

# ***CR 2001/69 - Income tax: Off-Market Share Buy-Back by Santos Ltd***

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⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *28 November 2001*



## **Class Ruling**

### **Income tax: Off-Market Share Buy-Back by Santos Ltd**

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#### ***Preamble***

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

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## **What this Class Ruling is about**

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

#### **Tax law(s)**

2. This Ruling relates to the application of the following provisions of the *Income Tax Assessment Act 1936* (‘The Act’):

- Section 45A (Streaming of dividends and capital benefits);
- Section 45B (Schemes to provide capital benefits);
- Section 45C (Effect of determinations under sections 45A);
- Section 159GZZZM (Purchase price in respect of buy-back);
- Section 160AQCBA (Further provisions relating to dividend streaming); and
- Section 177EA (Creation of franking debit or cancellation of franking credits).

## Class of persons

3. The class of persons to whom this Ruling applies is the shareholders of Santos Ltd (“*Santos*”) who dispose of shares under the Santos off-market share buy-back described in the Arrangement part of this Ruling.

## Qualifications

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

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraph 9 is carried out in accordance with the details of the arrangement provided in this Ruling.

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

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

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## Date of effect

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8. This Class Ruling applies from the date on which Santos formally releases its off-market share buy-back offer.

## Arrangement

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9. The arrangement that is the subject of the Ruling is described below. This description is based on the application for the

Class Ruling dated 11 September 2001 and the letter dated 3 October 2001 in relation to the proposal by Santos to undertake an off-market buy-back of shares. These documents, or relevant parts of it, as the case may be, form part of and are to be read with this description.

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

- (a) Santos has announced an off-market share buy-back offer (the “*buy-back*”). Santos will return shareholders equity of approximately \$250 million, which represents approximately 6 percent of the company’s share capital. That is approximately 39 million shares out of 619 million issued shares;
- (b) the buy-back price will be finalised to reflect the market value of shares prior to the announcement of the buy-back. It is intended to base the buy-back price on VWAP (Average of the daily volume weighted average sale price of ordinary shares sold on the ASX other than special crossings) over the period of five trading days prior to announcement and indexed from that date to the buy-back date by a suitable index such as the ASX Energy Index. At this stage an indicative buy-back price is expected to be in the order of \$6.26 per share;
- (c) all shareholders will be entitled to participate on equal terms in the buy-back. In the case of over subscription to the buy-back it is proposed to offer each shareholder a minimum buy-back of shares, including the avoidance of creating unmarketable parcels, with any excess scaled back on an equal basis;
- (d) the purpose of the buy-back (in addition to the issue of reset convertible preference shares) is to reduce the weighted average cost of capital of the company whilst maintaining its credit rating of BBB+ and allow sufficient flexibility within the current credit rating to pursue growth opportunities. In addition, the reduction in capital is expected to improve the company’s earnings per share and increase the intrinsic value per ordinary share;
- (e) the buy-back of \$250 million will be funded by an issue of reset convertible preference shares (“*Preference Shares*”), which will proceed subject to favourable market conditions;

- (f) the buy-back price will be allocated between share capital and retained earnings on a basis that preserves the amount of share capital per share of the remaining ordinary shares in the company. That is, a return of shareholders capital of \$2.63 per share (Share Capital \$1.626 billion and 619 million issued shares) and the balance of retained earnings \$3.63 per share in the case of a \$6.26 per share buy back. In the case of a \$250 million buy-back share capital will reduce by approximately \$105 million and retained earnings by approximately \$145 million.

## **Ruling**

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10. Subject to the qualifications in paragraphs 4 to 7 of this Ruling, and in relation to the proposed buy-back by Santos of approximately 6 percent of its share capital, being approximately 39 million shares out of 619 million issued shares, it is confirmed that:

- (a) shareholders who participate in the buy-back will be taken to have been paid a dividend out of the profits of Santos on the date that the buy-back occurs (called the dividend component). The amount of the dividend under section 159GZZZP will be the difference between the buy-back price received and that part of the price debited against Santos' share capital account, being \$2.63, for each share bought back;
- (b) for the purposes of determining whether:
- (i) the shareholder makes a capital gain or capital loss;
  - (ii) an amount is included in the assessable income of the shareholder under a provision of the 1936 Act or the 1997 Act (other than Parts 3-1 and 3-3 which deal with capital gains and capital losses); or
  - (iii) an amount is allowable as a deduction to the shareholder,

in respect of the buy-back, the shareholder is taken to have received \$2.63 as consideration for the disposal of a share under section 159GZZZQ. This is called the capital component.

If the selling shareholder is an Australian resident corporation and a loss would arise to the shareholder as a result of selling the share, the consideration taken to

be received by the shareholder or which the shareholder is taken to be entitled to receive will be increased by a “rebateable amount” calculated under subsection 159GZZZQ(9).

- (c) The Commissioner will not make a determination (under section 45A or 45B of the Act) that section 45C of the Act applies to the whole, or any part, of the capital component of the buy-back price received by a shareholder who participates in the buy-back.
- (d) The Commissioner will not make a determination under paragraph 160AQCBA(3)(b) of the Act to deny franking credit benefits to a shareholder who participates in the buy-back.
- (e) The Commissioner will not make a determination under paragraph 177EA(5)(b) of the Act to deny franking credit benefits to a shareholder who participates in the buy-back.

## **Explanations**

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### **A. Division 16K - effect of Share Buy-Back**

11. Santos has requested confirmation that the difference between the purchase price as defined in section 159GZZZM of the Act and the part of the purchase price debited against amounts standing to the credit of the share capital account will be a frankable dividend under section 160APA of the Act.

12. Under subsection 159GZZZP(1), where a company makes an off-market buy-back, the amount that is taken to be a dividend paid by the company is the buy-back price less the sum of the paid up amount of the share and any part of the buy-back price which is drawn against the share capital account of the company. The deemed dividend is taken to have been paid to the seller as a shareholder in the company and out of profits derived by the company.

13. The deemed dividend will be a frankable dividend pursuant to paragraph (ba) of the definition of frankable dividend in section 160APA of the Act. As the deemed dividend will be fully franked by the Company, this will have the following effect, subject to the application of the “45 day rule” (section 160APHO) and the “related payments rule” (section 160APHN of the Act):

- a resident individual shareholder will be required to include in assessable income the dividend component under section 44 and the attached franking credit pursuant to section 160AQT. The shareholder will be

entitled to claim a tax offset equal to the franking credit pursuant to section 160AQU.

- a resident corporate shareholder will be required to include the dividend component in assessable income pursuant to section 44. The shareholder may be entitled to claim an intercorporate dividend rebate pursuant to section 46. The shareholder will also be entitled to credit its Class C franking account with an amount equal to the franked amount of the dividend component on the date the dividend is paid pursuant to section 160APP.
- a non-resident shareholder will not be liable to pay Australian withholding tax on the dividend component as it will be fully franked - paragraph 128B(3)(ga).

14. Pursuant to section 159GZZZQ, the consideration for which a shareholder will be deemed to have disposed of its share pursuant to the buy-back will be:

- in the case of shareholder other than a company entitled to section 46 intercorporate dividend rebate, the capital component of the buy-back price in accordance with subsections 159GZZZQ(1) and (3); and
- in the case of a shareholder which is a company entitled to the intercorporate dividend rebate, the capital component of the buy-back price, unless the shareholder would realise a capital loss in which case, by virtue of subsection 159GZZZQ(8), the shareholder will only realise a capital loss if the buy-back price is less than the reduced cost base of the share.

## **B. Application of section 45A**

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

16. Although Santos will provide those shareholders that participate in the buy-back with a 'capital benefit' (as defined in paragraph 45A(3)(b)) the circumstances of the buy-back indicates that there is no streaming of capital benefits to some shareholders, who are advantaged shareholders, and dividends to other shareholders, being disadvantaged shareholders. Accordingly, section 45A has no application to the proposed buy-back.

**C. Application of section 45B**

17. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. For the provision to apply paragraph 45B(2)(c) requires that having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit.

18. Upon having regard to the relevant circumstances of the scheme (which are set out in subsection 45B(5)) it cannot be concluded that either Santos or the shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain a tax benefit. The view that section 45B would not apply is based on the conclusion that in substance, the scheme is a matter of capital. In particular, the capital component of the buy-back cannot be said to be attributable to the profits of the company, nor do the pattern of distributions indicate that it is being paid in substitution for a dividend.

**D. Application of sections 160AQCBA and 177EA**

19. Sections 160AQCBA and 177EA are concerned with striking down arrangements which inappropriately provide franking credit benefits to a relevant taxpayer.

20. Section 177EA is a general anti-avoidance provision that applies to a wide range of schemes to obtain a tax advantage in relation to franking credits. For the provision to apply paragraph 177EA(3)(e) requires that 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 the purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a franking credit benefit. In this arrangement the relevant taxpayer is the shareholders who participate in the buy-back and the scheme comprises the circumstances surrounding the buy-back of Ordinary Shares and the issue of Preference Shares.

21. Section 160AQCBA is a specific anti-streaming rule which applies where a company streams the payment of dividends, or streams the payment of dividends and the giving of other benefits, to its shareholders in such a way as to give shareholders who benefit most from franking credits a greater franking credit benefit than those who would not benefit to the same degree.

22. A portion of Santos' ordinary shareholding is held by non-residents who do not benefit from franking - a feature of the buy-back of Ordinary Shares - to the same extent as resident shareholders. The buy-back is therefore a means by which franking credits can be streamed to residents and away from non-residents and *prima facie* attracts the application of section 160AQCBA.

Furthermore, this feature is a relevant circumstance that the Commissioner must have regard to when determining whether section 177EA applies (as required by paragraph 177EA(19)(b)). Taking account of this and other relevant circumstances of the scheme, in particular paragraphs 177EA(19)(c) and (f), the Commissioner has come to the view that section 177EA also applies and a determination will be made to that effect.

23. However, the Commissioner will not make a determination that part of the franking credit benefit obtained by the participating shareholders be cancelled under subsections 160AQCBA(3)(b) or 177EA(5)(b) in view of the numerous shareholders involved as well as the nature of the arrangement.

## **Detailed contents list**

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24. Below is a detailed contents list for this Class Ruling:

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**Commissioner of Taxation**

28 November 2001

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*

CR 2001/1; TR 92/1; TR 97/16

*Subject references*

- Off-market share buy-back

*Legislative references:*

- TAA 1953 Part IVAAA
- ITAA 1936 Div 16K
- ITAA 1936 44
- ITAA 1936 45A
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(5)
- ITAA 1936 45C
- ITAA 1936 128B(3)(ga)
- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZP

- ITAA 1936 159GZZZP(1)
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1936 159GZZZQ(3)
- ITAA 1936 159GZZZQ(8)
- ITAA 1936 159GZZZQ(9)
- ITAA 1936 160APA
- ITAA 1936 160APP
- ITAA 1936 160APHO
- ITAA 1936 160APHN
- ITAA 1936 160AQCBA
- ITAA 1936 160AQCBA(3)(b)
- ITAA 1936 160AQT
- ITAA 1936 160AQU
- ITAA 1936 177EA
- ITAA 1936 177EA(3)(e)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(19)(c)
- ITAA 1936 177EA(19)(f)
- ITAA 1997 3-1
- ITAA 1997 3-3

ATO References

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