



Class Ruling

Income tax: share buy-back: Lemarne Corporation Limited

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

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

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

- section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- paragraph 128B(3)(ga) of the ITAA 1936;
- section 159GZZZK of the ITAA 1936;
- section 159GZZZP of the ITAA 1936;
- section 159GZZZQ of the ITAA 1936;
- Division 1A of Part IIIAA of the ITAA 1936;

- section 160APHO of the ITAA 1936;
- section 177EA of the ITAA 1936;
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 118-20 of the ITAA 1997;
- section 118-25 of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 202-45 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997; and
- paragraph 207-145(1)(a) of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders holding ordinary shares of Lemarne Corporation Limited (Lemarne) that disposed of their shares under the Lemarne off-market share buy-back (the Buy-Back) announced on 23 March 2006 and described in the Scheme part of this Ruling.

4. The class of entities to which this Ruling applies does not include Lemarne. The Ruling does not deal with how the taxation law applies to Lemarne in relation to the Buy-Back.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 23 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies from 1 July 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

10. The Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

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

- the application for a Class Ruling from KPMG dated 6 April 2006; and
- further information provided from KPMG 1 June 2006, 20 June 2006, 30 June 2006, 10 July 2006, 15 August 2006, 5 December 2006 and 23 January 2007.

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

15. Lemarne is an Australian resident listed company and as at 31 March 2006 had 14,418,727 ordinary shares on issue.

16. The management accounts of Lemarne as at 31 March 2006 showed total equity of approximately \$39,601,175, consisting of \$6,305,834 contributed equity, \$349,136 options granted reserve and \$32,946,205 retained profits.

17. Lemarne's shareholders as at 31 March 2006 were a mix of individuals, companies, trusts and superannuation funds. Directors of Lemarne and their associates controlled approximately 35% of Lemarne shares. Approximately 25% of the total number of Lemarne's ordinary shares were acquired prior to 20 September 1985. Non-resident shareholders held approximately 1.6% of Lemarne shares.

18. Lemarne announced on 23 March 2006 that it proposed to undertake a capital reduction of 50% of its issued capital at approximately \$2.70 per share. This price was to be adjusted for movement in the Standard and Poors/ASX 200 Industrials Index between 23 March 2006 and the closing date of the Buy-Back which ended up being 20 November 2006. It was Lemarne's intention that this be in the form of an off-market share buy-back (the Buy-Back). The price of \$2.70 per share was the volume weighted average price calculated over the five trading days prior to the announcement on 23 March 2006.

19. Lemarne has advised that the Buy-Back was undertaken to return excess funds generated by the sale of a former subsidiary and to improve earnings per share.

20. Under the Buy-Back, Lemarne offered to purchase up to 50% of each shareholder's holding. The Buy-Back was an 'equal access scheme' available to all shareholders, and was voluntary. Hence, shareholders not wishing to participate were not required to do anything. Furthermore, partial acceptances were allowed, but shareholders were not allowed to sell back more than 50% of their shares. Nor was it possible to transfer from a non-participating shareholder to a participating shareholder the non-participating shareholder's entitlement to participate in the Buy-Back. No scale backs would apply.

21. The price of \$2.70 per share represented a discount to Lemarne's prevailing ASX price of:

- 8.8% to the closing price on date of announcement; and
- 9.7% to the volume weighted average price per share (\$2.99) calculated over the five trading days immediately following the announcement of 23 March 2006.

22. On 21 November 2006, Lemarne announced that:

- the Buy-Back had been completed, and Lemarne would buy back 5,193,763 shares at a total cost of \$14,594,474.03; and
- the Buy-Back Price was \$2.81 per share.

23. Lemarne accounted for the Buy-Back Price for each share bought back as follows:

- Lemarne debited 65 cents per share against an amount standing to the credit of its untainted share capital account; and
- Lemarne debited \$2.16 per share against an amount standing to the credit of its retained earnings account.

Ruling

Buy-Back is an off-market purchase

24. The Buy-Back is an off-market purchase as defined by paragraph 159GZZZK(d) of the ITAA 1936.

The Capital Component

25. Participating shareholders are taken to have received \$0.65 as consideration in respect of the sale of each of their shares on 20 November 2006 pursuant to section 159GZZZQ of the ITAA 1936.

26. In this case, the Commissioner accepts that the Buy-Back price of \$2.81 is the market value for the purposes of subsection 159GZZZQ(2) of the ITAA 1936. That is, for the purposes of subsection 159GZZZQ(2) there is no further adjustment to the \$2.81 buy-back price.

27. The treatment of the consideration amount for tax purposes will depend on whether the sale is on capital account (where the shares are held for investment) or on revenue account. In general, the relevant treatment should be as follows:

(a) Shares held on capital account

The amount by which the Consideration of \$0.65 exceeds the cost base of each share will be a capital gain to the shareholder and included in the shareholder's assessable income. If the share's reduced cost base exceeds \$0.65, the difference will be a capital loss.

(b) Shares held on revenue account

Where the shares are held as trading stock, the consideration of \$0.65 is included in assessable income under section 6-5 of the ITAA 1997.

Where the shares are held as revenue assets the amount by which the consideration of \$0.65 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$0.65, the difference will be an allowable deduction.

The Dividend Component

28. Participating shareholders are taken to have been paid a dividend of \$2.16 (the Dividend Component) for each share bought back on the date the Buy-Back occurred pursuant to section 159GZZZP of the ITAA 1936.

29. The Buy-Back Price does not exceed the market value of Lemarne's shares at the time of the Buy-Back if the Buy-Back did not occur and was never proposed to occur, for the purposes of paragraph 202-45(c) of the ITAA 1997.

30. The whole amount of the Dividend Component constitutes a frankable distribution for the purposes of subsection 202-40(1) of the ITAA 1997.

Assessability of the Dividend Component and tax offset

31. The Dividend Component and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of resident individual, superannuation fund and company shareholders who participated in the Buy-Back under subsection 44(1) of ITAA 1936 and subsection 207-20(1) of the ITAA 1997. These shareholders are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend Component, subject to being a 'qualified person' (see paragraphs 54 to 60 of this Ruling).

Refundable tax offset

32. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997. Certain trustees and corporate tax entities are not entitled to the refundable tax offset rules because of subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident shareholders

33. The Dividend Component received by non-resident participating shareholders is exempt from withholding tax pursuant to paragraph 128B(3)(ga) of the ITAA 1936.

Qualified person

34. For the purposes of Division 1A of Part IIIA of the ITAA 1936 participating shareholders will be considered to satisfy the holding period rule under section 160APHO of the ITAA 1936 and therefore be qualified persons (as long as the related payments rule is also met) in relation to the Dividend Component received under the Buy-Back if:

- (a) the shares sold into the Buy-Back were acquired on or before 6 October 2006; and
- (b) during the period when the shares or interest in the shares were held the shareholders did not have 'materially diminished risks of loss or opportunities for gain' in respect of the shares or interest in the shares (as defined in section 160APHM of the ITAA 1936) for a continuous period of at least 45 days.

The anti-avoidance provisions

35. The Commissioner will not make a determination under section 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Component of the Buy-Back price received by participating shareholders.

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36. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received in relation to the Dividend Component under the Buy-Back by participating shareholders.

37. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny the whole, or any part, of the imputation benefits received in relation to the Dividend Component under the Buy-Back by participating shareholders.

Commissioner of Taxation

21 February 2007

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

The Dividend and Capital Components

38. The purchase price received by participating shareholders comprises two components:

- a dividend component; and
- a capital component.

The amount of each of these components is determined in accordance with sections 159GZZZP and 159GZZZQ of the ITAA 1936, having regard to how the company accounts for the off-market share buy-back.

The Capital Component

39. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 20 November 2006. The disposal may have different taxation implications for shareholders depending on how the shares were held, for instance:

- an investor who held their shares on capital account will be subject to the capital gains tax provisions; and
- a share trader who held their shares on revenue account will be subject to the ordinary income provisions.

40. It should be noted that shareholders who have both an income tax and a capital gains tax liability will generally have the amount of the capital gain reduced under the anti-overlap provisions contained in section 118-20 of the ITAA 1997. If the shares are held as trading stock the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

41. For the purposes of computing the amount of the gain or loss (on capital or revenue account) in these cases, the consideration in respect of the disposal of a share under a buy-back is determined in accordance with section 159GZZZQ of the ITAA 1936.

42. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the shareholder is taken to have received an amount equal to the purchase price (in this case the \$2.81 received for each share bought back) as consideration in respect of the sale of the share bought back. However, this amount is subject to certain adjustments in order to arrive at the Sale Consideration.

43. Subsection 159GZZZQ(2) of the ITAA 1936 is one of the adjusting provisions. It provides that if the purchase price is less than the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur the shareholder is taken to have received an amount equal to the market value as consideration in respect of the sale of the share bought back.

44. Lemarne has used a method of setting its buy-back price that reflects an appropriate method of obtaining market value for the purposes of determining the application of subsection 159GZZZQ(2) of the ITAA 1936 in accordance with TD 2004/22. The market value of each share is the volume weighted average price of the shares over the last five trading days before the first announcement of the Buy-Back (\$2.70), adjusted for the movement in the S&P/ASX 200 Industrial Index from the commencement of trading on 23 March 2006 (opening S&P/ASX 200 Industrials Index) to the close of trading on 20 November 2006 (closing S&P/ASX 200 Industrials Index). Lemarne had advised its shareholders that the proposed buy-back price would be \$2.70 (54 cents capital; \$2.16 dividend) as adjusted by the above methodology. Under this methodology, the Tax Office accepts that the buy-back price of \$2.81 is the market value for the purposes of subsection 159GZZZQ(2).

45. Under this method the subsection 159GZZZQ(2) of the ITAA 1936 adjustment has been incorporated by the company in setting its buy-back price and the resultant adjustment made to the capital component (54 cents to 65 cents).

46. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of \$2.81 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated under subsection 159GZZZQ(4). In the circumstances of the Buy-Back, the Reduction Amount is equivalent to the Dividend Amount, that is, \$2.16. Therefore, the Sale Consideration for each share disposed of under the Buy-Back is \$0.65 (\$2.81 less \$2.16).

The Dividend Component

47. Section 159GZZZP of the ITAA 1936 provides that where the buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price which is debited against the share capital account, is taken to be a dividend paid by the company to the seller on the day the buy-back occurs. In this case the purchase price was \$2.81 per share and 65 cents of this was debited to the share capital account. Thus the dividend amount is \$2.16 per share.

48. The dividend component of \$2.16 per share is frankable but only to the extent that the buy-back price does not exceed the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997). TD 2004/22 outlines how to determine what would have been the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur. The Commissioner accepts that the price-setting method in this case reflects the appropriate market value for the purpose of paragraph 202-45(c). Accordingly, the dividend component of \$2.16 is a frankable dividend.

Assessability of the Dividend Component and tax offset

49. For Australian resident individual and corporate tax entity shareholders, the dividend amount is included in their assessable income under subsection 44(1) of the ITAA 1936. Generally, an amount equal to the amount of the franking credit is included in their assessable income under subsection 207-20(1) of the ITAA 1997 and they are also entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 reflecting the franking credit attached to the dividend.

50. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend made by an entity only 'a qualified person in relation to the distribution for the purposes of Division 1A of Part IIIA of the ITAA 1936' is entitled to a franking credit or tax offset. Broadly speaking, to be a 'qualified person' in relation to the dividend paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule (or certain alternative rules) and the related payments rule. These two rules are discussed at paragraphs 54 to 60 of this Ruling.

Refundable tax offset

51. The franking credit on the Dividend Component will be subject to the refundable tax offset rule in Division 67 of the ITAA 1997, providing the participating shareholders are not excluded by subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident shareholders

52. As the dividend component of the consideration received under the Buy-Back is fully franked, a non-resident shareholder is not liable to Australian withholding tax on the dividend component (paragraph 128B(3)(ga) of the ITAA 1936).

The Buy-Back process

53. Lemarne conducted this Buy-Back by way of fixed price off-market share buy-back with an adjustment for the movement in the S&P/ASX 200 Industrials Index (at paragraphs 14 to 23 of this Ruling). This is to be contrasted with buy-backs conducted by way of a tender process where details, including price, are not known at announcement. In recent tender process off-market share buy-backs, the Commissioner has applied the discount to the volume weighted average price of a company's shares over the 5 days up to and including the closing date of the buy-back. Lemarne submitted, and the Commissioner agreed, that the appropriate time to calculate any discount in its circumstances was at or about announcement date.

Qualified person

54. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend made by an entity only 'a qualified person in relation to the distribution for the purposes of Division 1A of Part IIIAA of the ITAA 1936' is entitled to a franking credit or tax offset. Broadly speaking, to be a 'qualified person' in relation to the Dividend Component paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule.

55. Broadly, a shareholder will not satisfy the related payments rule if the shareholder, or associate of the shareholder, is under an obligation to make, or makes, a payment in respect of the dividend which effectively passes the benefit of the dividend to another person.

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

57. Under subsection 160APHM(2) of the ITAA 1936, a shareholder is taken to have materially diminished the risks of loss and opportunities for gain with respect to shares or interests in shares if the 'net position' of the shareholder results in the shareholder having less than 30% of the risks and opportunities relating to the shares or interest in shares.

58. In this case the Commissioner does not regard the announcement of the Buy-Back offer as affecting whether the shares or an interest in shares was held at risk or not.

59. There are 45 clear days between 6 October 2006 and 21 November 2006, that is, the date the offer was accepted. Therefore, a shareholder who acquired shares on or before 6 October 2006 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A shareholder who acquired shares after 6 October 2006 that were subsequently bought back under the Buy-Back is not a qualified person in relation to the dividend paid under the Buy-Back for the purposes of Division 1A of Part IIIAA of the ITAA 1936.

60. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first; subsection 160APHI(4) of the ITAA 1936. The 45 day rule operates on a last-in-first-out basis, so that shareholders will be deemed to have disposed of their most recently acquired shares first for the purposes of applying the 45 day rule. Accordingly, shareholders who acquired any additional Lemarne shares in the period 9 October 2006 to 20 November 2006 (being the cut-off date for shares to confer an entitlement to participate in the Buy-Back) may not qualify for the franking credits attached to the dividends paid on some or all of their shares sold into the Buy-Back.

The anti-avoidance provisions

Sections 45A and 45B

61. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of such a Determination is that all or part of the distribution of capital received by the shareholder under the Buy-Back is treated as an unfranked dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

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

63. Although a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) is provided to participating shareholders under the Buy-Back, the circumstances of the Buy-Back indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Accordingly, section 45A of the ITAA 1936 has no application to the Buy-Back.

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

- a. there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- b. under the scheme, a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
- c. having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose), of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

65. In the case of the Buy-Back, the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met.

66. However, the requisite purpose of enabling the shareholder to obtain a tax benefit, by way of capital distribution, is not present. Having regard to the 'relevant circumstances' of the scheme (the Buy-Back), as set out in subsection 45B(8) of the ITAA 1936, the inclusion of a capital element in the Buy-Back was appropriate. Further, the Capital Component of the Buy-Back cannot be said to be attributable to the profits of the company, nor does the pattern of distributions that have been made by Lemarne in the past indicate that the Capital Component was being paid in substitution for a dividend. Accordingly, section 45B of the ITAA 1936 has no application to the Buy-Back.

Section 177EA

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

68. Specifically, subsection 177EA(3) of the ITAA 1936 provides that section 177EA applies if:

- a. there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- b. either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or

- (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- c. the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- d. except for this section, the person (the 'relevant taxpayer') would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- e. having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

69. In the present case the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of Lemarne, its shareholders or any other relevant party, there is a purpose more than merely an incidental purpose of conferring an imputation benefit under the scheme. Under this scheme the relevant taxpayer is the participating shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

70. In arriving at a conclusion the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17) of the ITAA 1936. The relevant circumstances listed there encompass a range of circumstances which taken individually or collectively could indicate the requisite purpose. Due to the diverse nature of these circumstances some may not be present at any one time in any one scheme.

71. The Commissioner has come to the view that section 177EA of the ITAA 1936 applies to the Buy-Back. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the scheme, as outlined in subsection 177EA(17). Among the circumstances of the Buy-Back reflected in those paragraphs are:

- the delivery of franking credits in excess of what would have otherwise been distributed in the ordinary course of dividend declaration;
- the greater attraction of the Buy-Back to resident shareholders who could fully utilise the franking credits than to non-resident shareholders who could not;

- the greater attraction of the Buy-Back to some resident shareholders with a low marginal tax rate than other resident shareholders (for example, whereas superannuation funds are taxed at 15% and corporations at 30% individuals can be taxed at a marginal tax rate up to 45%); and
- that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

72. Where section 177EA of the ITAA 1936 applies the Commissioner has a discretion, pursuant to subsection 177EA(5) to make a determination to debit the company's franking account pursuant to paragraph 177EA(5)(a), or deny the imputation benefit to each shareholder pursuant to paragraph 177EA(5)(b). The Commissioner will exercise his discretion in such a way that he does not make a determination that the imputation benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b).

Section 204-30

73. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

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

74. Relevantly, if section 204-30 of the ITAA 1997 applies the Commissioner is vested with a discretion under subsection 204-30(3) to make a determination in writing either:

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

75. For section 204-30 of the ITAA 1997 to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than the members who do not participate in the Buy-Back. The words 'derives a greater benefit from franking credits' (imputation benefits) are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

76. A small percentage of Lemarne shareholding is held by non-residents. Under the Australian tax system non-resident shareholders do not benefit from franking to the same extent as resident shareholders. The Commissioner holds the view that the structure of an off-market buy-back is a means whereby franking credits may be streamed to resident shareholders, who will receive a greater benefit from franking credits than non-residents.

77. Although, section 204-30 of the ITAA 1997 applies to Lemarne's Buy-Back, the Commissioner will not make a determination pursuant to subsection 204-30(3). This is because the Commissioner will exercise his discretion under section 177EA of the ITAA 1936. One of the relevant circumstances in the application of the section 177EA is the fact that resident shareholders receive a greater benefit from franking credits than non-resident shareholders.

Appendix 2 – Detailed contents list

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

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2004/101; TD 2004/22

Subject references:

- dividend streaming arrangements
- frankable dividends
- share buy-backs

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