



Class Ruling

Income tax: off-market share buy-back: Gotalk Limited

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

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

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

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant 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 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 159GZZZP of the ITAA 1936;
- section 159GZZZQ of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-10 of the ITAA 1997;
- section 116-20 of the ITAA 1997; and
- section 855-10 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Gotalk Limited (Gotalk) who disposed of their shares to Gotalk under the Gotalk off-market share buy-back (Buy-Back) announced on 7 August 2009 and described in the Scheme part of this Ruling. In this Ruling, the shareholders of Gotalk are collectively referred to as 'shareholders' or 'participating shareholders'.

Qualifications

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 23 of this Ruling.

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

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

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Date of effect

8. This Ruling applies from 1 July 2009 to 30 June 2010. The Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

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

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

10. Gotalk is an Australian incorporated unlisted public company which carries on a telecommunications business. As at 31 March 2009, Gotalk's share capital comprised 116,572,140 fully paid ordinary shares. The unaudited consolidated balance sheet of Gotalk at 31 December 2008 disclosed total shareholders' equity of \$9,737,000, consisting of \$9,518,000 contributed share capital, reserves of \$710,000 and accumulated losses of \$491,000.

11. The shareholders in Gotalk are a mix of individuals, companies, trusts, partnerships and superannuation funds, some of whom are foreign residents. All shares were acquired after 19 September 1985.

12. On 7 August 2009 Gotalk announced its intention to undertake a fixed price capital-only off-market buy-back of its own shares. Gotalk would buy back shares via a tender process that determined the shares to be bought back (though not their price). Gotalk would buy back up to \$4.55 million worth of its ordinary shares up to a maximum of 35,000,000 shares. Gotalk announced that the buy-back price would be set at \$0.13 per share, representing the current market value of its shares.

13. The Buy-Back forms part of Gotalk's aim of facilitating a reduction in the size of its share register to less than 50 shareholders. The Buy-Back would achieve a return of excess capital to shareholders, provide liquidity to shareholders in the short term and provide shareholders with a relatively small number of shares with an opportunity to exit their holdings.

14. The Buy-Back was implemented through a fixed price tender offer process and was open to all eligible shareholders who were registered on the record date of 3 August 2009. Participation in the Buy-Back was voluntary. Shareholders not wishing to participate in the Buy-Back were not required to do anything.

15. The maximum number of shares an eligible shareholder could tender in the Buy-Back was the number of shares for which they were the registered shareholder.

16. Shareholders with less than 100,000 shares had to offer to sell all of their shares if they wished to participate in the Buy-Back.

17. The tender process opened on 10 August 2009 and closed on 21 August 2009.

18. Where the number of shares for which acceptances were received exceeded the number of shares Gotalk determined to buy back, a scale back mechanism applied.

19. Under the terms of the Gotalk Shareholders' Agreement, any shares tendered were first offered to all existing shareholders to purchase. The pre-emptive right expired on 18 September 2009. Any shares tendered that were not purchased by other shareholders by that date formed the basis for the Buy-Back.

20. All shares bought back under the Buy-Back were cancelled. This excludes shares acquired under the pre-emptive right agreement which does not form part of the Buy-Back.

21. Under the Buy-Back, \$0.13 per share was debited to Gotalk's untainted share capital account. Gotalk has confirmed that this is not a tainted share capital account for the purposes of Division 197 of the ITAA 1997.

22. On 21 September 2009 Gotalk shareholders approved the Buy-Back. On the same date Gotalk accepted the offers made by participating shareholders in respect of the off-market share buy-back.

23. On 28 September 2009 Gotalk confirmed:

- it had successfully completed the off-market share buy-back of 35,000,000 Gotalk shares, representing 30% of the issued capital of Gotalk;
- the total amount of capital repurchased under the Buy-Back was \$4.55 million; and
- a scale-back mechanism was applied, subject to paragraph 18 of this Ruling.

Ruling

Purchase price in respect of each share bought back

24. As the entire purchase price in respect of the shares acquired through the Buy-Back is debited against Gotalk's share capital account, participating shareholders will not be taken to have been paid a dividend under section 159GZZZP.

Consideration in respect of the sale of each share bought back

25. Participating shareholders are taken to have received \$0.13 per share as consideration (Sale Consideration) in respect of the sale of each of their shares bought back under the Buy-Back pursuant to section 159GZZZQ.

26. The treatment of the Sale 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.

Shares held on capital account

27. The Sale Consideration of \$0.13 per share represents the capital proceeds for capital gains tax (CGT) purposes under section 116-20 of the ITAA 1997. A shareholder will make a capital gain on a share if the Sale Consideration per share exceeds the cost base of that share. The capital gain is the amount of the excess. Similarly, a shareholder will make a capital loss if the Sale Consideration is less than the reduced cost base of that share.

28. The shares are taken to have been disposed of for CGT purposes on 21 September 2009 under subsection 104-10(3) of the ITAA 1997.

Shares held on revenue account

29. Where the shares are held as trading stock, the Sale Consideration of \$0.13 per share 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 Sale Consideration of \$0.13 per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$0.13 per share the difference is an allowable deduction.

Foreign resident shareholders

30. Under section 855-10 of the ITAA 1997, foreign resident shareholders that participated in the Buy-Back will only have CGT consequences if their shares bought back under the Buy-Back are 'taxable Australian property'.

The anti-avoidance provisions

31. The Commissioner will not make a determination under subsections 45A(2) or 45B(3) that section 45C applies to the whole, or any part, of the distribution.

Appendix 1 – Explanation

① *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.*

32. This Ruling does not deal with the taxation consequences of shares sold or acquired under the pre-emptive right agreement. That is, this Ruling only applies to entities whose shares were purchased by Gotalk under the Buy-Back.

Purchase price in respect of each share bought back

33. Under section 159GZZZM, the purchase price in respect of shares acquired through the Buy-Back is the amount of money the participating shareholder received as a result of or in respect of the Buy-Back.

34. Under section 159GZZZP, the purchase price of each share bought back contains a dividend component only if the Buy-Back price exceeds the amount debited against the company's share capital account. As the Buy-Back price of \$0.13 per share will be debited entirely against Gotalk's untainted share capital account, no part of the purchase price will be taken to be a dividend for income tax purposes.

Consideration in respect of the sale of each share bought back

35. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 21 September 2009. 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 CGT provisions; and
- a share trader who held their shares on revenue account will be subject to the ordinary income provisions.

36. It should be noted that participating shareholders who have both an income tax and CGT 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 capital loss is disregarded under section 118-25 of the ITAA 1997.

37. 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.

38. Subsection 159GZZZQ(1) provides that the shareholder is taken to have received an amount equal to the purchase price (in this case \$0.13 received for each share bought back) as consideration in respect of the sale of the share bought back.

39. The Commissioner accepts that the market value of each Gotalk share was \$0.13 per share, which accorded with the consideration received by participating shareholders.

Foreign resident shareholders

40. A foreign resident shareholder that participates in the Buy-Back disregards any capital gain or capital loss made in respect of a share bought back under the Buy-Back if the share is not taxable Australian property under the tests in section 855-15 of the ITAA 1997.

41. The term 'taxable Australian property' includes an 'indirect Australian real property interest' (item 2 in the table in section 855-15 and section 855-25 of the ITAA 1997). Gotalk have advised that its foreign shareholders (together with their associates) each hold less than 10% of Gotalk's shares. Therefore, none of the Gotalk shares disposed of into the Buy-Back pass the non-portfolio interest test (as defined in section 960-195 of the ITAA 1997) and consequently a Gotalk share is not an indirect Australian real property interest.

42. A Gotalk share that was disposed of into the Buy-Back will only be taxable Australian property if:

- it has been used by the foreign resident in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- it is a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a gain or loss on ceasing to be an Australian resident – item 5 of the table in section 855-15).

The anti-avoidance provisions

43. Sections 45A and 45B are two anti-avoidance provisions which, if either applies, allow the Commissioner to make a determination that section 45C 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 that is paid by the company. Accordingly, the application of these two provisions to the Buy-Back must be considered.

Section 45A

44. Section 45A 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.

45. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) 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 has no application to the Buy-Back.

Section 45B

46. Section 45B applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- 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
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

47. In the case of the Buy-Back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, having regard to the relevant circumstances of the scheme as set out in subsection 45B(8), it could not 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, other than a merely incidental purpose, of enabling a taxpayer to obtain a tax benefit.

48. Consequently, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the distribution.

Section 45C

49. As neither of sections 45A nor 45B apply to the Buy-Back, the Commissioner will not make a determination under either of those sections that section 45C will apply to deem any part of the Buy-Back consideration to be an unfranked dividend.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- return of capital on shares
- share buy-backs
- share capital

Legislative references:

- ITAA 1936 45A
- ITAA 1936 45A(2)
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(3)
- ITAA 1936 45B(8)
- ITAA 1936 45C

- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1997 6-5
- ITAA 1997 104-10
- ITAA 1997 104-10(3)
- ITAA 1997 104-165(3)
- ITAA 1997 116-20
- ITAA 1997 118-20
- ITAA 1997 118-25
- ITAA 1997 Div 197
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 855-25
- ITAA 1997 960-195
- TAA 1953
- Copyright Act 1968

Other references:

- Law Administration Practice Statement PS LA 2007/9

ATO references

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