



CR 2002/73 - Income tax: Share Buy-Back NRMA Insurance Group Limited

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Class Ruling

Income tax: Share Buy-Back NRMA Insurance Group Limited

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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**, **Withdrawal**, **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.*

What this Class Ruling is about

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

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- sections 44, 46 and 46A of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - sections 45A, 45B and 45C of the ITAA 1936;
 - section 128B of the ITAA 1936;
 - sections 159GZZZP and 159GZZZQ of the ITAA 1936;
 - sections 160APA, 160APP, 160AQF, 160AQT and 160AQU of the ITAA 1936;
 - section 160APHO of the ITAA 1936;
 - section 160AQCBA of the ITAA 1936;
 - section 177EA of the ITAA 1936; and
 - section 118-20 of the *Income Tax Assessment Act 1997* ('ITAA 1997').

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of NRMA Insurance Group Limited ('NIGL') who disposed of shares under the NIGL off-market share buy-back ('the Buy-Back') which opened for acceptances on 17 April 2001 and closed for acceptances at 5.00pm on 16 May 2001. The Buy-Back is described in the Arrangement part of this Ruling.
4. The class of persons to which this Ruling applies does not include NIGL. The Ruling does not deal with how the taxation law applies to NIGL in relation to the Buy-Back. Furthermore, it should be noted that certain information, which relates to the affairs of NIGL but is not in the public domain, has been taken into account in determining the application of certain anti-avoidance provisions in this Ruling. This information cannot be disclosed in the Ruling.

Qualifications

5. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
6. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described below at paragraphs 11 to 22 in this Ruling.
7. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling:
 - (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

9. This Ruling applies from 2 March 2001. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2001. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- the application for Class Ruling from NIGL dated 7 August 2001;
- the application for Private Binding Ruling (and the attachments thereto) from NIGL dated 20 December 2000;
- correspondence from Mallesons Stephen Jaques dated 23 February 2001, 27 February 2001, 28 February 2001, 2 March 2001, 7 March 2001, 8 March 2001, 9 March 2001, 14 May 2001 and 7 August 2001;
- the Buy-Back Offer Booklet issued by NIGL to shareholders; and
- the announcements of 17 May 2001 and 21 May 2001 by NIGL on the final price and scaleback of the Buy-Back.

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

12. On 2 March 2001 NIGL announced the Buy-Back. Under the Buy-Back NIGL intended to buy-back a maximum of 148.6 million shares, representing approximately 10% of the total number of shares on issue on 24 July 2000, the date of demutualisation. As at 22 November 2000 NIGL had 1,539 million ordinary shares on issue. There were no other classes of shares on issue.

13. It was explained in the Buy-Back Offer Booklet ('the Booklet') that the Buy-Back was one of a number of capital management initiatives being undertaken by NIGL to enhance its capital efficiency by returning some of the capital surplus to its operational and regulatory needs to shareholders. Further, it was hoped that this would have positive effects on return on equity and earnings per share over the longer term. The Buy-Back was funded from a mix of debt funding and funding from the sale of surplus investments.

14. The Buy-Back offer ('the Offer') was open for acceptance on 17 April 2001 and closed on 16 May 2001. The Offer was made to all NIGL shareholders with shares registered in their name on the Record Date (28 March 2001) entitling them to nominate for sale up to 100% of their shares. However, shares held under certain NIGL employee and executive share plans were excluded from the Buy-Back.

15. Under the Offer participating shareholders would receive \$1.78 as a capital amount and the balance of the Buy-Back price as a fully franked dividend. The capital amount equalled the cost base at which shareholders were taken to have acquired their shares under the demutualisation for capital gains tax purposes.

16. The Offer included a scaleback mechanism which would apply in the event that the total number of shares for which acceptances received pursuant to the Buy-Back exceeded 148.6 million. If this occurred, under the scaleback procedure NIGL would buy-back the first 600 shares from each participating shareholder (or if the participating shareholder accepted for a lesser number of shares, that amount). Acceptances in respect of shares over 600 would be determined on a pro-rata basis. The scale back of acceptances was to be determined in accordance with Clause 6.1.2 of the Booklet.

17. The Directors of NIGL were able to make a further adjustment to the Buy-Back price at their discretion, in accordance with Clause 6.1.3 of the Booklet.

18. The Buy-Back was governed by the laws of New South Wales.

19. On 17 May 2001 NIGL announced that the buy-back price was \$2.72. On 21 May 2001 NIGL announced that it had completed the

Buy-Back, with a total of 148,589,705 shares being bought back. The Buy-Back price of \$2.72 per share was determined in accordance with Clause 6.1.3 of the Booklet. The Buy-Back was oversubscribed with the result that the scaleback procedure was applied.

20. The Buy-Back price was allocated between share capital and retained profits. In relation to each share bought back NIGL debited \$1.78 to its share capital account and \$0.94 to its retained profits. The dividend component was fully franked.

21. At the time that the Buy-Back was proposed the Consolidated Balance Sheet, as at 31 December 2000, disclosed total shareholders' equity of \$2,927 million, consisting of \$2,944 million share capital, and accumulated losses of \$17 million. The balance of the franking account of NIGL and NRMA Insurance Ltd as at 31 December 2000 was \$80 million and \$322 million, respectively.

22. The shareholders in NIGL are a mix of individuals, companies and superannuation funds. Prior to the Buy-Back NIGL ascertained that 81.3% of the shares were held by individuals and the remainder (18.7%) held by institutional investors (for instance corporate investors, life insurance companies and superannuation funds). Less than 0.1% of the shares were held by non-residents.

Ruling

The Dividend Component

23. Participating shareholders are taken to have been paid a dividend out of the profits of NIGL on the 21 May 2001 ('the dividend component') of \$0.94 for each share bought back.

The Capital Component

24. Participating shareholders are taken to have received \$1.78 as consideration in respect of the disposal of each of their NIGL shares on the 21 May 2001 for the purposes of section 159GZZZQ (unless the shareholder is an Australian resident corporation to which subsections 159GZZZQ(8) and (9) apply). The treatment of this consideration amount for tax purposes will depend on whether the sale is on capital account (where the shares are held for investment) or on revenue account (where the shares are turned over in the course of business). In general, the relevant treatment should be as follows:

(a) *Shares held on capital account*

The amount by which the capital proceeds of \$1.78 exceeds the cost base of each share will be a capital

gain to the shareholder. If the share's reduced cost base exceeds \$1.78 the difference will be a capital loss.

(b) *Shares held on revenue account*

The amount by which the consideration on disposal of \$1.78 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$1.78 the difference will be an allowable deduction.

The Anti-avoidance Provisions

25. The Commissioner will not make a determination under paragraph 160AQCBA(3)(b) to deny the franking credit benefits received in relation to the dividend component of the Buy-Back by participating shareholders.

26. The Commissioner will not make a determination under paragraph 177EA(5)(b) to deny the whole, or any part, of the franking credit benefits received in relation to the dividend component of the Buy-Back by participating shareholders.

27. The Commissioner will not make a determination (under section 45A or 45B) that section 45C applies to the whole, or any part, of the capital component of the Buy-Back price received by participating shareholders.

Explanations

The Dividend and Capital Components

28. The purchase price received by participating shareholders comprises two components:

- a dividend component; and
- a capital component.

The amount of each of these components is determined in accordance with sections 159GZZZP and 159GZZZQ, having regard to how the company accounts for the off-market share buy-back as detailed below.

The Dividend Component

29. 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 to the

share capital account of the company is taken to be a dividend paid by the company on the day the buy-back occurs. In this case the purchase price was \$2.72 per share and \$1.78 of this was debited to the share capital account. Thus, the dividend amount is \$0.94 per share. This amount was fully franked.

30. For Australian resident individual shareholders the amount of the dividend (grossed-up for any franking credits attached to the dividend under section 160AQT) will be included in their assessable income under subsection 44(1). Resident individual shareholders will also be entitled to a franking rebate under section 160AQU reflecting the franking credits attached to the dividend.

31. For Australian resident corporate shareholders the amount of the dividend will be included in their assessable income under subsection 44(1). However, resident corporate shareholders may be eligible for the intercorporate dividend rebate under section 46. Resident corporate shareholders will also be eligible to receive franking credits under section 160APP.

32. As the dividend component of the consideration received under the Buy-Back is fully franked, a non-resident shareholder is not liable to Australian withholding tax on the dividend component (paragraph 128B(3)(ga)).

33. It should be noted that there are provisions which may deny a franking credit, franking rebate or the inter-corporate dividend rebate in certain circumstances. For instance, section 160APHO requires that a taxpayer receiving a franked dividend be a 'qualified person' in order to be entitled to a franking credit, franking rebate or intercorporate dividend rebate. Broadly speaking, to be a qualified person in relation to a dividend a taxpayer must satisfy both the holding period rule (or certain alternative rules) and the related payments rule.

34. Sections 160AQCBA and 177EA are anti-avoidance provisions concerned with striking down arrangements which inappropriately provide franking credit benefits to a relevant taxpayer. These provisions allow the Commissioner to make a determination denying all or a part of a shareholder's entitlement to a franking credit, franking rebate, intercorporate dividend rebate or other such benefits. In this case, no determination will be made to deny franking credit benefits received by participating shareholders under the Buy-Back. A discussion of these provisions appears later in this Class Ruling.

The Capital Component

35. The participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 21 May 2001. The

disposal may have different taxation implications for shareholders depending on how the shares were held; for instance:

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

It should be noted that share traders who have both an income tax and a capital gains tax liability will generally have the amount of the capital gain reduced under the anti-overlap provisions in section 118-20 of the ITAA 1997.

36. For the purposes of computing the amount of gain or loss (on capital or revenue account) in these cases, the consideration in respect of the disposal of a share under a buy-back is determined in accordance with section 159GZZZQ.

37. The consideration determined under section 159GZZZQ is:

- the buy-back price; less
- the reduction amount (within the meaning of subsection 159GZZZQ(4)).

Accordingly, for the purposes of calculating the profit or loss on disposal of the shares, under either the income or capital gains tax provisions, in most cases participating shareholders are taken to have received \$1.78 per share as the consideration on disposal ('the Disposal Consideration').

38. However, it should be noted that where the participating shareholder is entitled to the inter-corporate dividend rebate under sections 46 or 46A in respect of the dividend component of the Buy-Back price, an adjustment may be made to the Disposal Consideration. Under subsection 159GZZZQ(8), if that shareholder would incur a capital loss or a loss in respect of which he would be entitled to a deduction, the Disposal Consideration is increased by a 'rebatable amount' determined under subsection 159GZZZQ(9).

The Anti-avoidance Provisions

Section 160AQCBA

39. Section 160AQCBA applies where a company streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its shareholders in such a way that:

- (a) franking credit benefits are, or apart from this section would be, received by shareholders ('advantaged shareholders') who would, in the year of income in

which the dividends are paid, derive a greater benefit from franking credits than other shareholders (paragraph 160AQCBA(2)(a)); and

- (b) the other shareholders ('disadvantaged shareholders') will receive lesser franking credit benefits or will not receive any franking credit benefits, whether or not they receive any other benefits (paragraph 160AQCBA(2)(b)).

40. If section 160AQCBA applies the Commissioner is vested with a discretion under subsection 160AQCBA(3) to make a determination that either:

- (a) the streaming company will incur an additional franking debit in respect of each dividend paid or other benefit given to a disadvantaged shareholder (paragraph 160AQCBA(3)(a)); or
- (b) no franking credit benefit is to arise in respect of any streamed dividends paid to an advantaged shareholder (paragraph 160AQCBA(3)(b)).

41. For the section to apply, shareholders to whom dividends are streamed must derive a greater benefit from franking credits than the shareholders who do not participate in the Buy-Back. The words 'derive a greater benefit from franking credits' are defined in subsection 160AQCBA(17) by reference to the ability of the shareholders to fully utilise franking credits.

42. Having regard to the information provided by NIGL, it cannot be said that there exists, in relation to the shareholders of NIGL, a group of shareholders that have a greater ability to use the franking credits than other shareholders within the meaning of those words in subsection 160AQCBA(17). There are no identifiable characteristics attaching to the shareholding of NIGL that would suggest one part of that shareholding would benefit more or less from franking credits. Non-resident shareholders hold less than 1% of NIGL's shares. NIGL has sufficient franking credits to fully frank its initial interim dividend distribution and has indicated that it expects to continue to be in a position to fully frank any dividends for the foreseeable future. Accordingly, section 160AQCBA does not apply to the dividend component of the Buy-Back.

Section 177EA

43. 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. In essence, it applies to schemes for the disposition of shares, or an interest in shares where a franked dividend

is paid or payable in respect of the shares. This would include a buy-back with a franked dividend component.

44. Specifically, subsection 177EA(3) provides that the section applies where:

- (a) there is a scheme for a disposition of shares (or an interest in shares) in a company;
- (b) a frankable dividend has been paid or is payable or expected to be payable in respect of the shares;
- (c) the dividend or distribution was, or is expected to be, franked;
- (d) a person would receive, or could reasonably be expected to receive, franking credit benefits as a result of the dividend or 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 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.

45. In the present case, the conditions of paragraphs 177EA(3)(a) to (d) are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme (as provided for in subsection 177EA(19)), it would be concluded that, on the part of NIGL, its shareholders or any other relevant party, there is a purpose more than merely incidental, of conferring a franking credit benefit under the scheme. Under this arrangement the relevant taxpayer is the participating shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

46. 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(19). The relevant circumstances listed there 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.

47. Where section 177EA applies the Commissioner is vested with a discretion, pursuant to subsection 177EA(5), whether to make a determination. If the company is a party to the scheme he has a choice as to whether that determination is to debit the company's franking account pursuant to paragraph 177EA(5)(a), or to deny the

franking credit benefit either in whole or in part to each shareholder pursuant to paragraph 177EA(5)(b).

48. The Commissioner has come to the view that section 177EA applies to the Buy-Back. The allocation of the Buy-Back price between share capital and retained profits was such as to reflect a purpose, more than incidental, of enabling the participating shareholders to obtain a franking credit benefit. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the arrangement, in particular those covered by paragraphs 177EA(19)(c), (f) and (i).

49. Among the circumstances of the Buy-Back reflected in those paragraphs are: the proportion of dividend to capital in the Buy-Back price; the delivery of franking credits in excess of what would have otherwise been distributed in the ordinary course of dividend declaration; and the fact that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

50. In regard to the discretion pursuant to subsection 177EA(5), however, it would be inappropriate, given the large and diverse shareholding of the company, to make a determination to deny franking credit benefits in whole or in part in relation to each participating shareholder. Accordingly, the Commissioner will exercise his discretion in such a way that he does not make a determination that all or part of the franking credit benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b).

Sections 45A and 45B

51. As discussed earlier, part of the proceeds received by a shareholder in return for participating in a buy-back will be taken not to be a dividend for the purposes of the Act. This part is treated instead as a distribution of share capital by the company to the shareholder.

52. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C that all or part of the distribution of capital received by the shareholder under the Buy-Back is treated as an unfranked and non-rebatable dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

53. 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 capital and it is reasonable to assume that

the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

54. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) is provided to the participating shareholders the circumstances of the Buy-Back indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Accordingly, section 45A has no application to the Buy-Back.

55. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, the provision 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, 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, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

56. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) are met, the requisite purpose of enabling the shareholder to obtain a tax benefit (by way of a capital distribution) is not present.

57. Having regard to the relevant circumstances of the scheme (set out in subsection 45B(5)), it is apparent that the inclusion of a capital element in the Buy-Back price was not inappropriate. Further, 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.

Detailed contents list

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

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Commissioner of Taxation

 25 September 2002

Previous draft:

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Related Rulings/Determinations:
 TR 92/1; TR 92/20; TR 97/16;
 CR 2001/1
Subject references:

- capital
- dividends
- dividend streaming arrangements
- franking credits
- franking credit benefit
- retained profits
- return of capital on shares
- share buy backs
- share capital

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 44
- ITAA 1936 44(1)
- ITAA 1936 45A
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(5)
- ITAA 1936 45C
- ITAA 1936 46
- ITAA 1936 46A
- ITAA 1936 128B
- ITAA 1936 128B(3)(ga)
- ITAA 1936 159GZZZP

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|----------------------------|--------------------------|
| - ITAA 1936 159GZZZQ | - ITAA 1936 160AQU |
| - ITAA 1936 159GZZZQ(4) | - ITAA 1936 177EA |
| - ITAA 1936 159GZZZQ(8) | - ITAA 1936 177EA(3) |
| - ITAA 1936 159GZZZQ(9) | - ITAA 1936 177EA(3)(a) |
| - ITAA 1936 160APA | - ITAA 1936 177EA(3)(b) |
| - ITAA 1936 160APHO | - ITAA 1936 177EA(3)(c) |
| - ITAA 1936 160APP | - ITAA 1936 177EA(3)(d) |
| - ITAA 1936 160AQCBA | - ITAA 1936 177EA(5) |
| - ITAA 1936 160AQCBA(2)(a) | - ITAA 1936 177EA(5)(a) |
| - ITAA 1936 160AQCBA(2)(b) | - ITAA 1936 177EA(5)(b) |
| - ITAA 1936 160AQCBA(3) | - ITAA 1936 177EA(19) |
| - ITAA 1936 160AQCBA(3)(a) | - ITAA 1936 177EA(19)(c) |
| - ITAA 1936 160AQCBA(3)(b) | - ITAA 1936 177EA(19)(f) |
| - ITAA 1936 160AQCBA(17) | - ITAA 1936 177EA(19)(i) |
| - ITAA 1936 160AQF | - ITAA 1997 118-20 |
| - ITAA 1936 160AQT | - Copyright Act 1968 |

ATO References

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