



Class Ruling

Income tax: off-market share buy-back: Premium Investors 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, 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 128B of the ITAA 1936;
- section 159GZZZP of the ITAA 1936;
- section 159GZZZQ of the ITAA 1936;
- section 177EA 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;
- section 204-30 of the ITAA 1997;
- Division 725 of the ITAA 1997;
- Division 727 of the ITAA 1997;
- section 855-10 of the ITAA 1997; and
- section 855-15 of the ITAA 1997.

All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Premium Investors Limited (Premium) who disposed of their ordinary shares in Premium under the Premium off-market share buy-back (buy-back) described in the scheme part of this Ruling. In this Ruling, the shareholders of Premium are 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 26 of this Ruling.

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

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- this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2009 to 30 June 2010. However, the Ruling continues to apply after 30 June 2010 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. The following documents or relevant parts of them form part of and are to be read with the description.

10. The relevant documents or part of documents are:

- application for class ruling dated 7 August 2009;
- Off-market buy-back booklet dated 24 August 2009;
- Notice of general meeting and explanatory statement dated 20 July 2009;
- Independent Expert's Report dated 24 July 2009; and
- annual financial statements of Premium for the year ended 30 June 2009.

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

Background

11. Premium is a listed investment company whose shares have been listed on the Australian Securities Exchange (ASX) since November 2003.

12. Premium only has one class of shares, being ordinary shares. Premium's shareholders are both residents and non-residents and include:

- corporate and institutional investors;
- banking and finance groups;
- retail investors; and
- superannuation trustees.

13. Traditionally Premium has sought to pay out all investment earnings to shareholders as dividends over the extended market cycle and has set its dividend levels accordingly.

14. The financial statements of Premium as at 30 June 2009 provide the following relevant financial information:

ASSETS	186,800,000
Liabilities	1,432,000
Net Assets	185,368,000
Contributed Equity	220,827,000
Retained Profits/(Accumulated Losses)	(35,459,000)
Total Shareholders Funds	185,368,000

Capital Management Plan

15. On 8 July 2009, Premium announced details of an on-going capital management plan as follows:

- an immediate off-market equal access buy-back of up to 65% of issued capital at a 1.75% discount to Net Tangible Assets (NTA);
- a further on market buy-back over the next 12 months of up to 15% of issued capital; and
- proposed amendments to the Premium Constitution to provide shareholders with greater ability to ensure periodic capital management assessments.

16. Premium's capital management plan was approved by its shareholders at the general meeting held on 19 August 2009 including approval to buy-back up to 65% of its issued capital at a price representing a 1.75% discount to Premium's pre-tax NTA backing per share as at 30 September 2009.

Off-market share buy-back

17. The buy-back was conducted through a tender process. Shareholder participation in the buy-back was voluntary. Any shareholder who had shares registered in their name on the record date of 27 August 2009 was eligible to participate in the buy-back. Certain foreign shareholders were not entitled to participate in the buy-back.

18. In the event that the aggregate number of shares tendered under the buy-back exceeded the amount of shares able to be bought back by Premium, tenders would be scaled back on a pro-rata basis.

19. To the extent that eligible shareholders chose not to tender their full entitlement to the buy-back, Premium would allow other eligible shareholders to participate to a greater extent than 65% of their shareholding, provided that any excess was shared on a pro-rata basis across participating eligible shareholders.

20. Premium undertook not to buy back shares at more than a 14% discount to the volume weighted average price of its shares on the ASX for five days up to and including the closing date for tenders.

21. The tender opened on 31 August 2009 and closed on 30 September 2009.

22. The buy-back price was \$0.8685 representing a discount of 1.75% of the pre-tax NTA backing per share, calculated to 30 September 2009.

23. The buy-back contracts were entered into and payments for shares bought back were made on 9 October 2009.

24. On 9 October 2009 Premium announced that it had completed the buy-back of 135,470,529 shares, representing approximately 60.5% of its issued capital. No scale back or reallocation of entitlement to the buy-back was made.

25. The total amount of capital repurchased under the buy-back was debited against Premium's share capital account. Premium has confirmed that its share capital account is not a tainted capital account.

26. All shares bought back by Premium were cancelled.

Ruling

Purchase price in respect of each share bought back

27. As the entire purchase price in respect of the shares acquired through the buy-back was debited against Premium's share capital account, participating shareholders will not be taken to have been paid a dividend under section 159GZZZP of the ITAA 1936.

Consideration in respect of the sale of each share bought back

28. Participating shareholders will be taken to have received **\$0.8685** in respect of the sale of each of their shares bought back under the buy-back under section 159GZZZQ of the ITAA 1936.

29. The treatment of the consideration received 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

30. The consideration of **\$0.8685** per share represents the capital proceeds for capital gains tax (CGT) purposes under section 116-20. A participating shareholder will make a capital gain on a share if the consideration per share exceeds the cost base of that share. The capital gain is the amount of the excess (subsection 104-10(4)). A participating shareholder will make a capital loss if the consideration per share is less than the reduced cost base of the share. The capital loss is the amount of the difference (subsection 104-10(4)).

31. The shares are taken to have been disposed of for CGT purposes on 9 October 2009 (the buy-back contract date) under subsection 104-10(3).

Shares held on revenue account

32. Where the shares are held as trading stock, the consideration of **\$0.8685** per share is included in assessable income under section 6-5. Where the shares are held as revenue assets, the amount by which the consideration of **\$0.8685** per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost of each share exceeds the consideration of **\$0.8685** per share the difference is an allowable deduction.

Foreign resident shareholders

33. A foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happened under the buy-back, disregards under subsection 855-10(1) any capital gain or capital loss from CGT event A1 if their share in Premium was not taxable Australian property as defined in section 855-15.

34. There will be no dividend withholding tax imposed on the payment to foreign resident shareholders in respect of the shares bought back under the buy-back under subsection 128B(1) of the ITAA 1936.

Value shifting rules

35. There will be no consequences for a participating shareholder entity under Divisions 725 and 727 as a result of participating in the buy-back.

Anti-avoidance provisions

36. The Commissioner will not make a determination under sections 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the distribution of share capital received under the buy-back by participating shareholders.

37. The Commissioner will not make a determination under section 177EA of the ITAA 1936 in relation to participating shareholders under the buy-back.

38. The Commissioner will not make a determination under section 204-30 in relation to participating shareholders under the buy-back.

Commissioner of Taxation4 November 2009

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.*

Purchase price in respect of each share bought back

39. Under section 159GZZZM of the ITAA 1936, 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.

40. Under section 159GZZZP of the ITAA 1936, 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 **\$0.8685** per share has been debited entirely against Premium'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

41. Participating shareholders are taken to have disposed of those shares accepted under the buy-back on 9 October 2009 (the buy-back contract date). The disposal may have different income tax implications for participating shareholders depending on how the shares were held. For instance:

- an investor holding their shares on capital account will be subject to the CGT provisions; and
- a share trader holding their shares on revenue account will also be subject to the ordinary income provisions.

42. It should be noted that participating shareholders who have both an income tax and CGT liability will have the amount of the capital gain reduced under the anti-overlap provisions contained in section 118-20. If the shares were held as trading stock, the capital gain or capital loss is disregarded under section 118-25.

43. For the purpose 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.

44. 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 **\$0.8685** received for each share bought back) as consideration in respect of the sale of the share.

Foreign resident shareholders

45. Under subsection 855-10(1), an entity disregards a capital gain or capital loss from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

46. The term 'taxable Australian property' is defined in the table in section 855-15. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2 or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	a CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident).

47. A foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happened under the buy-back, can not disregard under subsection 855-10(1) a capital gain or capital loss from CGT event A1 if:

- their share in Premium is an indirect Australian real property interest (item 2 of the table in section 855-15); or
- their share in Premium has been used at any time by the foreign resident, or the trustee of a foreign trust for CGT purposes, in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15); or
- their share in Premium is covered by subsection 104-165(3) (item 5 of the table in section 855-15).

48. Unfranked dividends paid by a resident company to a non resident shareholder are subject to dividend withholding tax under subsection 128B(1) of the ITAA 1936.

49. As no part of the payment to foreign resident shareholders in respect of the shares bought back under the buy-back will be taken to be a dividend, there will be no dividend withholding tax consequences under subsection 128B(1) of the ITAA 1936.

Value shifting rules

50. There is a direct value shift under a scheme involving equity or loan interests in an entity if there is a decrease in the market value of some equity or loan interests in the entity which is reasonably attributable to things done under the scheme, occurring at or after the time when that thing is done, and an increase in the market value or issue at a discount of other equity or loan interests in the entity (section 725-145). There is an indirect value shift if there is an unequal exchange of economic benefits between the two entities (the losing entity and gaining entity (subsection 727-150(3))) or no economic benefit is provided to the losing entity by the gaining entity in connection with the scheme.

51. A direct value shift or indirect value shift can occur if there is a buy-back of shares at other than market value. There can only be consequences for a direct value shift if, in part, there is any entity that controls the target entity for value shifting purposes at some time during the scheme period defined in section 725-55 (paragraph 725-50(b)). Section 727-355 sets out the relevant tests for whether an entity controls a company for value shifting purposes.

52. There can only be consequences for an indirect value shift if the entities between which the value is shifted (the losing entity and the gaining entity) satisfy an ultimate controller test and or a common ownership nexus test at some time during the indirect value shift period defined in subsection 727-150(7) (paragraph 727-100(c) and sections 727-105 and 727-110).

53. On the basis of information provided, there is no entity that controls Premium for value shifting purposes or that meets, together with Premium, the ultimate controller test and or the common ownership nexus test as described above. As a result, there are no consequences under Divisions 725 and 727 for any direct value or indirect value shift that occurs under the share buy-back arrangement.

Anti-avoidance provisions

54. Sections 45A and 45B of the ITAA 1936 are anti-avoidance provisions which seek to deal with potential streaming of capital benefits and the payment of capital benefits to shareholders instead of dividends. If the Commissioner makes a determination pursuant to subsections 45A(2) or 45B(3) the amount of the capital benefit or a part of the capital benefit received by the shareholder under the buy-back is treated as an unfranked and non-rebatable dividend. Accordingly, the application of these two provisions to the buy-back must be considered.

Section 45A

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

56. 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 was no streaming of capital benefits to some shareholders in lieu of the payment of dividends to other shareholders. Accordingly, section 45A of the ITAA 1936 has no application to the buy-back.

Section 45B

57. Section 45B of the ITAA 1936 applies where certain capital payments are made to shareholders in substitution for dividends. Broadly this 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 for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

58. In the case of the buy-back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of enabling the shareholder to obtain a tax benefit by way of a capital distribution is not present.

59. Having regard to the relevant circumstances of the scheme (the buy-back) as set out in subsection 45B(8) of the ITAA 1936, it cannot 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. Further, the buy-back consideration cannot be said to be attributable to the profits of the company.

60. Consequently, the Commissioner will not make a determination under section 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 consideration received by shareholders.

Section 45C

61. As neither section 45A nor 45B of the ITAA 1936 apply to the buy-back, the Commissioner will not make a determination under either of those provisions that section 45C of the ITAA 1936 will apply to the buy-back.

62. No part of the buy-back consideration will be taken to be an unfranked dividend in the hands of participating shareholders.

Section 177EA

63. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes designed to obtain 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.

64. 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.

65. The Premium buy-back represents an arrangement that extinguishes the rights, powers or liabilities attaching to or otherwise relating to, the membership interests represented by the shares concerned. Consequently, the buy-back will constitute a scheme for the disposition of a membership interest.

66. For the purposes of section 177EA of the ITAA 1936, subsection 960-120(1) of the ITAA 1997 defines a distribution to include a dividend paid by the company. No part of the buy-back price paid by Premium constitutes a dividend.

67. The Commissioner will not make a determination under section 177EA of the ITAA 1936.

Section 204-30

68. Section 204-30 applies where a tax entity streams distributions to members (advantaged member) who will derive a greater benefit from imputation benefits than members (disadvantaged member) who will receive a lesser benefit from imputation (subsection 204-30(8)).

69. Where section 204-30 applies, the Commissioner may exercise his discretion pursuant to subsection 204-30(3) and make a determination in writing to cause a franking debit to arise in the accounts of the tax entity in relation to a distribution to a disadvantaged member, or cancel the imputation benefit of an advantaged member.

70. Under the buy-back scheme, all members are entitled to participate. However because no part of the consideration for the buy-back will constitute a dividend, no imputation benefit arises in relation to the participating or non-participating members.

71. Accordingly, the Commissioner will not make a determination under section 204-30.

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 128B
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- ITAA 1997 855-15
- ITAA 1997 960-120(1)
- TAA 1953
- Copyright Act 1968

Other references:

Law Administration Practice
Statement PS LA 2007/9

ATO references

NO: 1-1PL47XW

ISSN: 1445-2014

ATOLaw topic: Income Tax ~~ Entity specific matters ~~ share buy-backs