



Class Ruling

Income tax: off-market share buy-back: Telstra Corporation Limited

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	6
Scheme	7
Ruling	23
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
Explanation	48
Appendix 2:	
Detailed contents list	108

1 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 provisions identified below apply to the defined class of entities who take part in the scheme to which this Ruling relates.

Relevant provisions

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

- subsection 44(1) 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
- section 90 of the ITAA 1936
- subsection 95(1) of the ITAA 1936
- paragraph 128B(3)(ga) of the ITAA 1936
- section 159GZZZP of the ITAA 1936
- section 159GZZZQ of the ITAA 1936
- Division 1A of former Part IIIA of the ITAA 1936
- section 177EA of the ITAA 1936

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- Division 67 of the ITAA 1997
- section 104-10 of the ITAA 1997
- section 116-20 of the ITAA 1997
- section 118-20 of the ITAA 1997
- section 118-25 of the ITAA 1997
- section 202-5 of the ITAA 1997
- section 202-40 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-35 of the ITAA 1997
- section 207-145 of the ITAA 1997, and
- section 855-10 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936, unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Telstra Corporation Limited (Telstra) who:

- (a) disposed of their ordinary shares in Telstra under the Telstra off-market share buy-back which was announced by Telstra on 14 August 2014 and which is described in paragraphs 7 to 22 of this Ruling (the 'Telstra Buy-Back'), and
- (b) are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Telstra shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, these ordinary shareholders of Telstra are referred to as 'Participating Shareholders'.

Qualifications

4. 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 7 to 22 of this Ruling.

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

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

Date of effect

6. This Ruling applies from 1 July 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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

7. 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.

8. Telstra is a public company listed on the Australian Securities Exchange (ASX).

9. The share capital of Telstra is comprised solely of fully paid ordinary shares. The audited Statement of Financial Position of Telstra as at 31 December 2013 shows share capital of approximately \$5,698 million, reserves of approximately \$564,000 (in debit balance) and retained profits of approximately \$7,682 million.

10. Telstra's ordinary shareholders are a mix of individuals, companies, trusts, partnerships and superannuation funds, some of whom are non-residents.

11. On 14 August 2014, Telstra announced (First Announcement Date) its intention to undertake an off-market buy-back of its own shares. Telstra proposed to buy back approximately \$1 billion worth of its ordinary shares, representing approximately 1.75% of its issued capital (Buy-Back Limit). The proposed number of shares to be bought back was at the discretion of Telstra's Board of Directors, subject to the Buy-Back Limit.

12. The Telstra Buy-Back forms part of Telstra's capital management strategy and aims to return surplus capital and retained profits from recent key divestitures.

13. The Telstra Buy-Back was conducted through a tender process during a specified tender period and was open to:

- all shareholders who were registered as such on 22 August 2014 (Record Date), and
- all persons who beneficially held shares in Telstra which were registered in the name of the Telstra ESOP Trustee Pty Limited (TESOP Trustee) on the Record Date and which were held on trust by the TESOP Trustee for those persons in accordance with the Telstra Employee Share Ownership Plan II;

except for:

- shareholders who were not resident of either Australia or New Zealand
- shareholders whose shareholding was less than 925 shares and who did not offer to sell their entire holding, and
- shareholders under any Telstra employee share scheme where shares held under the employee share scheme were subject to dealing restrictions.

14. Participation in the Telstra Buy-Back was voluntary. Eligible shareholders who did not want to participate were not required to do anything. Non-Participating Shareholders did not receive any property, dividends or distributions as compensation for not participating in the Telstra Buy-Back.

15. The Telstra Buy-Back tender period opened on 8 September 2014 (Opening Date) and closed on 3 October 2014 (Closing Date).

16. Under the tender process, shareholders were able to submit offers to sell up to 100% of their shares at specified discount percentages (Tender Discount) to the volume weighted average price (VWAP) of Telstra shares over the five trading days up to and including the Closing Date. The Tender Discount ranged from 6% to 14%, in 1% intervals. Shareholders could also submit tenders to sell their shares at the Final Price Tender which was the price as finally determined under the tender process. Tenders at prices equal to or less than the Buy-Back Price (or Final Price Tenders) would be successful. Tenders at prices above the Buy-Back Price would not be accepted.

17. The Buy-Back Price was subject to two overriding limits:

- Telstra would not buy-back shares at a discount greater than 14% to the VWAP of Telstra shares over the five trading days up to and including the Closing Date (3 October 2014), and
- the Buy-Back Price would not exceed the market value of a Telstra share determined in accordance with Taxation Determination TD 2004/22.

18. On 6 October 2014 Telstra announced that:
- it had successfully completed the buy-back of 217,418,521 Telstra shares
 - the total amount of capital repurchased under the Telstra Buy-Back was \$1,000,125,197, representing 1.75% of the issued capital of Telstra
 - the final price for the Telstra Buy-Back was set at \$4.60 per share (Buy-Back Price), representing a discount of 13.89% to the VWAP of \$5.3418 of Telstra Shares over the five days up to and including the Closing Date of the Telstra Buy-Back (3 October 2014)
 - tenders at a 14% Tender Discount or as a Final Price Tender were successful, subject to such tenders being conditional upon a minimum price above the Buy-Back Price
 - tenders at a Tender Discount less than 14% were not accepted
 - the number of shares tendered at the Buy-Back Price exceeded the number of shares Telstra determined to buy-back. Accordingly, successful tenders were scaled back on a pro-rata basis (Scale Back)
 - before the Scale Back was applied, Telstra first bought back parcels of up to 925 shares from Participating Shareholders (including from shareholders whose entire shareholding comprised less than 925 shares) (Priority Parcels)
 - after all Priority Parcels had been bought back, Telstra then bought back residual parcels which comprised 370 shares or less so that no Participating Shareholder was left with an unmarketable parcel following the Telstra Buy-Back, and
 - after buying back Priority Parcels and ensuring that no Participating Shareholder was left with an unmarketable parcel of shares following the Telstra Buy-Back, a 69.79% Scale Back was applied.
19. All shares bought back under the Telstra Buy-Back were cancelled.
20. Under the Telstra Buy-Back, \$2.33 per share was debited to Telstra's untainted share capital account, and the balance of the Buy-Back Price was debited to Telstra's retained profits.
21. Telstra has not transferred any funds into its share capital account from other accounts. As a result, Telstra has an untainted share capital account for tax purposes.
22. Telstra shares were not indirect Australian real property interests (as defined in section 855-25 of the ITAA 1997) at the time CGT Event A1 happened as a result of the Telstra Buy-Back.

Ruling

Off-market purchase

23. For the purposes of Division 16K, the Telstra Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend Component

24. Participating Shareholders are taken to have been paid a dividend of \$2.27 (the Dividend Component) for each share bought back under section 159GZZZP.

25. The Dividend Component is a frankable distribution pursuant to section 202-40 of the ITAA 1997, and is capable of being franked in accordance with section 202-5 of the ITAA 1997.

26. The difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes.

Assessability of the Dividend Component and tax offset

Direct distributions

27. The Dividend Component of \$2.27 and, subject to being a 'qualified person', the amount of the franking credit on the Dividend Component, is included in the assessable income of Australian resident individual and corporate shareholders, and trustees of resident complying superannuation funds who participated in the Telstra Buy-Back in the income year in which the Telstra Buy-Back occurred (subsection 44(1) and subsection 207-20(1) of the ITAA 1997).

28. These Participating Shareholders will be 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'.

Indirect distributions

Partnerships

29. The Dividend Component of \$2.27 and, subject to being a qualified person, the amount of the franking credit on the Dividend Component is included in the assessable income of a Participating Shareholder that is a partnership for the purposes of computing the net income of the partnership under section 90.

Trusts

30. The Dividend Component of \$2.27 and, subject to being a qualified person, the amount of the franking credit on the Dividend Component is included in the assessable income of a Participating Shareholder that is a trustee of a trust for the purposes of computing the net income of the trust under subsection 95(1).

Refundable tax offset

31. 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 67-25(1D) of the ITAA 1997.

Non-resident Participating Shareholders

32. As the Dividend Component is fully franked, non-resident Participating Shareholders are not liable for Australian withholding tax on the Dividend Component (paragraph 128B(3)(ga)).

Sale Consideration

33. Participating Shareholders are taken to have received \$2.77 as consideration in respect of each share bought back under the Telstra Buy-Back (Sale Consideration) on 6 October 2014 in accordance with section 159GZZZQ, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

34. TD 2004/22 outlines how to determine what would have been the market value of the share at the time of the Telstra Buy-Back if the Telstra Buy-Back did not occur and was never proposed to occur. If the Buy-Back Price for each share bought back under the Telstra Buy-Back was less than what would have been the market value of the share if the Telstra Buy-Back did not occur and was never proposed to occur then, in accordance with TD 2004/22, the market value rule in subsection 159GZZZQ(2) applies to the Telstra Buy-Back.

35. The effect of the rule is that the difference between the Buy-Back Price and the market value, determined in accordance with TD 2004/22, will be included in the consideration received for the disposal of the share for ordinary income or capital gains tax (CGT) purposes, in addition to the capital amount of \$2.33 per share debited to the share capital account (Capital Component). Accordingly, the Sale Consideration is \$2.77.

36. The treatment of the Sale Consideration will depend on whether the sale is on capital account or on revenue account.

Shares held on capital account

37. The shares are taken to have been disposed of for CGT purposes on 6 October 2014 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

38. The Sale Consideration of \$2.77 represents the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997. A Participating Shareholder (other than a partnership) 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 Participating Shareholder (other than a partnership) will make a capital loss on a share if the Sale Consideration per share is less than the reduced cost base of the share (subsection 104-10(4) of the ITAA 1997).

39. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Telstra share sold into the Telstra Buy-Back by the partnership (subsection 106-5(2) of the ITAA 1997). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of Telstra shares into the Telstra Buy-Back.

Shares held on revenue account

40. Where shares were held as trading stock, the Sale Consideration of \$2.77 per share is included in assessable income under section 6-5 of the ITAA 1997. Participating Shareholders (other than partnerships) who held shares as trading stock will also make a capital gain or capital loss calculated as discussed at paragraph 38 of this Ruling. However, under section 118-25 of the ITAA 1997 any capital gain or capital loss these Participating Shareholders make will be disregarded if at the time of the CGT event the shares are held by them as trading stock. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

41. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$2.77 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$2.77 per share the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of that share these Participating Shareholders (other than partnerships) will also make a capital gain. However, under section 118-20 of the ITAA 1997 any capital gain these Participating Shareholders make will be reduced if, because of the event, an amount has otherwise been included in assessable income. The capital gain will be reduced to zero if the capital gain does not exceed the amount otherwise included in assessable income (subsection 118-20(2) of the ITAA 1997). If the capital gain exceeds the amount otherwise included in assessable income, the capital gain will be reduced by the amount otherwise included in assessable income (subsection 118-20(3) of the ITAA 1997). There is a similar reduction for partners in partnerships (paragraph 118-20(1)(b), paragraph 118-20(2)(b) and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating Shareholders: CGT consequences

42. A Participating Shareholder who was a foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happened will disregard a capital gain or capital loss made from CGT event A1, unless the Telstra share:

- has been used at any time by the Participating Shareholder 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
- is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Qualified persons

43. For the purposes of Division 1A of former Part IIIAA, Participating Shareholders will be considered to satisfy the holding period rule under former section 160APHO, and be qualified persons (as long as the related payments rule is also met) in relation to the Dividend Component received under the Telstra Buy-Back, if:

- the shares sold into the Telstra Buy-Back were acquired on or before 19 August 2014; and
- during the period when the shares were held the Participating Shareholders had sufficient risks of loss or opportunities for gain in respect of the shares (as defined in former section 160APHM) for a continuous period of at least 45 days. Neither the announcement of the Telstra Buy-Back, the making of an invitation to shareholders to offer to sell their Telstra shares nor the making of an offer by a shareholder to Telstra in respect of a Telstra share will affect whether the shares bought back under the Telstra Buy-Back are held 'at risk' for the purposes of Division 1A of former Part IIIAA.

44. The 'last-in first-out' rule in former subsection 160APHI(4) has no effect for the purposes of the Telstra Buy-Back in respect of Telstra shares acquired on or after 20 August 2014 (the Ex-entitlement Date) which do not confer an entitlement to participate in the Telstra Buy-Back.

The anti-avoidance provisions

45. The Commissioner will not make a determination under subsection 45A(2) or 45B(3) that section 45C applies to the whole, or any part, of the Capital Component of the Buy-Back Price received by Participating Shareholders.

CR 2014/90

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

47. 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 of the Buy-Back Price by Participating Shareholders.

Commissioner of Taxation

29 October 2014

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.*

Off-market purchase

48. For the purposes of Division 16K, where a company buys a share in itself from a shareholder the purchase is a 'buy-back' (paragraph 159GZZZK(a)).

49. Division 16K categorises a buy-back as either an 'on-market purchase' or an 'off-market purchase'.

50. A buy-back is an on-market purchase if the share bought back is listed for quotation in the official list of a stock exchange in Australia or elsewhere, and the buy-back is made in the ordinary course of trading on that stock exchange (paragraph 159GZZZK(c)). A buy-back that is not an on-market purchase is an off-market purchase (paragraph 159GZZZK(d)).

51. Although Telstra's ordinary shares are listed for quotation in the official list of the ASX, the Telstra Buy-Back was not made in the ordinary course of trading on the ASX. As a result, for the purposes of Division 16K, the Telstra Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend and Capital Components

52. The Buy-Back Price received by Participating Shareholders comprises two components:

- a Dividend Component, and
- a Capital Component.

53. The amount of each of these components is determined in accordance with sections 159GZZZP and 159GZZZQ, having regard to how Telstra accounted for the Telstra Buy-Back.

The Dividend Component

54. Section 159GZZZP 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 amounts standing to the credit of the share capital account is taken to be a dividend paid by the company to the seller on the day the buy-back occurs.

55. The Buy-Back Price was \$4.60 per share, of which \$2.33 per share was debited against amounts standing to the credit of Telstra's share capital account (Capital Component). As a result, the Dividend Component is taken to be \$2.27 per share.

56. The Dividend Component of \$2.27 per share is frankable, but only to the extent that the Buy-Back Price does not exceed the market value of a Telstra share at the time of the Telstra Buy-Back if the Telstra Buy-Back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997).

57. TD 2004/22 prescribes how to determine what would have been the market value of a Telstra share at the time of the Telstra Buy-Back if the Telstra Buy-Back did not occur and was never proposed to occur. In respect of the Telstra Buy-Back, the Buy-Back Price per share did not exceed the market value determined in accordance with TD 2004/22. As a result, all of the Dividend Component of the Buy-Back Price is frankable.

Assessability of the Dividend Component and tax offset

Direct distributions

58. For Participating Shareholders who are Australian residents (other than a partnership or a trust) and who directly received the Dividend Component:

- the Dividend Component is included in the assessable income of each Participating Shareholder under subsection 44(1), and
- subject to the 'qualified person' rule, the amount of the franking credit on the Dividend Component is included in the assessable income of each Participating Shareholder under subsection 207-20(1) of the ITAA 1997.

59. Subject to the 'qualified person' rule, these Participating 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.

Indirect distributions

Partnerships

60. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of the partnership for the purposes of computing the net income of the partnership under section 90.

61. Subject to the 'qualified person' rule, pursuant to subsection 207-35(1) of the ITAA 1997, the amount of the franking credit on the Dividend Component is included in the assessable income of the partnership for the purposes of computing the net income of the partnership under section 90.

Trusts

62. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of the trustee for the purposes of computing the net income of the trust under subsection 95(1).

63. Subject to the 'qualified person' rule, pursuant to subsection 207-35(1) of the ITAA 1997, the amount of the franking credit on the Dividend Component is included in the assessable income of the trustee for the purposes of computing the net income of the trust under subsection 95(1).

Refundable tax offset

64. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided they are not excluded from the refundable tax offset rules by subsections 67-25(1A) to 67-25(1D) of the ITAA 1997.

Non-resident Participating Shareholders

65. As the Dividend Component of the Buy-Back Price is fully franked, and no determination will be made in respect of the Dividend Component under either paragraph 204-30(3)(c) of the ITAA 1997 or paragraph 177EA(5)(b), a non-resident Participating Shareholder is not liable to Australian withholding tax on the Dividend Component (paragraph 128B(3)(ga)).

The Capital Component***Calculation of Sale Consideration***

66. For the purposes of determining the amount of a gain or loss (for Telstra shares held on capital or revenue account), the consideration in respect of the disposal of a share (the Sale Consideration) under an off-market share buy-back is determined in accordance with section 159GZZZQ.

67. Subsection 159GZZZQ(1) provides that a shareholder is taken to have received an amount equal to the purchase price (in this case the Buy-Back Price of \$4.60 received for each Telstra 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.

68. Subsection 159GZZZQ(2) 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 (calculated as 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 of the share as consideration in respect of the sale of the share bought back.

69. For the purposes of determining the application of subsection 159GZZZQ(2) the following methodology has been proposed by Telstra and accepted by the Commissioner in accordance with TD 2004/22: The market value of a Telstra share is the VWAP of a Telstra share over the last five trading days before the first announcement of the Telstra Buy-Back, adjusted for the percentage change in the S&P/ASX 200 Index from the commencement of trading on the First Announcement Date (14 August 2014) to the close of trading on the date the buy-back closed (3 October 2014).

70. Under this methodology, the market value of a Telstra share bought back was calculated to be \$5.04. As a result, Participating Shareholders are taken to have received \$5.04 for the sale of each Telstra share rather than \$4.60.

71. Pursuant to subsection 159GZZZQ(3), the deemed consideration of \$5.04 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated under subsection 159GZZZQ(4). In the circumstances of the Telstra Buy-Back, the Reduction Amount is equivalent to the Dividend Component (\$2.27), unless a Participating Shareholder is a corporate tax entity to whom subsection 159GZZZQ(8) applies. As a result, the Sale Consideration for each Telstra share disposed of under the Telstra Buy-Back is \$2.77 (\$5.04 less \$2.27).

72. However, it should be noted that where a Participating Shareholder is a corporate tax entity which is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the Dividend Component, an adjustment may be made to the Sale Consideration. Under subsection 159GZZZQ(8), if such a participating shareholder would otherwise make either a capital loss or a deductible loss (or any increase in such a loss) in respect of the sale of a Telstra share bought back under the Telstra Buy-Back, the Sale Consideration is increased by an off-settable amount determined under subsection 159GZZZQ(9). The Reduction Amount is reduced by so much of the off-settable amount that does not exceed the capital loss or the deductible loss.

73. Participating Shareholders are taken to have disposed of their shares accepted under the Telstra Buy-Back on 6 October 2014 (CGT event A1). The disposal may have different taxation implications for Participating 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 and the CGT provisions.

Shares held on capital account

74. The Sale Consideration of \$2.77 per share represents the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997. A Participating Shareholder (other than a partnership¹) will make a capital gain in respect of the disposal of a share if the Sale Consideration per share exceeds the cost base of the share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder (other than a partnership²) will make a capital loss in respect of the disposal of a share if the Sale Consideration per share is less than the reduced cost base of the share (subsection 104-10(4) of the ITAA 1997).

75. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Telstra share sold into the Telstra Buy-Back by the partnership (subsection 106-5(2) of the ITAA 1997). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of Telstra shares into the Telstra Buy-Back.

Shares held on revenue account

76. Where shares were held as trading stock, the Sale Consideration of \$2.77 per share is included in assessable income under section 6-5 of the ITAA 1997. Participating Shareholders (other than partnerships) who disposed of shares held as trading stock will also make a capital gain or capital loss. However, as the shares were held as trading stock, the capital gain or loss is disregarded under section 118-25 of the ITAA 1997. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

77. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$2.77 per share exceeds the cost of each share is included in assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$2.77 per share the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of the share these Participating Shareholders (other than partnerships) will also make a capital gain. However, Participating Shareholders who held their shares as revenue assets will have the amount of the capital gain reduced under the anti-overlap provisions contained in section 118-20 of the ITAA 1997. There is a similar reduction for partners in partnerships (paragraph 118-20(1)(b), paragraph 118-20(2)(b) and subsection 118-20(3) of the ITAA 1997).

¹ Any capital gain will be made by the partners individually: subsection 106-5(1) of the ITAA 1997.

² Any capital loss will be made by the partners individually: subsection 106-5(1) of the ITAA 1997.

Foreign resident Participating Shareholders: CGT consequences

78. Under subsection 855-10(1) of the ITAA 1997, 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'.

79. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. 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).

80. Items 1 and 4 of the table in section 855-15 of the ITAA 1997 do not apply to a Telstra share.

81. Telstra has also advised that at the time CGT event A1 happened as a result of the Telstra Buy-Back, a Telstra share was not an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997) as the interest did not pass the non-portfolio interest test (section 960-195 of the ITAA 1997) at that time, or throughout the period prescribed by subparagraph 855-25(1)(a)(ii) of the ITAA 1997.

82. As a result, under subsection 855-10(1) of the ITAA 1997, a Participating Shareholder that is a foreign resident, or the trustee of a foreign trust, will disregard a capital gain or capital loss made from CGT event A1 unless:

- the Telstra share has been used at any time by the foreign resident or the trustee of a foreign trust 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
- the Telstra share is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Qualified persons

83. 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 former Division 1A of Part IIIAA is required to include the franking credit in its assessable income or is entitled to claim a tax offset in respect of it. Broadly speaking, to be a qualified person in relation to the Dividend Component paid under the Telstra Buy-Back a Participating Shareholder must satisfy both the 'holding period rule' and the 'related payments rule'.

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

85. The holding period rule requires a shareholder to hold the shares on which the dividend is paid 'at risk' for a continuous period of at least 45 days during the relevant qualification period. In the absence of a related payment, the relevant qualification period is the primary qualification period, which commences on the day after the shares are acquired and ends on the 45th day after the day on which they became ex-dividend. In determining whether a shareholder has satisfied the holding period rule, any days during which there is a materially diminished risk of loss or opportunity for gain in respect of the relevant shares are not counted. The day of acquisition and the day of disposal of the relevant shares are also not counted.

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

87. The Commissioner does not regard the announcement of the Telstra Buy-Back as affecting whether Telstra shares were held at risk or not.

88. There are 45 clear days between 19 August 2014 and 6 October 2014 (the date tender offers were accepted). As a result, a Participating Shareholder who acquired shares on or before 19 August 2014 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A Participating Shareholder who acquired shares after 19 August 2014 that were subsequently bought back under the Telstra Buy-Back may not be a qualified person in relation to the dividend paid under the Telstra Buy-Back for the purposes of former Division 1A of Part IIIAA except in certain circumstances.

89. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first (former subsection 160APHI(4)). 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, Participating Shareholders who, after 19 August 2014, acquired any additional Telstra shares, which conferred an entitlement to participate in the Telstra Buy-Back, may not qualify for the franking credits attached to the dividends paid on some or all of the shares sold into the Telstra Buy-Back.

90. However, Telstra shares acquired by Participating Shareholders which did not confer an entitlement to participate in the Telstra Buy-Back (ex-entitlement shares) which were purchased after Telstra shares that did confer an entitlement to participate in the Telstra Buy-Back (cum-entitlement shares) will not be considered to take the place of tendered cum-entitlement shares under an application of the 'last-in first-out' rule in former subsection 160APHI(4). Ex-entitlement shares do not constitute 'related securities' for the purposes of former subsection 160APHI(2) to any cum-entitlement shares. Accordingly, for any additional Telstra shares that a Participating Shareholder acquired on or after 20 August 2014 that did not confer an entitlement to participate in the Telstra Buy-Back, the 'last-in first out' rule in former subsection 160APHI(4) will not apply in relation to those shares.

The anti-avoidance provisions

Sections 45A and 45B

91. Sections 45A and 45B are two anti-avoidance provisions, which if they apply, 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 a Participating Shareholder under the Telstra Buy-Back is treated as an unfranked dividend. Accordingly, the application of these two provisions to the Telstra Buy-Back must be considered.

92. 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.

93. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) is provided to Participating Shareholders under the Telstra Buy-Back, the circumstances of the Telstra Buy-Back indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Under the Telstra Buy-Back, all Participating Shareholders received both a Capital Component as well as a Dividend Component in equal proportion based on the number of shares they sold into the Telstra Buy-Back. Accordingly, section 45A has no application to the Telstra Buy-Back.

94. Section 45B 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 (the 'relevant 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 the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

95. While the conditions of paragraphs 45B(2)(a) and (b) have been met in respect of the Telstra Buy-Back, the requisite purpose of enabling a Participating Shareholder to obtain a tax benefit by way of a dividend disguised as a capital distribution was not present.

96. Having regard to the 'relevant circumstances' (as set out in subsection 45B(8)) of the Telstra Buy-Back, it is apparent that:

- the Capital Component of the Buy-Back Price is acceptable in Telstra's circumstances;
- the Capital Component of the Buy-Back Price cannot be said to be attributable to the profits of Telstra;
- the pattern of distributions of Telstra does not indicate that the Capital Component was paid in substitution for a dividend;
- the Telstra Buy-Back is not expected to alter Telstra's dividend policy; and
- as a consequence of the Telstra Buy-Back, the distribution of share capital resulted in a reduction in ordinary shares in Telstra held by Participating Shareholders.

97. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to treat all or part of the Capital Component of the Buy-Back Price as an unfranked dividend paid by Telstra.

Section 177EA

98. Section 177EA 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.

99. Specifically, subsection 177EA(3) 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.

100. The conditions of paragraphs 177EA(3)(a) to 177EA(3)(d) are satisfied in respect of the Telstra Buy-Back. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of Telstra, its shareholders or any other relevant party, there is a more than incidental purpose of conferring an imputation benefit under the scheme. In respect of the Telstra Buy-Back, the relevant taxpayer is the Participating Shareholder and the scheme comprises the circumstances surrounding the Telstra Buy-Back.

101. 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). The relevant circumstances listed in subsection 177EA(17) 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.

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

- the greater attraction of the Telstra Buy-Back to resident shareholders who could fully utilise the franking credits than to non-resident shareholders who could not.

103. Where section 177EA applies the Commissioner has a discretion pursuant to subsection 177EA(5) to make a determination to debit Telstra's franking account pursuant to paragraph 177EA(5)(a), or deny the imputation benefit to each Participating Shareholder pursuant to paragraph 177EA(5)(b). The Commissioner will exercise his discretion in such a way that he will not make a determination that the imputation benefit obtained by Participating Shareholders will be denied under paragraph 177EA(5)(b).

Section 204-30 of the ITAA 1997

104. 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 section 204-30 of the ITAA 1997 would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997); and
- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); 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) of the ITAA 1997).

105. If section 204-30 of the ITAA 1997 applies, the Commissioner is vested with a discretion under subsection 204-30(3) of the ITAA 1997 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) of the ITAA 1997); or

- (b) that no imputation benefit is to arise in respect of any streamed distribution made to a favoured member and specified in the determination (paragraph 204-30(3)(c) of the ITAA 1997).

106. For section 204-30 of the ITAA 1997 to apply, Participating Shareholders to whom distributions are streamed must derive a greater benefit from franking credits than ordinary shareholders of Telstra who do not participate in the Telstra Buy-Back. Some of the cases in which a member of an entity 'derives a greater benefit from franking credits' are listed in subsection 204-30(8) of the ITAA 1997 by reference to the ability of a member to fully utilise franking credits.

107. A portion of Telstra's ordinary shares are held by non-resident shareholders who do not benefit from franking credits (a feature of the Telstra Buy-Back) to the same extent as resident shareholders. As a result, the conditions in subsection 204-30(1) of the ITAA 1997 for section 204-30 of the ITAA 1997 to apply are met. However, the Commissioner will not make a determination under subsection 204-30(3) of the ITAA 1997.

Appendix 2 – Detailed contents list

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

	Paragraph
What this Ruling is about	1
Relevant provisions	2
Class of entities	3
Qualifications	4
Date of effect	6
Scheme	7
Ruling	23
Off-market purchase	23
The Dividend Component	24
Assessability of the Dividend Component and tax offset	27
<i>Direct distributions</i>	27
<i>Indirect distributions</i>	29
<i>Partnerships</i>	29
<i>Trusts</i>	30
<i>Refundable tax offset</i>	31
<i>Non-resident Participating Shareholders</i>	32
Sale Consideration	33
<i>Share held on capital account</i>	37
<i>Shares held on revenue account</i>	40
<i>Foreign resident Participating Shareholders: CGT consequences</i>	42
Qualified persons	43
The anti-avoidance provisions	45
Appendix 1 – Explanation	48
Off-market purchase	48
The Dividend and Capital Components	52
The Dividend Component	54
Assessability of the Dividend Component and tax offset	58
<i>Direct distributions</i>	58
<i>Indirect distributions</i>	60
<i>Partnerships</i>	60
<i>Trusts</i>	62
<i>Refundable tax offset</i>	64

<i>Non-resident Participating Shareholders</i>	65
The Capital Component	66
<i>Calculation of Sale Consideration</i>	66
<i>Shares held on capital account</i>	74
<i>Shares held on revenue account</i>	76
<i>Foreign resident Participating Shareholders: CGT consequences</i>	78
Qualified persons	83
The anti-avoidance provisions	91
<i>Sections 45A and 45B</i>	91
<i>Section 177EA</i>	98
<i>Section 204-30 of the ITAA 1997</i>	104
Appendix 2 – Detailed contents list	108

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22; TR 2006/10

Subject references:

- CGT event A1 – disposal of a CGT asset
- CGT exemptions
- CGT taxable Australian property
- deemed dividends
- disposal of trading stock
- dividend income
- dividend streaming arrangements
- dividend substitution
- franked dividends
- imputation credits
- non-resident dividend withholding tax
- qualified person
- refund of imputation credits
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Income tax ~~ Capital gains tax ~~ Exemptions ~~ Other
Income tax ~~ Capital management ~~ Share buy back
Income tax ~~ Capital management ~~ Qualified person
rule
International issues ~~ Non-resident withholding tax
obligations

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