



Class Ruling

Income tax: CMI Limited – off-market share buy-back

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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:
- subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
 - subsection 44(1) of the 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
 - Division 16K of the ITAA 1936

- section 159GZZZK of the ITAA 1936
- section 159GZZZP of the ITAA 1936
- section 159GZZZQ of the ITAA 1936
- Division 1A of former Part IIIAA 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
- subsection 106-5(2) 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
- Subdivision 207-B 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 CMI Limited (CMI) who:

- disposed of their ordinary shares in CMI under the off-market share buy-back that was announced by CMI on 18 November 2016 and which is described in paragraphs 8 to 25 of this Ruling (the 'Buy-Back'), and
- 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 CMI 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 CMI are referred to as '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 8 to 25 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.

Date of effect

7. This Ruling applies from 1 July 2016 to 30 June 2017. The Ruling continues to apply after 30 June 2017 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

8. 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:

- draft application for Class Ruling of 4 October 2016
- 2016 CMI Annual Report dated 18 August 2016, and
- further particulars 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.

9. CMI is an Australian resident company whose shares have been listed on the Australian Securities Exchange (ASX) since 22 April 1993.

10. The audited Statement of Financial Position of CMI as at 30 June 2016 showed total share capital of \$35,322,000 and retained profits of \$15,117,000. As at 30 June 2016, CMI had 34,852,634 fully paid ordinary shares. CMI did not have any other shares on issue.

11. CMI's ordinary shareholders are a mix of individuals, companies, trusts, partnerships and superannuation funds, some of whom are non-residents. There are no shareholders who hold pre-CGT shares in CMI.

12. On 18 November 2016, CMI announced (the First Announcement Date) its intention to undertake an off-market share buy-back of its ordinary shares. CMI announced it was intending to repurchase up to 10% of its issued capital.

13. The Buy-Back formed part of CMI's strategy to provide increased value to CMI's shareholders.

14. On the First Announcement Date, CMI also announced its intention to change its business strategy and name. The Buy-Back would allow shareholders who did not wish to remain with the company after the changes to exit CMI's share register. At that time, the Australian Stock Exchange (ASX) suspended trading of CMI ordinary shares.

15. The Buy-Back was conducted through an offer which was open to CMI shareholders with a registered address in Australia and New Zealand that held ordinary shares on 25 November 2016 (the Record Date). Under the terms of the buy-back, Participating Shareholders were required to tender all their shares.

16. The Buy-Back offer period opened on 30 November 2016 and closed on 4 January 2017. The Buy-Back date would be 5 January 2017. An Extraordinary General Meeting (EGM) was held on 23 December 2016 which approved the business strategy change but not the name change for CMI.

17. Participation in the Buy-Back was voluntary. Eligible shareholders who did not wish 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 Buy-Back.

18. Under the terms of the Buy-Back, \$1.01 per share would be debited to CMI's share capital account, and the balance would be comprised of a fully franked dividend. CMI advised that it intended to buy back its ordinary shares at market value.

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

- CMI would not buy back shares at a discount greater than 14% applied to the volume weighted average price (VWAP) of a CMI ordinary share over the five days up to and including the closing date of the buy-back, and

- the Buy-Back Price would not exceed the market value of a CMI share determined in accordance with the methodology in Taxation Determination TD 2004/22 *Income tax: for Off-Market Share Buy-Backs of listed shares, whether the buy-back price is set by tender process or not, what is the market value of the share for the purposes of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936?*

20. Under the Buy-Back, if the number of shares offered exceeded the number of shares CMI had determined to buy back (***the Limit***), CMI would buy back the number of shares from each ***Accepting Shareholder*** determined by the following procedures:

Note: bold italic terms in this paragraph have the meaning as defined in the *CMI Limited Off-Market Share Buy-Back Booklet* dated 25 November 2016.

- (i) first, CMI would buy back all of the shares held by each Accepting Shareholder holding a parcel of shares valued at \$2,000 or less (determined as set out in (vi) below), which equates to 1796 or less shares (***the Priority Allocation***)
- (ii) second, CMI would calculate the difference between the number of shares comprising the Limit and the number of shares comprising all Priority Allocations to determine the number of shares CMI could also buy back without exceeding the Limit (***the Remaining Allocation***)
- (iii) third, subject to paragraph (v), CMI would buy back the Remaining Allocation from each other Accepting Shareholder (***the Remaining Shareholders***) on a pro rata basis (***the Pro Rata Allocation***) up to the Limit. For the avoidance of doubt, each Remaining Shareholder would have an equal percentage of shares bought back by CMI
- (iv) fourth, if, after the Pro Rata Allocation occurred, any Remaining Shareholder held a parcel of shares valued at \$500 or less (determined as set out in (vi) below), which equates to 449, or less, shares (***the Small Residual Holding***), CMI would also buy back each Small Residual Holding, and
- (v) fifth, if CMI complied with paragraphs (i) to (iv) (inclusive) and the number of shares to be bought back by CMI exceeded the Limit, CMI might reduce the percentage of shares it bought back from each Remaining Shareholder under paragraph (iii) to ensure that the Limit is not exceeded,

subject to the shareholder spread requirements for CMI under ***the ASX Listing Rules*** continuing to be met.

- (vi) the value of a parcel of shares held by an Accepting Shareholder would be calculated by multiplying the number of shares held by the Accepting Shareholder by \$1.11, being the volume weighted average trading price of the shares calculated four weeks prior to the announcement of the off-market buy-back (being 21 October 2016).

21. On 6 January 2017, CMI announced that:

- it had successfully bought back 3,485,263 CMI shares, representing 10% of the issued shares of CMI
- the Buy-Back Price was \$1.25 per share, which was equal to the market value of a CMI share as at 5 January 2017 as calculated in accordance with TD 2004/22, and
- maximum buy-back of 10% of CMI shares on issue.

22. Under the Buy-Back, \$1.01 per share was debited to CMI's untainted share capital account, and the balance of the Buy-Back Price (the Dividend Component), being \$0.24, was debited to CMI's retained profits. The Dividend Component was fully franked.

23. All shares bought back under the Buy-Back were cancelled.

24. More than 50% of the market value of CMI's assets do not relate to real property situated in Australia.

25. CMI ordinary shares recommenced trading on the ASX on 20 January 2017.

Ruling

Off-market purchase

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

The Dividend Component

27. Participating Shareholders are taken to have been paid a dividend of 24 cents on 5 January 2017 for each share disposed of in the Buy-Back (section 159GZZZP).

28. 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.

29. The difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes (subsection 159GZZZP(2)).

Assessability of the Dividend Component and tax offset***Direct distributions***

30. The Dividend Component of 24 cents per share and, subject to the shareholder being a 'qualified person', the amount of the franking credit on the Dividend Component, is included in the assessable income of Australian resident individuals and corporate shareholders, and trustees of resident complying superannuation funds who participated in the Buy-Back in the income year in which the Buy-Back occurred (subsection 44(1), and subsection 207-20(1) of the ITAA 1997).

31. 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 attached to the Dividend Component, subject to being a 'qualified person'.

Indirect distributions***Partnerships***

32. The Dividend Component of 24 cents per share and, subject to being a 'qualified person', the amount of the franking credit attached to 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 pursuant to section 90.

Trusts

33. The Dividend Component of 24 cents per share and, subject to being a 'qualified person', the amount of the franking credit attached to 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 pursuant to subsection 95(1).

Partners and Beneficiaries

34. Subsections 207-35(3) to 207-35(6) of the ITAA 1997 set out the circumstances in which a partner or beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution. Where the franked distribution flows indirectly (within the meaning of Subdivision 207-B of the ITAA 1997), through a trust or partnership to a resident that is an individual, a corporate tax entity (at the time the distribution flows indirectly to it) or a trustee mentioned in paragraphs 207-45(c), 207-45(ca) or 207-45(d) of the ITAA 1997, the entity will, subject to the 'qualified person' rule, be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45 of the ITAA 1997).

Refundable tax offset

35. 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 in accordance with subsections 67-25(1A) to 67-25(1DA) of the ITAA 1997.

Non-resident Participating Shareholders

36. As the Dividend Component is fully franked, non-resident Participating Shareholders are not liable to Australian withholding tax in respect of the Dividend Component (paragraph 128B(3)(ga)).

Sale Consideration

37. A Participating Shareholder is taken to have received \$1.01 per share as consideration in respect of each share bought back under the Buy-Back on 5 January 2017 in accordance with section 159GZZZQ, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

38. If the Buy-Back Price for each share bought back under the Buy-Back was less than what would have been the market value of the share if the Buy-Back did not occur and was never proposed to occur, then the market value rule in subsection 159GZZZQ(2) applies to the Buy-Back. TD 2004/22 outlines the Commissioner's approach for determining what would have been the market value of the share for the purposes of subsection 159GZZZQ(2).

39. The effect of the rule is that if the Buy-Back Price was less than the market value, determined in accordance with TD 2004/22, the difference is included in the consideration received for the disposal of the share, in addition to the amount of \$1.01 per share debited to CMI's share capital account. As the Buy-Back Price was equal to the market value of a CMI ordinary share as determined in accordance with TD 2004/22, the Sale Consideration is \$1.01 per share.

40. 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

41. The shares are taken to have been disposed of for capital gains tax (CGT) purposes on 5 January 2017 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

42. The Sale Consideration of \$1.01 per share 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).

43. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each CMI share sold into the 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 CMI shares into the Buy-Back.

Shares held on revenue account

44. Where shares were held as trading stock, the Sale Consideration of \$1.01 per share is included in assessable income pursuant to section 6-5 of the ITAA 1997. Participating Shareholders (other than partnerships) that held shares as trading stock also made a capital gain or capital loss. However, under section 118-25 of the ITAA 1997, any capital gain or capital loss the Participating Shareholders made will be disregarded if at the time of the CGT event, the shares were held as trading stock. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

45. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$1.01 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income. Correspondingly, if the cost of each share exceeds the Sale Consideration of \$1.01 per share, the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of that share, the Participating Shareholders (other than partnerships) will also make a capital gain. However, under section 118-20 of the ITAA 1997, any capital gain the Participating Shareholders made will be reduced if, because of the event, an amount is otherwise 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 (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating Shareholders: CGT consequences

46. Under section 855-10 of the ITAA 1997, foreign resident shareholders who participate in the Buy-Back will only have CGT consequences if the shares purchased under the Buy-Back are 'taxable Australian property'.

Qualified persons

47. For the purposes of paragraph 207-145(1)(a) of the ITAA 1997 which refers to 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 Buy-Back, if:

- the shares sold into the Buy-Back were acquired on or before 20 November 2016, 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 Buy-Back, the making of an invitation to shareholders to offer to sell their CMI shares nor the making of an offer by a shareholder to CMI in respect of a CMI share will affect whether the shares bought back under the Buy Back are held 'at risk' for the purposes of Division 1A of former Part IIIAA.

48. As CMI shares were suspended from trading on 18 November 2016, all shareholders who acquired CMI shares on or before 18 November 2016 will be qualified persons (subject to meeting the related payments rule).

The anti-avoidance provisions

49. 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 Capital Component of the Buy-Back Price received by Participating Shareholders.

50. 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.

51. 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 Taxation15 February 2017

Appendix 1 – Explanation

■ *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

52. 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)).

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

54. 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)).

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

The Dividend Component and Capital Component

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

- a Dividend Component, and
- a Capital Component.

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

The Dividend Component

58. 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 company's share capital account is taken to be a dividend paid by the company to the seller on the day the buy-back occurred.

59. The Buy-Back Price was \$1.25 per share, of which \$1.01 (the Capital Component) was debited against amounts standing to the credit of CMI's share capital account. As a result, the Dividend Component paid by CMI on 5 January 2017 is taken to be 24 cents per share.

60. The Dividend Component of 24 cents per share is frankable, but only to the extent that the Buy Back Price does not exceed the market value of a CMI share at the time of the Buy-Back if the buy-back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997).

61. TD 2004/22 sets out the Commissioner's view as to how to determine what would have been the market value of a CMI share at the time of the Buy-Back as if the buy-back did not occur and was never proposed to occur. In this case, the Buy Back Price per share is equal to the market value determined in accordance with TD 2004/22. Therefore, the entire Dividend Component is frankable.

Assessability of the Dividend Component and tax offset

Direct distributions

62. 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.

63. Subject to the 'qualified person' rule, the 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

64. 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.

65. Under subsection 207-35(1) of the ITAA 1997 (and subject to the 'qualified person' rule), 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

66. 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). 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).

Partners and beneficiaries

67. Subsections 207-35(3) to 207-35(6) of the ITAA 1997 set out the circumstances in which a partner or beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution. Where the franked distribution flows indirectly (within the meaning of Subdivision 207-B of the ITAA 1997) through a trust or partnership to a resident that is an individual, a corporate tax entity (at the time the distribution flows indirectly to it) or a trustee mentioned in paragraphs 207-45(c), 207-45(ca) or 207-45(d) of the ITAA 1997, the entity will, subject to the qualified person rule, be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45 of the ITAA 1997).

Refundable tax offset

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

Non-resident Participating Shareholders

69. 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***

70. For the purposes of determining the amount of a gain or loss (for CMI shares either held on capital or revenue account), the consideration received by a Participating Shareholder in respect of the disposal of a share (the Sale Consideration) under the Buy-Back is determined in accordance with section 159GZZZQ. The effect of section 159GZZZQ is to adjust the Capital Component in order to determine the Sale Consideration for CGT purposes or revenue account treatment.

71. Subsection 159GZZZQ(1) provides that a Participating Shareholder is taken to have received an amount equal to the purchase price 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.

72. CMI had intended to buy back its shares at market value. The purchase price for the Buy-Back is \$1.25, determined with the following formula:

$$\text{VWAP} \quad \times \quad \frac{\text{Closing S\&P / ASX 200 Index}}{\text{Opening S\&P / ASX 200 Index}}$$

Where:

VWAP = the volume weighted average price of CMI share on the ASX over the last five trading days before 18 November 2016

Opening S&P/ASX 200 Index = S&P/ASX Index at the commencement of trading on 18 November 2016

Closing S&P/ASX 200 Index = S&P/ASX 200 Index at the close of trading on 5 January 2017

73. 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.

74. For the purposes of determining the application of subsection 159GZZZQ(2) the following methodology as outlined in TD 2004/22 has been used: the market value of a CMI share at the Buy-Back date is the VWAP of a CMI share price on the ASX over the five days prior to 18 November 2016, adjusted for the percentage change in the S&P/ASX 200 index from the commencement of trading on 18 November 2016 to the close of trading on 5 January 2017.

75. Under this methodology, the market value of a CMI share bought back was calculated as \$1.25, which is equal to the Buy-Back Price. Therefore, the deemed consideration received by Participating Shareholders for the sale of each CMI share is the Buy-Back Price, \$1.25 per share. CMI had proposed to its shareholders to buy back its shares at market value and the Commissioner acknowledges that the Buy-Back Price of \$1.25 is the market value of a CMI share at the time of the Buy-Back.

76. Pursuant to subsection 159GZZZQ(3), the deemed consideration of \$1.25 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated pursuant to subsection 159GZZZQ(4). In the circumstances of the Buy-Back, the Reduction Amount is equivalent to the Dividend Component of 24 cents, unless a Participating Shareholder is a corporate tax entity to whom subsection 159GZZZQ(8) applies (see paragraph 77 below). As a result, the Sale Consideration for each CMI share disposed of under the Buy-Back is \$1.01 (being \$1.25 less 24 cents).

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

78. Participating Shareholders are taken to have disposed of their shares accepted under the Buy-Back on 5 January 2017 (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

79. The Sale Consideration of \$1.01 per share 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 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 partnership) 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).

80. Where the Participating Shareholder is a partnership, any capital gain or capital loss will be made by the partners individually – subsection 106-5(1) of the ITAA 1997. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each CMI share sold into the 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 CMI shares into the Buy-Back.

Shares held on revenue account

81. Where shares were held as trading stock, the Sale Consideration of \$1.01 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 capital loss is disregarded pursuant to 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).

82. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$1.01 per share exceeds the cost of each share is included in assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$1.01 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) also made a capital gain. However, Participating Shareholders who held their shares as revenue assets other than as trading stock will have the amount of the capital gain reduced under the CGT anti-overlap provisions contained in section 118-20 of the ITAA 1997. There is a similar reduction for partners in partnerships (paragraphs 118 20(1)(b) and 118-20(2)(b), and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating Shareholders: CGT consequences

83. A foreign resident shareholder who 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 855-10 of the ITAA 1997. A CMI share that is disposed of in the Buy-Back will constitute taxable Australian property if the share:

- is an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997)

- was 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
- is a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident) (item 5 of the table in section 855-15 of the ITAA 1997).

Qualified persons

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

85. 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.

86. 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.

87. 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.

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

89. There are at least 45 clear days from 18 November 2016 (the First Announcement Date) to 5 January 2017 (the date a contract for acquisition of shares was entered into by CMI and a Participating Shareholder). As a result, a Participating Shareholder who acquired shares on or before 18 November 2016 that were bought back under the Buy-Back satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days.

The anti-avoidance provisions

Sections 45A and 45B

90. 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 Buy-Back is treated as an unfranked dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

91. Section 45A 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.

92. 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. Under the Buy-Back, all Participating Shareholders received both a distribution of share capital as well as a Dividend Component in equal proportion based on the number of shares they sold into the Buy-Back. Accordingly, section 45A has no application to the Buy-Back.

93. 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)).

94. While the conditions of paragraphs 45B(2)(a) and 45B(2)(b) were met in respect of the Buy-Back, the requisite purpose of enabling a person to obtain a tax benefit as a result of the capital distribution was not present.

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

- the distribution of share capital of \$1.01 per share accords with average capital per share and could not be said to be attributable to the profits of CMI
- the pattern of distributions of CMI does not indicate that the distribution of share capital of \$1.01 per share reflects amounts in substitution for a dividend
- the Buy-Back is not expected to alter CMI's dividend policy, and
- as a consequence of the Buy-Back, the distribution of share capital resulted in the cancellation of ordinary shares in CMI held by Participating Shareholders and a corresponding loss of dividend, voting and other rights.

96. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to treat all or part of the distribution of share capital of \$1.01 per share as an unfranked dividend paid by CMI.

Section 177EA

97. 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.

98. 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.

99. The conditions of paragraphs 177EA(3)(a) to 177EA(3)(d) are satisfied in respect of the 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 CMI, 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 Buy-Back, the relevant taxpayer is the Participating Shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

100. 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 that subsection 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.

101. The Commissioner has formed the view that section 177EA applies to the 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 Buy-Back reflected in those paragraphs is the greater attraction of the Buy-Back to resident shareholders of the franking credits than for non-resident shareholders.

102. Where section 177EA applies the Commissioner has a discretion pursuant to subsection 177EA(5) to make a determination to debit CMI'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

103. 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)
- (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).

104. If section 204-30 of the ITAA 1997 applies, the Commissioner has 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).

105. 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 CMI who do not participate in the 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.

106. A portion of CMI's ordinary shares are held by non-resident shareholders who do not benefit from franking credits 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.

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Income tax ~~ Capital gains tax ~~ Exemptions ~~ Other
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Income tax ~~ Capital management ~~ Qualified person rule.

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