA 1997, section 45B can apply to distributions by corporate unit trusts and public trading trusts treated like a company or a head company of a consolidated group. The modifications to the applied law pursuant to section 713-140 of the ITAA 1997 provide that a reference to a dividend in the ITAA 1936 and ITAA 1997 includes a reference to a distribution from the trust out of profits and a reference to a share capital account includes a reference to the amount of the trust estate that is not attributable to profits.

16. However, corporate unit trusts and public trading trusts which are not subject to the consolidation rules and are treated as companies under Divisions 6B or 6C of Part III are subject to the rules against 'unit trust dividend' substitution at subsections 102L(18) and 102T(19) respectively and section 45B does not apply to them.

Non-share distributions to the extent to which they are a non-share capital return

17. The debt/equity rules in Division 974 of the ITAA 1997 characterise an interest in a company as equity or debt for the purpose of determining the taxation treatment of the return on the interest. Under these rules, an equity interest may include an interest that is not in the form of a share and is called a 'non-share equity interest'. Certain distributions on a non-share equity interest, called 'non-share dividends', are entitled to be franked and are treated in the same way as a frankable dividend. However, it is also recognised through the concept of 'non-share capital returns' that not all non-share distributions will be dividends.

18. Subsection 45B(7) provides that, for the purposes of the application of section 45B, a non-share distribution to an equity holder is taken to be a distribution to the equity holder of share capital to the extent to which it is a non-share capital return. Thus, transactions that involve non-share capital returns are also susceptible to the application of section 45B.

19. A 'non-share distribution' is defined in Division 974 of the ITAA 1997 as a distribution to a holder of a non-share equity interest. An 'equity holder' is an entity that holds an 'equity interest' which, as defined in Division 974 of the ITAA 1997, may include a non-share interest. To the extent that a non-share distribution is not a non-share dividend[15] it is a 'non-share capital return.' A non-share distribution is not a non-share dividend to the extent to which the company debits the distribution against the company's non-share capital account or the company's share capital account (if permitted by the Corporations Act).[16] Thus, a non-share capital return is the amount of the non-share distribution that has been debited against the company's non-share capital account or share capital account.

20. A company's non-share capital account is a notional account required by Division 164 of the ITAA 1997 which records contributions to the company in respect of non-share equity interests and returns by it of those contributions. The account continues in existence even if the company ceases to have any non-share equity interests on issue; further, the balance of the account cannot fall below nil.[17]

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[15] Section 974 -125 of the ITAA 1997.

[16] Section 974 -120 of the ITAA 1997.

[17] Subsections 164-10(2) and (3) of the ITAA 1997.

21. The only credits and debits that can be made to the non-share capital account are specified in sections 164-15 and 164-20 of the ITAA 1997. Thus, the circumstances in which a company can validly debit its non-share capital account are limited. Subsection 164-20(1) of the ITAA 1997 provides that the company may debit the whole or a part of a non-share distribution against the company's non-share capital account:

(a) to the extent to which the distribution is made as consideration for the surrender, cancellation or redemption of a non-share equity interest, or

(b) to the extent to which the distribution is made in connection with a reduction in the market value of a non-share equity interest as long as the amount of the distribution is equal to the amount of the reduction in market value.

22. The total of the amounts debited to the account in respect of a particular non-share equity interest cannot exceed the total of the amounts credited to the account in respect of the interest.[18] The other circumstance where a debit is permitted to the non-share capital account is in the case where the equity interest changes to a debt interest.[19]

23. Accordingly, distributions of non-share capital returns in consideration for the surrender, redemption or cancellation of a non-share equity interest or in connection with a reduction in the market value of a non-share equity interest will also be the subject of this practice statement, and will be referred to as non-share capital reductions. Some examples of non-share equity interests in respect of which non-share capital returns may be made include certain convertible notes or perpetual securities; the return on which are contingent on the profitability of the company.

24. Another example of a non-share equity interest in respect of which non-share capital returns may be made are certain loans made to companies which are often interest free, have no fixed repayment date for the principal and instead are repayable on demand by the lender. These interests are often called 'at call' loans. Prior to 1 July 2005, at call loans covered by subsection 974-75(4) of the ITAA 1997 were deemed to be debt interests and therefore section 45B could not apply to such interests. With effect from 1 July 2005, certain at call loans will continue to be treated as a debt interest if they meet the requirements in subsections 974-75(6) and (7) of the ITAA 1997. However, loans which do not meet the requirements of subsections 974-75(6) and (7) of the ITAA 1997, for instance because they are not made by a connected entity of the borrower company, or the borrower company has an annual turnover of $20 million or more at the end of any income year, may constitute non-share equity interests and thus section 45B may apply to non-share capital returns made in respect of such interests.

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[18] Subsection 164-20(2) of the ITAA 1997.

[19] Subsections 164-20(3) and (4) of the ITAA 1997. (In the event of the re-characterisation of an equity interest into debt, a person is not ordinarily provided with a capital benefit within the meaning of paragraph 45B(2)(a) and therefore section 45B cannot apply. Consequently, this scenario is not discussed further in this practice statement.)

Background to section 45B

25. In 1998 the Company Law Reform Bill 1997 removed some of the restrictions on share capital reductions by giving companies the ability to return capital subject to the reduction being fair and reasonable to shareholders as a whole and not prejudicial to creditors. Previously, a company could not undertake a share capital reduction without confirmation from the court as well as shareholder approval. Under the amendments a company would be permitted to reduce its capital after notification to Australian Securities and Investments Commission and approval by the appropriate majority of shareholders. This, in addition to earlier changes made to the Corporations Law in relation to share buy-backs, made it easier for companies to make distributions of capital to shareholders. Thus, the form of any distribution to shareholders became largely a matter of the company's choice.

26. As a result of these changes to the Corporations Law, the *Taxation Laws Amendment (Company Law Review) Act 1998* amended the ITAA 1936 and introduced, amongst other provisions, section 45B. Section 45B (as it was introduced at that time) was a specific anti-avoidance provision concerned with providing a framework in the taxation law that would prevent companies from distributing what are effectively profits to shareholders as preferentially taxed capital rather than dividends.[20]

27. Section 45B was further amended in 2002 by the *New Business Tax System (Consolidations, Value Shifting, Demergers and Other Measures) Act 2002* so that it could also act as an integrity rule in the circumstances of a demerger. The application of section 45B to demergers is discussed in Law Administration Practice Statement PS LA 2005/21 *Application of section 45B of the Income Tax Assessment Act 1936 to demergers*.

The purpose of section 45B

28. Subsection 45B(1) provides that the purpose of section 45B is to ensure that relevant amounts are treated as dividends for tax purposes if the capital and profit components of a demerger allocation do not reflect the circumstances of the demerger, or certain payments, allocations or distributions are made in substitution for dividends.

29. Thus, as observed at paragraph 18 in PS LA 2005/21, section 45B serves two objects, one concerned with the provision of 'demerger benefits' and the second concerned with the provision of 'capital benefits'. This practice statement addresses arrangements subject to the second object, as a share capital reduction results in the distribution of share capital to the shareholder and thus the provision of a 'capital benefit'.

30. In essence, the second object of section 45B is concerned with ensuring that companies do not distribute what are effectively profits to shareholders as preferentially-taxed capital rather than dividends. The substituted dividend rule of section 45B requires that the Commissioner identify and weigh all of the relevant circumstances surrounding the provision of a 'capital benefit' to the relevant taxpayer, in order to determine whether the object of delivering a tax preferred receipt to the shareholders constitutes a more than incidental purpose of the scheme.

[20] Explanatory Memorandum for the Taxation Laws Amendment (Company Law Review) Bill 1998, at paragraph 1.5.

31. Section 45B does not premise that a dividend would have been paid if the share capital had not been distributed, unlike Part IVA which operates on the basis of reasonable expectation of the alternative. Rather, the reference in section 45B to dividend substitution is a reference to the distribution being more readily attributable to the company's profits than its share capital.

32. As noted at paragraph 59 in PS LA 2005/21, section 45B is concerned not only with capital benefits provided in substitution for an ordinary dividend, but also the substitution of capital benefits for extraordinary dividends.

Section 45B is not a profits first rule

33. Section 45B is not a 'profits first' rule. It is a sanction against schemes to provide shareholders with capital benefits, including distributions of share capital, which were entered into or carried out for a significant purpose of enabling the shareholder to benefit from receiving preferentially taxed capital rather than profit.

34. However, although section 45B does not apply on a profits first basis, by implication it does presuppose some objective non-tax basis for distributing capital rather than profits, where both are available. Essentially, profits are a gain to the company which, when surplus to the company's needs, are meant to be divided amongst the shareholders; hence the word 'dividend'. Share capital, on the other hand, is the money contributed by the company's members for carrying out its objects until some event or circumstance renders its retention unnecessary, whereupon it may be returned.

35. However, generation of surplus funds from carrying on business in the ordinary way is the occasion for the distribution of a dividend, not a return of capital. Indeed, the Corporations Law reflects this difference by imposing more onerous statutory requirements on a distribution of share capital.

36. Broadly, the Corporations Act provides that a distribution of profit is a matter for the discretion of the company's directors, provided profits are available[21] and the company is solvent.[22] A distribution of share capital, on the other hand, is a more restrictive exercise which requires the agreement of the shareholders acting in the certainty that the distribution is fair and reasonable to the company's shareholders as a whole and does not materially prejudice the company's ability to pay its creditors.[23]

37. In other words, profits are distributed by executive decision, but distribution of a company's share capital, which is the money contributed by its members for carrying out its objects,[24] requires the members' agreement that, in effect, it is no longer needed by the company for that purpose.

38. If, therefore, a company can choose to distribute either capital or profits, there should be compelling, objective and commercial reasons why a company would choose the difficulty of distributing share capital over the relative simplicity of distributing profits, other than the tax preference of shareholders. Section 45B provides for those reasons to be identified and considered in determining whether the requisite purpose for the application of the section is present in relation to the distribution.[25]

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[21] Section 254T of the Corporations Act.

[22] Section 588G of the Corporations Act.

[23] Section 256B of the Corporations Act.

[24] *Knowles And Haslem v. Ballarat Trustees, Executors And Agency Co. Ltd* (1916) 22 CLR 212 at 253.

[25] Subsection 45B(8) provides for all of the relevant circumstances of the scheme to distribute share capital to be considered in coming to an objective conclusion as to whether the requisite purpose for the section to apply is present. Paragraph 45B(8)(k) is especially pertinent to exploring the non-tax reasons for the capital distribution.

The application of section 45B to share capital reductions

39. In so far as it relates to the provision of a capital benefit, subsection 45B(2) provides that section 45B applies where:

- there is a scheme under which a person is provided with a capital benefit by a company
- under the scheme, a taxpayer (the 'relevant taxpayer'), who may or may not be the person provided with the capital benefit, obtains a tax benefit, and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into 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 (the 'relevant taxpayer') to obtain a tax benefit.

Scheme

40. A 'scheme' for the purposes of section 45B of the ITAA 1936 is taken to have the same meaning as provided in subsection 177A(1) of Part IVA of the ITAA 1936 pursuant to the reference to 'scheme' in subsection 995-1 of the ITAA 1997 contained in section 45B(10) of the ITAA 1936.[26] That definition is widely drawn and includes any agreement, arrangement, understanding, promise, undertaking, scheme, plan or proposal. In particular, a scheme is anything that satisfies any of the terms in the statutory definition. It does not have to be a 'wide scheme' nor does its reach have to include matters covering its overall commercial result or its 'practical meaning': *Commissioner of Taxation v. Hart*.[27] However the 'scheme' is defined, it must be related to the tax benefit obtained.[28] For further discussion regarding the meaning of scheme reference should also be made to Law Administration Practice Statement PS LA 2005/24 *Application of General Anti-Avoidance Rules*, which provides practical guidance on the application of the general anti-avoidance rules.

41. Accordingly, a share capital reduction would normally constitute either a scheme or a part of a scheme for the purposes of section 45B. The identification of the scheme and, in particular, whether other transactions connected to the share capital reduction form part of the scheme or not, will depend on the circumstances of the case. The objective purpose required to be drawn by paragraph 45B(2)(c) is tested against a person who entered into or carried out the scheme or any part of the scheme. Thus, as long as the scheme gives rise to a tax benefit, whether the scheme is wider or narrower than other schemes that can be identified should not be relevant in determining whether section 45B applies or not.

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[26] Section 45B(10) of the ITAA 1936 was amended by Item 126 of Schedule 6 of the *Tax Laws Amendment (2010 Measures No. 1) Act 2010* with effect from 3 June 2010.

[27] (2004) 217 CLR 216; 2004 ATC 4599; 55 ATR 712 per Gummow and Hayne JJ at CLR 238-239; ATC 4610-4611; ATR 725-726.

[28] *Commissioner of Taxation v. Hart* (2004) 217 CLR 216; 2004 ATC 4599; 55 ATR 712 per Gleeson CJ and McHugh J at CLR 225; ATC 4603; ATR 716-717.

Provided with a capital benefit

42. The concept of being provided with a 'capital benefit' is explained in subsection 45B(5). The subsection indicates that a person is provided with a 'capital benefit' if:

- they are provided with an ownership interest in a company
- they receive distributions of share capital or share premium, or
- something is done that increases the value of their ownership interest.

43. Generally a capital benefit can be provided to a shareholder (or a non-shareholder) by issuing ownership interests, distributing share capital or share premium, or altering the character of an ownership interest in a way which increases its value in the hands of the owner, for example by adding preferential rights. This method of providing a capital benefit may not affect the company's economic position, but it nonetheless advantages the taxpayer economically by adding value to their ownership interests, which can subsequently be realised in their hands.

44. However, here we are primarily concerned with a share capital reduction by way of a return of share capital to the shareholder, which constitutes a capital benefit within the meaning of paragraph 45B(5)(b). A non-share capital reduction will also involve a person being provided with a capital benefit, being the distribution of share capital under paragraph 45B(5)(b), to the extent to which it involves the equity holder receiving a distribution of non-share capital return. This is because subsection 45B(7) provides that a non-share distribution to an equity holder is taken to be the distribution to the equity holder of share capital to the extent to which it is a non-share capital return.

45. Accordingly, a person is provided with a capital benefit to the extent to which a non-share equity interest is redeemed (and therefore repaid), or part of the interest is redeemed or repaid, and the company debits the non-share capital account to reflect this.

The relevant taxpayer

46. The 'relevant taxpayer' is the taxpayer who obtains a tax benefit, within the meaning of subsection 45B(9), under the scheme. Under a share capital reduction or non-share capital reduction, the relevant taxpayer (or taxpayers) will ordinarily be one or more of the owners or shareholders of the company, as it is they who are provided with the capital benefit and thus, a tax benefit. However, there is no requirement that the relevant taxpayer be the person who is provided with the capital benefit.

47. This practice statement proceeds on the basis that the relevant taxpayer(s) are the owners or shareholders of the company in order to provide useful guidance on the application of section 45B. However, tax officers should recognise that there may be cases where the relevant taxpayer is someone other than a shareholder in the company.

Tax benefit

48. Under subsection 45B(9) the relevant taxpayer obtains a tax benefit if an amount of tax payable, or any other amount payable under the ITAA 1936 and ITAA 1997, by the relevant taxpayer would, apart from section 45B, be less than the amount that would have been payable, or would be payable at a later time than it would have been payable, if the capital benefit had been a dividend.

49. As discussed in paragraphs 36 to 40 of PS LA 2005/21, the tax effect of paying the amount as a dividend must be taken into account in determining whether the taxpayer has obtained a tax benefit or not. In this regard, the tax payable (or any other amount payable under the Act) on the notional dividend is ascertained in a continuum and not just for the year in which the dividend is received. In other words, the provision acknowledges that the notional dividend might not give rise to an amount payable for the year in which it is received, due, for example, to the taxpayer's having carried forward losses or the dividend's being franked; but the provision also recognises that the absorption of those losses or the use of those franking credits means they are not available in future years to reduce tax in those years, as they would have been if a capital benefit had been paid instead of a dividend. Thus, the preservation of tax losses or franking credits for use in the future would ordinarily mean that a tax benefit is obtained within the meaning of subsection 45B(9).[29] However, if the notional dividend was received as 'non-assessable non-exempt income'[30] it could not absorb tax losses, being neither assessable nor exempt income, and would not therefore ordinarily result in tax (or any other amount) payable for either the year of receipt or for some later year. Accordingly, for the purposes of subsection 45B(9), the replacement of a non-assessable, non-exempt dividend with a capital benefit would not normally enable the shareholder, as the relevant taxpayer, to 'obtain a tax benefit'.

A more than incidental purpose of enabling a taxpayer to obtain a tax benefit

50. Section 45B only applies if, 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.[31] In the majority of matters this will be the critical issue determining whether the provision applies or not.

51. Section 45B follows Part IVA in that the conclusion about the requisite purpose is drawn by having regard to a number of objective matters listed in subsection 45B(8) (with the exception of paragraph 45B(8)(j) which is relevant only to demergers), including the matters in subparagraphs 177D(b)(i) to (viii) which are introduced at paragraph 45B(8)(k).

52. Also similar to Part IVA, section 45B does not require any inquiry into the subjective motives of the relevant taxpayer or persons who entered into or carried out the scheme or any part of it.[32] Thus, section 45B is concerned with determining the objective purpose of the persons who entered into or carried out the scheme.

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[29] Explanatory Memorandum for the Taxation Laws Amendment (Company Law Review) Bill 1998 at paragraphs 1.26 and 1.27.

[30] See section 23AJ.

[31] Paragraph 45B(2)(c).

[32] *Federal Commissioner of Taxation v. Spotless Services Ltd* (1996) 186 CLR 404; 96 ATC 5201; 34 ATR 183 at CLR 421; ATC 5201; ATR 192; *Federal Commissioner of Taxation v. Hart* (2004) 217 CLR 216; 2004 ATC 4599; 55 ATR 712 at [65] per Gummow and Hayne JJ.

Whose purpose?

53. Section 45B considers the purpose of any one of the persons who entered into or carried out the scheme or any part of the scheme. Relevant persons would include the company, its directors and managers, and its shareholders. In complex commercial transactions these persons will consult widely and rely upon professional advisers, and the 'actual parties to the scheme subjectively may not have any purpose, independent of that of a professional adviser.'[33] Where this is so, it may be appropriate to attribute the purpose of a professional adviser to one or more of the parties.[34]

A more than incidental purpose

54. A more than incidental purpose includes a 'main or substantial purpose', but does not need to be the 'most influential or prevailing purpose'. It will not include circumstances where it occurs 'fortuitously or in subordinate conjunction with one of the main or substantial purposes…or merely follows that purpose as a natural incident.'[35]

55. A person (or persons) can be found objectively to have two or more purposes, none of which is merely incidental. In such a case, all that is necessary for section 45B to apply is that one of those purposes is a more than incidental purpose of obtaining a tax benefit (either as a demerger benefit or a capital benefit). For example, if persons entering into or carrying out a scheme of a return of capital, when considered objectively, have a substantial purpose of obtaining a tax benefit in the form of a capital benefit, the fact that they have other purposes that are more than incidental will not prevent section 45B from applying.

The relevant circumstances

56. Subsection 45B(8) lists the relevant circumstances of the scheme which the Commissioner must have regard to when determining whether or not the requisite purpose exists. The list of circumstances is not exhaustive and the Commissioner may have regard to other circumstances which he regards as relevant.

57. The relevant circumstances listed in subsection 45B(8) encompass a range of matters which, when taken individually or collectively, will reveal whether the requisite purpose exists or not. Due to the diverse nature of these circumstances, some may be of no consequence in ascertaining whether or not that purpose exists. In all cases however, tax officers should have regard to all the circumstances, and determine whether they tend towards, against or are neutral as to the conclusion of a purpose of enabling the relevant taxpayer to obtain a tax benefit.

58. The factors which are used to determine purpose under Part IVA are included by virtue of paragraph 45B(8)(k). The Part IVA factors are to be given equal attention in determining purpose under section 45B(8); the Explanatory Memorandum to section 45B as originally enacted in 1998 indicated that in addition to the Part IVA matters, 'other matters more specifically relevant to schemes to obtain a tax benefit' were included to give 'further guidance' to the operation of this section.[36]

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[33] *FC of T v. Consolidated Press Holdings Ltd & Anor* (2001) 207 CLR 235; 2001 ATC 4343; 47 ATR 229.

[34] *FC of T v. Consolidated Press Holdings Ltd & Anor* (2001) 207 CLR 235; 2001 ATC 4343; 47 ATR 229.

[35] The Explanatory Memorandum (House of Representatives) to Taxation Laws Amendment (Company Law Review) Bill 1998, at paragraphs 1.31 and 1.32.

[36] The Explanatory Memorandum (House of Representatives) to Taxation Laws Amendment (Company Law Review) Bill 1998, at paragraphs 1.34 and 1.35.

(1) The attribution question

59. The first relevant circumstance (paragraph 45B(8)(a)) concerns the extent to which the capital benefit is attributable to capital and profits (realised and unrealised) of the company or of an associate (within the meaning of section 318) of the company. The implication of this inquiry at paragraph 45B(8)(a) is that despite a distribution taking the form of share capital it can be ascribed in fact to either the company's share capital or the profits of the company or its associates.

60. If the provision of share capital is attributable to profits, this would ordinarily lead to the conclusion that the persons, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for the purpose of enabling a taxpayer to obtain a tax benefit. This is because a distribution of share capital attributable to profits is, in effect, distributing profits. It is thus being made in substitution for a dividend and secures the associated tax deferral advantages for the shareholder. The result for the company is that share capital is distributed and functions as distributable profits and profits are changed into capital *de facto* without converting them into capital *de jure*.[37]

61. The inquiry contemplated by the words 'attributable to' is essentially a practical one concerned with determining whether there is a discernible connection between the amount distributed as share capital and the share capital and profits that are realistically available for distribution, including the profits of an associate of the company. The connection need not be that of a sole, dominant, direct or proximate cause and effect; a contributory causal connection is sufficient.[38]

62. Therefore, in determining whether the distribution of share capital is attributable to either share capital or profits, tax officers should take account of the pertinent characteristics of share capital and profits and the availability of each in the circumstances of the company (including the availability of profits in associates) and in the context of the pertinent scheme. These characteristics are discussed below. Tax officers should also have regard to the occasion for the share capital reduction, that is, the circumstances surrounding the making of the capital distribution.

63. A capital distribution that is attributable to share capital should reflect circumstances which show that the share capital distributed is genuinely surplus to the company's need of it and that it is not merely a cash distribution debited against share capital on the basis of shareholder tax preference. For instance, the capital distribution may coincide with the disposal of a significant part of the business structure which can be identified as releasing share capital. However, if the disposal also realises a profit the ensuing distribution should, subject to all the other relevant circumstances, be considered in terms of its attribution to both share capital and the profit from the disposal.

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[37] *Webb v. FC of T* (1922) 30 CLR 450 at 467 per *Isaacs* J

[38] *Commissioner of Taxation (Cth) v. Sun Alliance Investments Pty Ltd (in liq)* (2005) 222 ALR 286 at 304 [80] to [82] as per Gleeson CJ, Gummow, Kirby, Callinan and Heydon JJ referring to Donaldson J in *Walsh v. Rother District Council* [1978] 1 All ER 510 at 514.

64. Broadly, the capital of a company is the money contributed, or agreed to be contributed by its members for carrying out its objects.[39] Generally, the money so contributed is to be retained as a permanent fund while the company pursues its objects. Company law requires, in the case of a company limited by shares, that the capital subscribed by the shareholder be maintained as a fund for the protection of creditors (the doctrine of maintenance of capital). One consequence of this doctrine is that a company may not pay a dividend except out of distributable profits. Another consequence is that a company must not distribute its issued capital to members prior to winding up. As discussed however, the Corporations Act contains a number of exceptions to the doctrine of maintenance of capital, including the case of an authorised share capital reduction. The exceptions generally contemplate some special event or circumstance affecting the enterprise of the company which renders the retention of capital unnecessary.

65. Whatever the circumstances may be, they would not ordinarily include generating more money than required for the purposes of the business. The generation of surplus funds from carrying on the business of the company in the ordinary way is the occasion for the distribution of a dividend, not a return of capital.

66. The doctrine of maintenance of capital continues to be an important part of company law. Share capital maintains its character as the shareholders' proportionate contribution to, and their measurement of, ownership of the corporate business. It is also the fixed sum by reference to which the growth of the business is measured and identified as distributable profits. Under the corporate paradigm, contributed capital is meant to be invested in the objects of the business and, generally, to provide lasting support to the business. Profits which are excess to the requirements of the business are meant to be distributed to the shareholders.

67. As mentioned previously in paragraphs 35 to 37 of this practice statement, a distribution of profits to the members is a discretionary matter for the company's board of directors, whose responsibility it is to supervise the management of the corporation's business on behalf of the members. In contrast, a distribution of share capital to the members, though recommended by the board of directors, must be approved by a majority of the members as it is a matter which goes to the essential structure of the business.

68. Therefore, a distribution of profit would normally be expected to be a relatively ordinary corporate event and a distribution of capital a relatively extraordinary one. A decision to reduce capital would generally be expected to coincide with and be influenced by some other commercial circumstance. For example, a release of the capital from a disposal of part of the business structure, some other business structural change, or in some circumstances its replacement with debt capital where it is shown to be more profitable for shareholders. It should be noted, however, that the fact that the capital distribution has been funded from debt does not preclude it from being attributable to profits.

69. The profit to be taken into account under paragraph 45B(8)(a) includes profits, whether realised or unrealised, of the company making the distribution, or of an associate of the company. This means, for instance, that profits of subsidiaries may be taken into account for the purposes of determining whether the capital distribution is attributable to profits.

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[39] *Knowles And Haslem v. Ballarat Trustees, Executors And Agency Co. Ltd* (1916) 22 CLR 212 at 253.

70. The term 'profits' is not defined in the income tax law and takes its ordinary meaning. It has a wide scope and is not limited to the Corporations Act's conception of the term.[40] The word profits, as it is generally understood, implies a gain made by a business and disclosed by a comparison between the state of that business at one point in time and its state at another.[41] Thus, in strict legal terms, an unrealised gain, whether or not it is of a 'permanent character' and whether or not it meets the technical requirements for distribution of the Corporations Act, constitutes profits for the purposes of paragraph 45B(8)(a).[42] It should also be noted that a company can pay dividends out of current year profits despite having accumulated losses.[43] The discussion in Taxation Ruling TR 2003/8 Income tax: distribution of property by companies to shareholders – amounts to be included as an assessable dividend, of the meaning of 'profits derived' in the context of subsection 44(1) is also relevant in determining whether there are profits or not.

71. Therefore, the notion of 'profits' in paragraph 45B(8)(a) may be wider than that under the Corporations Act. The attribution inquiry extends beyond profits legally distributable by the company to profits which, as a practical matter of fact, are available to be harvested by the company for distribution at that time or at a future time.

72. Nevertheless, tax officers should also take account of the nature and circumstances of the particular company, its distribution culture and whether there are commercial concerns with distributing the profits, including distributing any unrealised profits if relevant, in determining whether section 45B applies. For example, a corporate group could have some unrealised profit that may be so ephemeral as to render its distribution imprudent. Aspects of corporate distributions are discussed further with respect to the relevant circumstances identified in paragraphs 45B(8)(b) and 45B(8)(k).[44] The mere existence of profits will not automatically trigger the application of section 45B; rather, the availability of profits is but one matter to be considered in the attribution inquiry posed by paragraph 45B(8)(a).

73. As discussed at paragraph 57 in PS LA 2005/21, if the capital distribution is attributable to the disposal of assets of the business, a reasonable approach should be taken in determining the extent to which share capital was invested in the disposed assets and is available to be distributed to shareholders. In some instances the capital may be traced directly to the asset and in others it may be a matter of inferring its allocation on a reasonable basis. For example, it may be appropriate to allocate capital across the enterprise as a whole, based on valuing assets according to their market value. This is sometimes referred to as the 'slice approach' to the compilation of assets as between capital and profit.

74. Similarly, if the occasion for the share capital reduction is to increase the company's gearing ratio (the debt to equity ratio) it should be borne in mind that equity includes both retained profits and share capital and that this is an occasion that affects both. This means that an increase in the gearing ratio can be achieved just as effectively by returning profits as reducing share capital, including by way of dividend. Generally, in the absence of other relevant factors which indicate otherwise, tax officers should regard the capital distribution as being attributable to the share capital and retained earnings on a proportionate basis.

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[40] *MacFarlane v. Federal Commissioner of Taxation* (1986) 67 ALR 624 at 644-645.

[41] *In Re Spanish Prospecting Company* (1911) 1 Ch 92 per Fletcher Moulton LJ at 98, *FC of T v. Slater Holdings Ltd* (1984) 156 CLR 447; 84 ATC 4883; 15 ATR 1299 at CLR 460; ATC 4889; ATR 1306, *FC of T v. Sun Alliance Investments Pty Ltd (In liq)* [2005] HCA 70 at [67].

[42] *MacFarlane v. Federal Commissioner of Taxation* (1986) 67 ALR 624 at 644-645, *FC of T v. Sun Alliance Investments Pty Ltd (In liq)* [2005] HCA 70 at [61] to [68].

[43] *Ammonia Soda Co v. Chamberlain* [1918] 1 Ch 266, *Lee v. Neuchatel Asphalte Co.* (1889) 41 Ch D 1.

[44] See paragraph 108 of this practice statement.

75. With respect to non-share capital reductions and whether it can be said that the distribution of non-share capital is attributable to profits, the policy underlying the debt/equity rules should be acknowledged. It provides that equity interests are to be treated similarly, regardless of whether they are shares in legal form or not, for the purposes of determining the taxation treatment of returns.[45] Non-share equity is generally regarded as serving a similar function in relation to a company as a share does. Accordingly, the discussion above is also applicable to non-share equity.

76. However, tax officers should also take account of any specific circumstances of the company, including its particular funding needs, and the nature of the non-share equity interest when determining whether a distribution of non-share capital is attributable to profits or not.

(2) The distribution culture

77. Paragraph 45B(8)(b) directs attention to the pattern of distributions of dividends, bonus shares and returns of capital or share premium by the company or an associate (within the meaning in section 318) of the company. This includes any special dividends and share buy-backs. The inference here is that an interruption to the normal pattern of profit distribution and its replacement with a distribution of capital may suggest dividend substitution. It may become apparent after having regard to the general pattern of distributions of the company that the company has a pattern of making capital distributions (with the capital performing the function of dividends).

78. The fact that the company has maintained its ordinary dividend policy does not preclude a distribution of share capital occurring in place of an extraordinary distribution of profit and does not necessarily, depending on the circumstances, point away from the requisite purpose. Also, the fact that the company may not have made any distributions previously, whether of profit or share capital, does not point away from the requisite purpose.

79. However, tax officers should also have regard to the company's distribution culture and other relevant commercial exigencies that impact on the company's ability to make distributions, whether of dividends or capital, in evaluating this relevant circumstance. For example, companies may consider the perceptions and expectations of shareholders when deciding whether to increase ordinary dividend distributions. Tax officers should also be alert to any change in a company's distribution culture brought about by a change to its guiding mind.

80. Some companies may have a policy of maintaining a certain level of distributable profits (a buffer). For example, a company may have a history of retaining excess profits when profits are higher so as to be able to distribute dividends when profits are lower. If, objectively, this is done to maintain consistent dividend payouts or to counter downturns in the business cycle, these are factors which should be taken into account by tax officers and would point against the requisite purpose.

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[45] The Explanatory Memorandum to the New Business Tax System (Debt and Equity) Bill 2001, at paragraphs 1.11 and 2.68.

(3) Characteristics of shareholders

81. Paragraphs 45B(8)(c) to (f) require that consideration be given to the tax characteristics of the shareholders in order to determine the tax effects of the scheme. If the tax characteristics of the shareholders of the company are such as to indicate there is a tax preference for one form of distribution over another, this may be suggestive of a more than incidental purpose of delivering a tax benefit, particularly if the composition of the distribution does not follow the substance of what was provided.

82. In the case of public companies, particularly those which do not have a key significant shareholder (or group of shareholders with particular characteristics), it can be inferred objectively that the head entity and its subsidiaries would generally be aware of the broad tax characteristics of the shareholders of the company, but not their more detailed tax characteristics. Nevertheless, a public company may enter into a scheme, without knowing the precise tax profile of each of its shareholders, upon the premise that large numbers of its shareholders will have tax characteristics that will enable them to secure a tax advantage by a particular form of distribution, and for that purpose.

83. In the case of a closely held group, the more detailed tax characteristics of the shareholders of the company are more likely to be known to the group.

84. To the extent that the shareholders' tax characteristics are known, they should be considered thoroughly to discern whether it indicates the requisite purpose. However, it should also be borne in mind that the application of section 45B turns upon facts objectively determined, so the relevant taxpayers' tax characteristics would not be excluded from consideration because the company, its associated entities or any other person who entered into or carried out the scheme were subjectively unaware of them.

Capital losses

85. Paragraph 45B(8)(c) considers whether the shareholders of a company receiving a capital benefit have any capital losses they could apply to the capital benefit as this would result in reduced or no CGT implications for shareholders. Where shareholders have capital losses that can be applied against the capital benefit this would suggest that the capital benefit was provided for the purpose of securing a tax benefit.

Pre-CGT ownership interests

86. Paragraph 45B(8)(d) directs attention to whether some or all of the ownership interests held by the shareholders of the company were acquired or are taken to have been acquired by them before 20 September 1985. Where taxpayers receive a capital distribution in respect of a pre-CGT asset there would ordinarily be no CGT implications for the shareholders and this could influence the company's decision to return capital to shareholders. However, if the capital reduction involves cancellation of a resident shareholder's pre-CGT share (CGT event C2), tax officers should be mindful that CGT event K6[46] might also happen.

[46] Section 104-230 of the ITAA 1997.

Residency of the shareholders of the company

87. Paragraph 45B(8)(e) requires consideration of whether the shareholders of the company are non-residents. The implication of non-residency is that it would normally point towards a tax preference for a distribution of capital over profit. Non-residents are normally taxed on dividends at the rate of 15%, but they are not exposed to capital gains on the disposal of shares unless those shares are 'indirect Australian real property interests' as defined in section 855-25 of the ITAA 1997.[47]

Cost base of the ownership interests

88. Paragraph 45B(8)(f) directs that attention be paid to whether the cost base (for the purposes of ITAA 1997) of the relevant ownership interest is not substantially less than the value of the capital benefit. Where the cost base of the ownership interest is similar or greater in value than the capital benefit provided, the capital distribution will not expose the relevant taxpayer to a capital gain under CGT event G1 or CGT event C2 where the provision of the capital benefit involves the subsequent cancellation of a share. This could point towards a tax preference for capital over profit.

Nature of interest after the return of capital

89. Paragraph 45B(8)(h) requires that regard be had to whether the interest held by the shareholders after the share capital reduction is the same as the interest would have been if an equivalent dividend had been paid. This matter examines the effect of the capital reduction on the substance of the shareholder's interest in the company directly and relative to other shareholders.

90. This relevant circumstance proceeds from the premise that when a dividend is paid the shareholder's interest remains unchanged, and that a distribution of capital made in similar circumstances may be performing the same function as a dividend and be made in substitution for it. It has regard not only to whether there has been a cancellation or variation in the shareholder's interest, but also to whether the shareholder's interest has remained the same comparative with other shareholders.

91. An equal share capital reduction under which no shares are cancelled (often called a pro-rata return of capital) does not affect the shareholder's substantive interests, either individually or *inter se* and thus the interests remain the same as if a dividend had been paid instead. From the shareholders' perspective a reduction of capital without a cancellation of shares is not dissimilar economically to a special dividend in that cash is distributed to them while they retain the share with all of its rights intact.

92. Pursuant to an equal share capital reduction, whereby a proportion of shares is cancelled for each shareholder, the shareholders' interests are affected individually, in that they own less shares in the company. However, on a comparative basis the interests of shareholders in the company before and after the reduction remain largely the same; their proportionate voting rights and, indeed, their other rights and obligations as shareholders remain substantially unchanged. Thus, this aspect of an equal share capital reduction by way of share cancellation may point towards the capital reduction being made in substitution for a dividend.

[47] Section 855-25 was introduced into the ITAA 1997 in 2006 and applies to CGT events that happen after 12 December 2006. Prior to that amendment, section 136-25 of the ITAA 1997 had a similar effect in relation to shares with the necessary connection to Australia.

93. In contrast, a selective share capital reduction which involves cancellation of shares does affect proportionate shareholder interests in the company such that they would be less than the taxpayer's pre-reduction interest. Depending on the facts, a selective capital reduction may point away from the capital reduction being made in substitution for a dividend.[48]

Scheme involving the later disposal of ownership interests

94. Paragraph 45B(8)(i) directs attention to those cases where the scheme involves the provision of ownership interests and the later disposal of those interests, or an increase in the value of ownership interests and the later disposal of those interests; recognising that the proceeds on disposal of such ownership interests may provide the equivalent of a cash dividend in a more tax-effective form. Such a scheme would not necessarily involve a share capital reduction, but it does point to a preference for a capital benefit over a dividend.

95. Generally, share capital reductions involve a distribution of share capital (in the form of cash) and do not involve the provision of ownership interests and in such a case this circumstance is irrelevant. However, there may be cases where the cash is received and compulsorily subscribed by shareholders in return for further ownership interests. The initial distribution when judged on its merits may not look like dividend substitution, but in combination with the subsequent disposal of the further ownership interests the two may suggest dividend substitution. There may also be cases where the share capital reduction is in fact satisfied by the transfer of shares (for example, in a subsidiary) in circumstances which do not constitute a tax law demerger. Such transactions, if coupled with a subsequent disposal may equally suggest dividend substitution.

96. It is a question of fact whether the scheme of a share capital reduction involves the later disposal of the ownership interests or not. In determining whether the scheme of provision and later disposal of ownership interests is suggestive of obtaining a tax benefit, it is necessary to have regard to such factors as the length of time the ownership interests are held, any arrangements to reduce the risk of holding them, and the temporal nexus between the share capital reduction and the arrangement for the disposal of the ownership interests.

Transactions between the entity and an associate

97. Paragraph 45B(8)(j) is expressed to concern demergers within the meaning of section 125-70 of the ITAA 1997 only and is therefore not dealt with in this practice statement.[49]

The Part IVA matters

98. Paragraph 45B(8)(k) requires that regard be had to any of the matters referred to in subparagraphs 177D(b)(i) to (viii). The matters referred to in these subparagraphs are matters of reference for 'the dominant purpose' test in Part IVA. However, in the context of section 45B they facilitate the 'more than incidental purpose test' and do not introduce a different purpose test. Furthermore, they are matters by reference to which one is able to examine a return of capital from a broad, practical perspective in order to identify and compare its tax and non-tax objectives.

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[48] Depending on the wider circumstances however, tax officers may consider whether a selective capital reduction could suggest capital streaming for the purposes of section 45A.

[49] For further information refer to PSLA 2005/21 at paragraphs 81 to 83.

99. The subparagraphs 177D(b)(i) to (viii) matters operate together to direct attention to the means by which the tax benefit has been obtained, and broadly include the manner in which the scheme was entered into or carried out, the form and substance of the scheme, the timing of the scheme, the financial, tax and non-tax effects of the scheme and the nature of any connection between the taxpayer and other parties to the scheme. Many of the relevant circumstances discussed above amplify or elaborate on the subparagraphs 177D(b)(i) to (viii) matters and to this extent there may be some overlap.

100. One of the chief indicators against the application of section 45B will be the non-tax objects or effects of the return of capital scheme. The eight matters in paragraph 177D(b) constitute the essential facts and circumstances of a scheme, including the outcomes for the parties to the scheme, by reference to which the tax and non-tax objects of the scheme are able to be revealed and contrasted from an objective point of view.

Subparagraph 177D(b)(i)

101. Subparagraph 177D(b)(i) refers to the manner in which the scheme was entered into or carried out. This is a reference to consideration of the way in which a method or procedure by which the particular scheme in question was established; in other words consideration of the decisions, steps and events that combine to make up the scheme.

Subparagraph 177D(b)(ii)

102. Subparagraph 177D(b)(ii) refers to the form and substance of the scheme. The form of the scheme is the visible aspect of the scheme; the substance of the scheme is its essential nature which is normally determined from its commercial and economic implications.

103. A share capital reduction, a distribution of share capital, would constitute the form of a scheme and the substance of it would be determined from the effects of the scheme on the commercial and economic circumstances of the shareholders and the company. For example, where a company returns excess capital, which is referable to a disposal of part of its business, as long as the amount returned to shareholders is attributable to the share capital invested in that part of the business, the substance of the scheme would accord with its form.

Subparagraph 177D(b)(iii)

104. Subparagraph 177D(b)(iii) directs attention to the time at which the scheme was entered into and the length of the period during which the scheme was carried out. This factor requires not only reference to time measurement but also reference to the timing of the scheme from the point of view of the scheme's coincidence with events or circumstances beyond the scheme itself. In particular, it enables consideration of the extent to which the timing and duration of the scheme go towards delivering the relevant tax benefit or are related to commercial opportunities or requirements.

105. For example, the company may have raised share capital for the purposes of making a significant corporate acquisition which due to intervening circumstances did not occur, and the company now has no need for the funds raised. In such a case, the timing of the share capital reduction with the occasion of the share capital becoming surplus to company requirements points to a non-tax purpose.

Subparagraph 177D(b)(iv)

106. Subparagraph 177D(b)(iv) requires that consideration be given to 'the result in relation to the operation of this Act that, but for this Part, would be achieved by the scheme'.

107. The reference to 'this Part' could present an interpretational difficulty when applied in the context of section 45B. In its original context it is a reference to Part IVA. In the context of section 45B, however, 'this Part' could be interpreted as a reference to Part III which includes both sections 44 and 45B.

108. However, subparagraph 177D(b)(iv) should not be disregarded in relation to section 45B. The reference in paragraph 45B(8)(k) to 'any of the matters referred to in subparagraphs 177D(b)(i) to (viii)' suggests that the legislature intended that subparagraph 177D(b)(iv) should apply in the context of section 45B; in which case, the most sensible construction of the words of subparagraph 177D(b)(iv) is to read 'this Part' to mean 'this section'. The issue then becomes a matter of identifying the tax results of the scheme if section 45B were not to apply. In regard to this matter, it is critical to consider just what constitutes the scheme, as this will have a direct bearing on the breadth and scope of the tax results for the relevant taxpayers that are taken into consideration.

109. The more immediate result under the ITAA 1936 and ITAA 1997 of a share capital reduction is that because the distribution is debited against the company's share capital account the distribution carries the tax advantage of falling outside the definition of dividend in subsection 6(1) of the ITAA 1936, and is not received as income in the shareholder's hands. Instead, in the case of a pro-rata return of capital which involves no cancellation of shares the cost base of the affected shares will be reduced by the amount of the capital returned under CGT event G1,[50] and shareholders will realise a capital gain to the extent that the capital distribution exceeds the shareholder's cost base in the shares.

110. In the case of a share capital reduction which involves a cancellation of shares, the cancellation results in CGT event C2 happening to the shareholder.[51] If the capital distribution is more than the asset's cost base, the taxpayer will make a capital gain. If the capital distribution is less than the asset's reduced cost base, the shareholder will make a capital loss.

111. In the case of a non-share capital reduction, by debiting the distribution against the company's non-share capital account or share capital account (if permitted by the Corporations Act) the distribution is not a non-share dividend under subsection 974-120(2) of the ITAA 1997 and is not assessable to the shareholder under section 44. If the non-share capital return is made for the surrender, cancellation or redemption of the non-share equity interest and it is a traditional security any gain or loss will be assessable or deductible under sections 26BB and 70B. The capital gains tax provisions will also apply; CGT event C2 is relevant. Double taxation is prevented by section 118-20 of the ITAA 1997. Often the consideration received for the cancellation will be equal to the cost base of the non-share equity interest, resulting in no capital gain or loss to the shareholder.

[50] Section 104-135 of the ITAA 1997.
[51] Section 104-25 of the ITAA 1997.

112. However, if a non-share capital return is made in connection with a reduction in the market value of the non-share equity interest (and there is no cancellation of the interest) CGT event G1 cannot apply, as it is expressed to apply if a company makes a payment to a taxpayer in respect of a share. A 'share' is defined under section 995-1 of the ITAA 1997 to mean a share in the capital of the company, and includes stock and does not include a non-share equity interest in a company. The repayment may be treated as a partial redemption (with a cost base attributable to that part of the interest that has been redeemed) and CGT event C2 would apply in relation to the partial redemption. A partial redemption may also be subject to the traditional securities regime.

113. Another tax consequence resulting from share and non-share capital reductions is that the company can preserve franking credits by distributing share capital rather than paying a dividend. If the company has scarce franking credits, this would be significant and could suggest that the company has distributed capital and not profits on the basis of the shareholders' tax preference.

Subparagraph 177D(b)(v)

114. Subparagraph 177D(b)(v) directs attention to any change in the financial position of the shareholders that results, will result or may reasonably be expected to result from the share capital reduction scheme. The most significant financial change for shareholders is that they receive a cash distribution or some other benefit from the company. If the scheme is an equal share capital reduction, the shareholders will receive the distribution with their proportionate interests in the company (that is, their income producing investment) remaining essentially the same. This would point towards the requisite purpose. On the other hand, if the scheme is a selective share capital reduction the receipt of the distribution would give rise to a reduction in the shareholder's investment and hence point away from the requisite purpose.

Subparagraph 177D(b)(vi)

115. Subparagraph 177D(b)(vi) requires that consideration be given to any change in the financial position of any person who has, or has had, any connection with the relevant taxpayer, that is the shareholders. In relation to a share capital reduction the company would generally be the only other party whose financial position will change as a result of the scheme.

116. The financial result for a company of returning capital to the shareholders is that it divests itself of that amount of value. A less direct financial result may be that a distribution of share capital would forestall shareholder demand for the comparable alternative of a franked distribution, and, in turn, the need for the company to ensure that it has sufficient franking credits to make such a franked distribution.

117. A share capital reduction may also increase the company's gearing ratio regardless of whether equity is substituted by new debt or existing debt, although the effect is enhanced if new debt is taken on. Practically from a market perspective, as equity can be more expensive than debt (depending on prevailing interest rates), substituting debt for equity can reduce the company's cost of funds, which in turn may increase company profitability, shareholder returns and the share price. Of course, a company's profitability can depend also on a range of other factors.

118. In evaluating the financial effect of increasing gearing, tax officers should have regard to the nature of the company's business, the company's gearing history, whether the reduction will result in a substantial change to gearing levels and the relative benefits for the company (and shareholders) resulting from the substitution of debt for equity.

119. As previously noted however, gearing can also be increased by paying out dividends, in particular by way of a special dividend. Thus, when examining these aspects of a company's enterprise tax officers should also have regard to the company's distribution culture and any objective consequences arising from it.

Subparagraph 177D(b)(vii)

120. Subparagraph 177D(b)(vii) directs attention to any 'other' consequence of the return of capital scheme for the shareholders or the company.

121. The decision to reduce share capital as opposed to paying out a dividend may be a consequence of the distribution culture of the particular company. Accordingly, tax officers should have regard to the objective consequences of the share capital reduction on the company with respect to its dividend history and its ability to provide stable dividends in the future. Thus, this provision requires that regard be given to the nature of the company's business and how this impacts on its ability to pay dividends, as well as objective shareholder and 'market' expectations in relation to the company's distributions. Furthermore, particularly in the case where the return is attributable to unrealised profits, regard should also be had to whether, in the company's circumstances, it would be commercially responsible to distribute profits. In other words, tax officers might consider what an objective, prudent director would do in the company's circumstances.

122. A share capital reduction that involves the cancellation of shares will result in the reduction of the number of shares on issue and therefore may impact on the earnings per share (EPS) performance indicator that investors have regard to; the company's earnings will be referable to a smaller number of shares. However, whether EPS increases or not as a result of the share cancellation is subject to other factors; in particular, future company performance and whether the company finances the cancellation with new debt rather than paying out assets.

123. With respect to non-share capital reductions, the nature of the interest and any commercial or regulatory consequences arising from its repayment or redemption should also be considered by tax officers. For example, in legal form the non-share equity interest may be debt and thus there may be commercial expectations or practices in relation to its redemption or reduction.

Subparagraph 177D(b)(viii)

124. Subparagraph 177D(b)(viii) requires consideration of the nature of any connection (whether of a business, family or other nature) between the shareholders and any person referred to in paragraph (vi); ordinarily that would be the company that is distributing share capital to the shareholders. The connection between the two parties is the relationship of shareholder and company.

125. This relationship has a bearing on the nature of corporate distributions, including decisions regarding the particular form of a distribution. Broadly, the company, through its board of directors, manages the corporate business enterprise in the interests of the shareholders who, in turn, benefit from corporate distributions. Ordinarily, whether the distribution takes the form of capital or profits is a decision made in the interests of both shareholders and the business, as these interests converge.

Section 45B determinations and their effect

126. If the conditions for application in subsection 45B(2) are met, the Commissioner is empowered under subsection 45B(3) to make a determination that section 45C applies in relation to the whole, or a part, of the capital benefit.

127. A determination under subsection 45B(3) will be made where it is considered there is a more than incidental purpose of enabling a taxpayer to obtain a tax advantage through the provision of a capital benefit in substitution for a dividend.

128. The effect of section 45C is that the amount of the capital benefit, or part of the benefit, is taken, for the purposes of the ITAA 1936 and ITAA 1997, to be an unfranked and unrebatable dividend that is paid by the company out of profits of the company to the shareholder or relevant taxpayer at the time that the shareholder or relevant taxpayer is provided with the capital benefit (subsections 45C(1) and (2)). The result is that the whole or part of the capital benefit in respect of which the determination is made is fully assessable, or subject to withholding tax, in the hands of the recipient.

129. The Commissioner's written determination under subsection 45B(3) applying section 45C will ordinarily be made in the name of a Deputy Commissioner of the relevant Business Service Line by officers in that line at the level of Executive Level 2 or above.[52] An example of a written determination is included at the end of this practice statement.

130. In addition, under subsection 45C(3) the Commissioner is empowered to make a further determination that the whole or part of the capital benefit was paid under a scheme for which a purpose, other than an incidental purpose, was to avoid franking debits arising in relation to the distribution from the company if the Commissioner has made a determination in respect of the capital benefit under paragraph 45B(3)(b). Such a further determination would result in an additional franking debit arising in the company's franking account.

131. The ability to make a further determination under subsection 45C(3) recognises that the preservation of franking credits in the company's accounts may be a more than incidental purpose of the parties to a scheme to provide capital benefits in substitution for dividends. The amount of the franking debit is equal to the franking debit that would have arisen if the amount in respect of which the determination is made had been a fully franked dividend and arises on the day on which notice of the determination is served on the company.

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[52] Tax officers should refer to the *Taxation Authorisations Guidelines* on the Intranet to ensure they are authorised to make the determination.

Case examples

132. The following case examples are included in the practice statement to assist tax officers with the process of considering and weighing a range of circumstances in which capital reductions could occur. However, the examples should not be relied on as precedents, as each case the Commissioner is presented with will have its own particular circumstances, some of which may be similar to those covered by the examples and others of which will not be similar but will nonetheless influence whether or not section 45B should apply. Tax officers are also reminded that in considering the application of section 45B to a scheme they must have regard to all of the relevant circumstances of the scheme and consider whether, and to what extent, each points to, or away from, the requisite purpose, or is neutral in that regard.

Example 1

133. Largeco Limited (Largeco) is a listed company heading up a group which carries on three different core businesses, each through a separate, wholly-owned, subsidiary company and each with a different economic cycle. The subsidiaries' profit is generally fully franked and distributed annually to their parent, Largeco.

134. Largeco's balance sheet records a net asset position of $600 million comprising paid up share capital of $275 million, fully frankable retained earnings of $25 million and unrealised profit of $300 million, which is essentially the accretion to value of the capital invested in the business infrastructures of the three subsidiary companies.

135. Largeco has had in place a borrowing facility of $30 million for the past 6 months, which the company had arranged to purchase a business rival of one of their subsidiaries. The purchase has fallen through, but the loan facility is at such a favourable rate of interest that Largeco can demonstrate that it is in the company's financial interest, and, by extension, its shareholders' interest, to use the facility to make an equal capital reduction to the shareholders and incur the cost of the borrowed capital, that is, the interest payable, as a deductible expense.[53]

136. Also, Largeco does not want to pay out its retained earnings, $15 million of which is earmarked for the next semi-annual dividend and the remaining $10 million has for the past ten years been retained as a buffer against the possible repeat of its three core businesses suffering a downturn at the one time.

137. These circumstances suggest that the return of capital is not attributable to profit, is not inconsistent with the company's distribution culture and is explainable as being commercially advantageous to both the company and the shareholders; they point away from the requisite purpose in paragraph 45B(2)(c).

Example 2

138. Shaftco Ltd (Shaftco) is an opal prospector and miner which was formed and listed four years ago. It runs its mining operations through Pitco Pty Ltd (Pitco) and its prospecting operation through Seekco Pty Ltd (Seekco), both wholly-owned subsidiary companies.

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[53] Taxation Ruling TR 95/25 Income tax: deductions for interest under subsection 51(1) of the *Income Tax Assessment Act 1936* following *FC of T v. Roberts; FC of T v. Smith* should be consulted for its discussion of the deductibility of interest on money borrowed to replace share capital.

139. Shaftco's balance sheet records negative earnings of $6 million and paid-up share capital of $10 million. $9million of the paid-up capital was invested in Pitco which used it to purchase two opal mines, Twinkle for $7 million and Sparkle for $2 million. The remaining $1 million of share capital was invested in Seekco. Half of it has been spent on exploration fees, but so far no new opal deposits have been found.

140. Twinkle has produced very little opal and a recent assay has resulted in its being devalued to $1 million, hence the negative earnings figure of $6 million on the Shaftco balance sheet. Sparkle, on the other hand, has held its value and its opal production has realised a net accounting profit for 2006 of $2.5 million and for 2007 of $2.75 million. Capital allowances have reduced Pitco's accounting profit to a nil taxable income each year.

141. Shaftco has never paid a dividend, but it recently announced a pro-rata return of capital of $4 million 'to enable investors to share in the good fortune of the Sparkle mine'. The company also indicated that the return of capital is to be funded by a loan to Shaftco from Pitco.

142. The circumstances described above indicate that as a practical matter of fact 90% of Shaftco's paid up capital was invested in two mines which have been written down in value to $3 million and the remaining 10% is being expended on prospecting for new opal deposits. In other words, the availability of capital to return to shareholders is not supported by the facts. However, Pitco has distributable profits which will be used to fund the return of capital.

143. These circumstances suggest strongly that the return of capital is attributable to the profits of Pitco from the sale of opal, rather than the paid up capital of Shaftco and therefore point towards the requisite purpose in paragraph 45B(2)(c).

Example 3

144. Motorco Ltd (Motorco) is a listed manufacturer of sports cars and motorcycles, the latter being manufactured in a wholly owned subsidiary, Victor Pty Ltd (Victor). Motorco's balance sheet records paid up share capital of $500 million, retained earnings of $30 million that is frankable to 50% and unrealised profit of $300 million that is accounted for in the accretion to value of manufacturing plant.

145. Motorco purchased Victor as a going concern twenty years ago. Victor performed well for several years but motorcycle sales have been in decline for some time and have reached the point where the business has recorded significant losses for the past three years.

146. However, Motorco was recently made an offer for Victor by the motorcycle manufacturer, Royal Speedster Corporation Ltd (Royal Speedster), based in India. Royal Speedster's plan is to buy the shares in Victor from Motorco for $400 million, sell off the real estate and move Victor's manufacturing plant, stock and intellectual property to India.

147. Motorco was happy to dispose of Victor for what amounted to a reasonable capital profit over the cost base of its Victor shares. As a consequence of the sale of Victor, Motorco announced an imminent reduction of its share capital by way of a return of capital to its shareholders and, subject to Motorco's continuing to trade profitably in the following year, to pay a partially franked, special dividend.

148. The companies' shared financial history is not altogether clear. Motorco's original purchase of Victor was financed from a mix of Motorco's paid up capital and borrowings which it eventually repaid from profit. Also, ten years ago, Motorco guaranteed two third-party loans to Victor, which it ultimately repaid on Victor's behalf but was never reimbursed by Victor. The extent that Motorco's repayment of the loans was sourced in either share capital or profit is also unclear.

149. In the absence of actual evidence of the application of Motorco's share capital to its investment in Victor, Motorco has decided to adopt a slice approach and apportion its share capital across all of its assets. Motorco's investment in Victor accounts for half of its net assets and, accordingly, accounts for $250 million of its share capital which it now proposes to return to its shareholders.

150. In Motorco's circumstances, it is reasonable to attribute $250 million of its share capital to the asset represented by the Victor shares. It is also reasonable to infer its release from the disposal of those shares and its availability for repayment to the Motorco shareholders. Further, the fact that profit from the disposal of the Victor shares has been earmarked for distribution to the shareholders by way of a special dividend suggests that Motorco is not distributing share capital and retaining profit on the basis of the tax preference of its shareholders. In short, these circumstances point away from the requisite purpose in paragraph 45B(2)(c).

Example 4

151. In 2004 Fred Alcove borrowed $100,000, on the security of a First Mortgage over his private residence and, with his savings of $20,000, used the borrowed money to capitalise a newly formed company, Niche Pty Ltd (Niche), to carry on a modest transport business he controlled. Niche invested the capital in the acquisition of a second hand prime mover.

152. After three years of successful trading, Mr Alcove's equity in Niche comprises share capital of $120,000 and retained earnings of $250,000.

153. Mr Alcove wants to remove the Mortgage Security over his home and thus free his main private asset from exposure to creditors. He understands the different tax consequences between paying a dividend and distributing capital.

154. As the guiding mind of Niche, Mr Alcove decided to reduce the company's capital by $100,000 and distribute it to himself as shareholder so he could pay back his loan and disencumber his private residence. Mr Alcove's essential purpose therefore was to recover his equity in Niche to repay the private loan which financed it. His equity in Niche included Niche's paid up capital and its realised profit (retained earnings).

155. Setting aside tax implications, in terms of withdrawing equity from the company it would appear that it makes no difference to Mr Alcove whether the distribution is sourced in share capital or profit, or both. Nor does it make any real financial difference to Niche whether it distributes capital and retains profits, or distributes profits and retains capital. Also, the legal formality which differentiates a distribution of capital from one of profit is less likely to be an impediment where the company's executive and membership are indistinguishable.

156. Notwithstanding that share capital and profit might appear to be substantially interchangeable in the case of closely held companies, the fact remains that from the company's perspective the fund of profit that might have been divided and distributed as a dividend has been impounded to replace the capital of the business *de facto* and the fund of paid up capital has been reduced simply to provide a cash distribution to the shareholder, Mr Alcove.

157. In these circumstances, the shareholder's tax preference for capital over profits would appear objectively to be a significant factor in the decision to distribute the money from the company as return of share capital rather than a dividend out of profit. This suggests the presence of the requisite purpose in paragraph 45B(2)(c).

Example 5

158. Famco Pty Ltd (Famco) is a medium sized, closely held company which manufactures leather accessories. The shareholding in Famco has been held equally by husband and wife Charles and Alice and their two sons, Dick and Harry, since its incorporation in 1988 when Famco also began trading with start up share capital of $2 million. Famco has grown steadily to the point where it now has net assets of $20 million. The company last paid a dividend in 1993, which Charles and Alice used to finance the purchase of their new residence.

159. Among its assets Famco holds the issued shares in Champers Pty Ltd (Champers), which it bought in 1998. Champers runs a vineyard in the Hunter Valley. The family members are all employed in the leather business except Harry who manages the vineyard for Champers.

160. As a result of his experience with Champers Harry has decided to strike out on his own as a wine grower and would therefore like to liquidate his interest in Famco in order to fund his new project. The other family members are not interested in acquiring Harry's shares in Famco, but the family do not want him to sell his shares to a third party. After seeking advice, Harry convinces the other members of the family to agree to the creation of Headco Pty Ltd (Headco) and its capitalisation with Famco shares which they exchange for Headco shares, choosing CGT rollover relief under subdivision 124-G of the ITAA 1997.

161. The other family members, as shareholders in Headco, also agree to a selective capital reduction and cancellation of Harry's shares in Headco for full market value. The distribution of capital was received by Harry as the capital proceeds for the cancellation of his shares in Headco.[54] The cost base of Harry's shares is $500,000 and his capital gain from the cancellation is $4.5 million 50% of which (that is, $2.25 million) is included in his assessable income.[55]

162. In the absence of objective evidence to the contrary, the interposition of Headco, which has effectively capitalised the profits of Famco, appears to have no other purpose than to facilitate the subsequent capital reduction. In these circumstances, it seems reasonable to infer that the interposition of Headco and the subsequent selective capital distribution and cancellation of Harry's shares constitute a scheme for the purposes of subsection 45B.

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[54] *CGT event C2* under section 104-25 of the ITAA 1997.

[55] Subdivisions 115-A and B of the ITAA 1997.

163. The known circumstances of the scheme indicate that the distribution of capital is attributable to profit of Famco and that the scheme has been entered into and carried out for a substantial purpose of delivering a share of that profit to Harry in a tax preferred form. This is the requisite purpose in paragraph 45B(2)(c).

Example 6

164. Freshco Pty Limited (Freshco) runs a fruit market business at several suburban outlets. Ron and Nancy, the sole shareholders, financed the company in July 2005 with paid-up capital of $10 and an at-call interest-free loan of $6 million which was used by Freshco to set up its market sites, that is, the profit yielding structure of the company's business.

165. The company generates an annual GST turnover of $22 million. For income tax purposes these features combine to characterise the loan as an ***equity interest***[56] and loan repayments to be deemed a ***non-share capital return***.[57]

166. Subsection 45B(7) will deem the non-share capital return to be a distribution of share capital for the purposes of section 45B and hence the provision of a capital benefit under subsection 45B(5).

167. Freshco's business has performed consistently well and the company has distributed its annual after tax profit for the 2006 and 2007 income years to Ron and Nancy as fully franked dividends. Ron and Nancy have other investments, their marginal tax rates are both 45%.

168. In January 2008, following an attractive offer from a property developer, Freshco sold one of its market outlets for $3 million, realising a profit of $1 million, not all of which was subject to company tax. Their accountant advised Ron and Nancy that if they would like to share in the profit from the site, the company could pay them a partially franked special dividend or repay part of their loan. Ron and Nancy decide to seek a private binding ruling from the Commissioner, in particular, whether section 45B would apply to a non-share capital return of $1 million.

169. In this instance, there is a strong suggestion that the provision of the capital benefit (the part repayment of at-call loan capital) is attributable to the profit from the sale of the market site. Furthermore, whilst the at-call loan is clearly designed to put Ron and Nancy in the position of creditors of the company, there has been no prior indication of any intention on their part to have the loan repaid or partly repaid, nor is there indication of financial need on their part which would ordinarily trigger its repayment. It is also noteworthy that the remaining proceeds of $2 million from the sale of the market site have been committed to the establishment of a new market in a newly created suburb.

170. The circumstances in this case, in the absence of other evidence to the contrary, suggest a significant purpose on the part of Ron and Nancy, as directors of Freshco, of enabling themselves, as shareholders and taxpayers, to have access to the profit from the sale of the market site in a tax effective way. This is the requisite purpose in paragraph 45B(2)(c).

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[56] Subsection 974-70(1) of the ITAA 1997.

[57] Section 974-125 of the ITAA 1997.

An example of a determination under subsection 45B(3)

171. The following is an example of a determination made under subsection 45B(3).

> DETERMINATION MADE PURSUANT TO SUBSECTION 45B(3) OF THE INCOME TAX ASSESSMENT ACT 1936
>
> The shareholders of BIG Co Limited
>
> I, (name), Deputy Commissioner of Taxation, Large Business and International, in the exercise of the powers and functions delegated to me by the Commissioner of Taxation by instrument of delegation signed and dated on the 2^{nd} day of August 2007 determine under paragraph 45B(3)(b) of the Income Tax Assessment Act 1936 (the Act) that section 45C of the Act applies to the distribution of $1.50 per share paid by BIG Co Limited on 1 April 2008 to its shareholders registered on the Record Date, being 15 March 2008.
>
> In accordance with section 45C of the Act, the distribution of $1.50 per share is taken for the purposes of the Act to be an unfranked dividend paid out of the profits of the company to each of its shareholders (the taxpayers) and shall be included in the assessable income of the taxpayers for the income year in which they derive the distributions.
>
> Signed at Sydney, this 1st day of May 2008
>
> (Name)
>
> Deputy Commissioner of Taxation, Large Business and International

Amendment history

19 October 2012

Part	Comment
Generally	Updated to current style guide and updated legislative references.
Footnote 1A	Renumbered to footnote 2.
Paragraphs 89, 90 and footnotes 47 and 53	Deleted.
Contact officer	Updated.

17 May 2012

Part	Comment
Related practice statements	Inserted PS LA 2012/1
Contact officer	Details updated.

1 May 2012

Part	Comment
Paragraph 4 & footnote 1A	Removed old paragraph and inserted new paragraph due to the issue of PS LA 2012/1. Inserted footnote 1A

Subject references	dividend streaming arrangements non-share equity interest return of capital on shares share capital reduction
Legislative references	ITAA 1936 6(1) ITAA 1936 6(1)(e) ITAA 1936 6(4) ITAA 1936 Pt III ITAA 1936 23AJ ITAA 1936 26BB ITAA 1936 44 ITAA 1936 44(1) ITAA 1936 45A ITAA 1936 45B ITAA 1936 45B(1) ITAA 1936 45B(2) ITAA 1936 45B(2)(a) ITAA 1936 45B(2)(c) ITAA 1936 45B(3) ITAA 1936 45B(3)(b) ITAA 1936 45B(5) ITAA 1936 45B(5)(b) ITAA 1936 45B(7) ITAA 1936 45B(8) ITAA 1936 45B(8)(a) ITAA 1936 45B(8)(b) ITAA 1936 45B(8)(c) ITAA 1936 45B(8)(d) ITAA 1936 45B(8)(e) ITAA 1936 45B(8)(f) ITAA 1936 45B(8)(g) ITAA 1936 45B(8)(h) ITAA 1936 45B(8)(i) ITAA 1936 45B(8)(j) ITAA 1936 45B(8)(k) ITAA 1936 45B(9) ITAA 1936 45B(10) ITAA 1936 45C ITAA 1936 5C(1) ITAA 1936 45C(2) ITAA 1936 45C(3) ITAA 1936 46 ITAA 1936 46A ITAA 1936 46AB ITAA 1936 46F ITAA 1936 70B ITAA 1936 Pt III Div 6B ITAA 1936 Pt III Div 6C ITAA 1936 102L(18) ITAA 1936 102T(19) ITAA 1936 Pt III Div 16K ITAA 1936 159GZZZK ITAA 1936 Pt IIIAA ITAA 1936 160AOAA ITAA 1936 160APA ITAA 1936 Pt IVA

	ITAA 1936 177A(1) ITAA 1936 177D(b) ITAA 1936 177D(b)(i) ITAA 1936 177D(b)(ii) ITAA 1936 177D(b)(iii) ITAA 1936 177D(b)(iv) ITAA 1936 177D(b)(v) ITAA 1936 177D(b)(vi) ITAA 1936 177D(b)(vii) ITAA 1936 177D(b)(viii) ITAA 1936 318 ITAA 1997 104-25 ITAA 1997 104-135 ITAA 1997 104-135(3) ITAA 1997 104-230 ITAA 1997 115-A ITAA 1997 115-B ITAA 1997 118-20 ITAA 1997 Div 125 ITAA 1997 125-70 ITAA 1997 136-25 ITAA 1997 Div 164 ITAA 1997 164-10(2) ITAA 1997 164-10(3) ITAA 1997 164-15 ITAA 1997 164-20 ITAA 1997 164-20(1) ITAA 1997 164-20(2) ITAA 1997 164-20(3) ITAA 1997 164-20(4) ITAA 1997 Div 713 ITAA 1997 713-140 ITAA 1997 855-25 ITAA 1997 Div 974 ITAA 1997 974-70(1) ITAA 1997 974-75(4) ITAA 1997 974-75(6) ITAA 1997 974-75(7) ITAA 1997 974-120 ITAA 1997 974-120(2) ITAA 1997 974-125 ITAA 1997 995-1 Company Law Reform Bill 1997 Corporations Act 2001 Corporations Act 2001 Div 1 Part 2J.1 Corporations Act 2001 Div 2 Part 2J.1 Corporations Act 2001 Div 3 Part 2J.1 Corporations Act 2001 254K Corporations Act 2001 254T Corporations Act 2001 256B Corporations Act 2001 256B(2) Corporations Act 2001 257A Corporations Act 2001 257J Corporations Act 2001 257H Corporations Act 2001 258A Corporations Act 2001 258F Corporations Act 2001 588G New Business Tax System (Consolidations, Value Shifting,

	Demergers and Other Measures) Act 2002 Taxation Laws Amendment (Company Law Review) Act 1998 Tax Laws Amendment (Repeal of Inoperative Provisions) Act 2006 Sch 1
Related public rulings	TR 95/25 TR 2003/8
Related practice statements	PS LA 2005/21 PS LA 2005/24 PS LA 2007/9 PS LA 2012/1
Case references	Ammonia Soda Co v. Chamberlain [1918] 1 Ch 266 Commissioner of Taxation v. Hart (2004) 217 CLR 216; 2004 ATC 4599; 55 ATR 712 FC of T v. Consolidated Press Holdings Ltd & Anor (2001) 207 CLR 235; 2001 ATC 4343; 47 ATR 229. FC of T v. Slater Holdings Ltd (1984) 156 CLR 447; 84 ATC 4883; 15 ATR 1299 Commissioner of Taxation (Cth) v. Sun Alliance Investments Pty Ltd (in liq) (2005) 225 CLR 488; (2005) 222 ALR 286; [2005] HCA 70; 2005 ATC 4955; (2005) 60 ATR 560 Federal Commissioner of Taxation v. Spotless Services Ltd (1996) 186 CLR 404; 96 ATC 5201; 34 ATR 183 In Re Spanish Prospecting Company (1911) 1 Ch 92 Knowles And Haslem v. Ballarat Trustees, Executors And Agency Co. Ltd (1916) 22 CLR 212 at 253 Lee v. Neuchatel Asphalte Co. (1889) 41 Ch D 1 MacFarlane v. Federal Commissioner of Taxation (1986) 13 FCR 356; (1986) 67 ALR 624; (1986) 86 ATC 4477; (1986) 17 ATR 808 Walsh v. Rother District Council (1978) 77 LGR 111; [1978] 1 All ER 510; (1978) 143 JP 33; [1978] ICR 1216 Webb v. FC of T (1922) 30 CLR 450
Other references	Explanatory Memorandum for the Taxation Laws Amendment (Company Law Review) Bill 1998 Explanatory Memorandum to the New Business Tax System (Debt and Equity) Bill 2001 Ford H.A.J., Austin R.P., and Ramsay I.M., 2003, *Ford's Principles of Corporations Law* (11th ed) LexisNexis Butterworths, Sydney Media Alert C104/02 (released by the Minister for Revenue and Assistant Treasurer dated 27 September 2002)
File references	08/7223
Date issued	15 May 2008
Date of effect	15 May 2008
Business line	Japheth Gill

ATO references

ISSN	2651-9526
ATOlaw topics	Tax integrity measures ~~ Part IVA ~~ General anti-avoidance rules Income tax ~~ Capital management ~~ Share capital return