


CR 2004/100 - Income tax: share buy-back: Insurance Australia Group Limited

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Class Ruling

Income tax: share buy-back: Insurance Australia Group Limited

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Preamble

*The number, subject heading, **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 Class Ruling are:
- section 44 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;
 - paragraph 128B(3)(ga) of the ITAA 1936;
 - Division 16K of the ITAA 1936;
 - section 177EA of the ITAA 1936;
 - subsection 110-55(9) of the *Income Tax Assessment Act 1997* (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 202-45 of the ITAA 1997;

- section 204-30 of the ITAA 1997;
- section 205-15 of the ITAA 1997;
- section 207-20 of the ITAA 1997;
- section 207-145 of the ITAA 1997;
- section 960-120 of the ITAA 1997; and
- section 995-1 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of Insurance Australia Group Limited (IAG) (Participating Shareholders) who disposed of shares under the IAG off-market share buy-back (the Buy-Back) announced by IAG on 26 February 2004 and open during the period 24 May 2004 to 18 June 2004, and described in the Arrangement part of this Ruling.

4. The class of persons to which this Ruling applies does not include IAG. The Ruling does not deal with how the taxation law applies to IAG in relation to the Buy-Back. Furthermore, it should be noted that certain information which relates to the affairs of IAG, 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 done so in accordance with the arrangement described in paragraphs 11 to 25.

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

- 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
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Class Ruling applies to the year ended 30 June 2004. 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). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2004. 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 entered 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 this Ruling is described below. This description is based on the following documents, which are attached to the file record maintained by the Australian Tax Office for this ruling. 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 a Class Ruling dated 19 March 2004;
- letters from Mallesons Stephen Jaques dated 21 April 2004 and 29 April 2004;
- the Buy-Back tender booklet issued by IAG to shareholders; and

- Media Release from IAG dated 21 June 2004.

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

12. On 26 February 2004 IAG announced a selective off-market share buy-back under which it intended to buy back around \$350 million of ordinary shares, subject to a maximum number of 100 million shares. IAG had undertaken two previous buy-backs, one in 2001, and one in 2002. As at 27 February 2004, IAG had approximately 1,684 million ordinary shares on issue. IAG ordinary shares are held by a mix of individuals, superannuation funds, companies and other institutional investors. IAG estimates that 0.16% of IAG shares are held by non-residents. Under the terms of the Buy-Back IAG had the right to choose to buy back any number of shares, or none at all.

13. As at 31 December 2003, the Consolidated Balance Sheet disclosed total shareholder's equity of \$3,434 million, and \$228 million of accumulated losses (IAG, the parent entity, had retained profits of \$423 million). IAG has the capacity to fully frank approximately \$1,150 million of dividends, and expects to continue to be in a position to fully frank any dividends for the foreseeable future.

14. IAG explained in the Buy-Back Tender Booklet that the Buy-Back was offered so as to create and maintain a prudent and efficient capital structure and to increase IAG's earnings per share over time. The Buy-Back offer would also provide shareholders with a relatively small number of shares with an opportunity to exit their holdings without appointing a stockholder or incurring transaction costs such as brokerage fees.

15. The Buy-Back would be funded from available funds resulting from the sale of its Clearview business and from the sale of surplus investments. The dividend component would be sourced from operating profits.

16. The Buy-Back conducted through a tender process was open to all shareholders, with the exception of shareholders who held shares under IAG's Allocation Share Plan, Bonus Equity Share Plan, Performance Award Rights Plan or non-executive directors share plan. Shareholders with a registered address outside Australia were also not eligible to participate in the Buy-Back. Participation by shareholders was voluntary.

17. The tender period opened on Monday 24 May 2004 and closed on Friday 18 June 2004. Under the tender process all eligible shareholders were invited to offer to sell some or all of their shares.

18. Shareholders who held 1,000 shares or less and who wished to participate in the Buy-Back were required to tender all of their shares at one tender price, being either a specified price within a specified price range of between \$4.00 and \$5.00 per share ('the Tender Range') or the final price, as determined by IAG after the closing date of the Buy-Back ('the Final Price'). Shareholders who

held more than 1,000 shares were permitted to offer different parcels of shares at different prices within the Tender Range, or at the Final Price.

19. Shares tendered at a price above the Buy-Back price were not bought back. Shares tendered at or below the Buy-Back Price, or as a Final Price tender, were bought back.

20. A scale back would have applied if the total number of shares tendered at or below the Buy-Back Price and as Final Price Tenders was more than the total number of shares IAG determined to buy back.

21. Shareholders who tendered their shares into the Buy-Back could have withdrawn some or all of the tenders, or amended their tender by notifying IAG no later than 5.00 pm on Friday 18 June 2004.

22. IAG accounted for the Buy-Back Price for each Share bought back as follows:

- IAG debited \$1.78 against an amount standing to the credit of IAG's untainted share capital account; and
- IAG debited \$2.62 against an amount standing to the credit of its retained earnings account.

23. The capital amount equalled the cost base at which shareholders were taken to have acquired their shares under the demutualisation for capital gains purposes.

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

25. The calculation of acceptances and possible scale back was completed on 21 June 2004. On that date IAG announced:

- IAG had successfully completed its off-market buy-back;
- the Buy-Back Price was \$4.40;
- all shares tendered at or below \$4.40, or as a final price have been bought back in full and no scale back was applied;
- the Buy-Back Price of \$4.40 is comprised of a capital component of \$1.78 and a \$2.62 fully franked dividend;
- 94.1 million shares were bought back for a total of \$414 million;
- for capital gains tax purposes, an Australian resident individual or complying superannuation entity shareholder whose shares are bought back will be deemed to have disposed of each share for capital proceeds of \$2.16 (being the \$1.78 capital component of the final buy-back price and a \$0.38 adjustment for excess of Maximum Buy-Back Price); and

- payment for the shares bought back were mailed to successful shareholders, or credited to their bank accounts, on 28 June 2004.

Ruling

The Dividend Component

26. Participating shareholders are taken to have been paid a dividend of \$2.62 (the Dividend Component) for each share bought back on the date the Buy-Back occurred under section 159GZZZP of the ITAA 1936.

27. The Dividend Component is a frankable distribution under section 202-40(1) of the ITAA 1997, and is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

Assessability of the Dividend Component and Tax Offset

28. The Dividend Component of \$2.62 and an amount equal to the franking credit on the Dividend Component ('gross-up') is included in the assessable income of resident individual, superannuation fund and company shareholders who participate in the Buy-Back. Those 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.

Non-resident shareholders

29. As the Dividend Component is fully franked, participating non-resident shareholders are not liable for withholding tax under paragraph 128B(3)(ga) of the ITAA 1936.

Sale of shares under the Buy-Back

30. Participating Shareholders are taken to have received \$2.16 as consideration in respect of the sale of each share bought back under the Buy-Back ('the Sale Consideration'), in accordance with section 159GZZZQ of the ITAA 1936.

31. The Buy-Back Price for each share bought back under the Buy-Back was less than the market value of the share at the time of the Buy-Back (the market value of the shares being determined as if the Buy-Back did not occur and was never proposed to occur (Taxation Determination TD 2004/22)). As the Buy-Back was an off-market share Buy-Back, the market value rule in subsection 159GZZZQ(2) applies to the Buy-Back. The effect of this rule is that the difference between the Buy-Back Price and the market value will be treated as consideration for ordinary income or capital gains tax purposes.

32. The tax treatment of the Sale Consideration 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.

Shares held on capital account

33. The Sale Consideration represents the capital proceeds for capital gains tax purposes pursuant to section 116-20 of the ITAA 1997. A shareholder will make a capital gain on the sale of the share if the capital proceeds of \$2.16 exceed the cost base of the share. The capital gain is the amount of the excess. Similarly, a shareholder will make a capital loss if the capital proceeds are less than the reduced cost base of the share.

34. The shares are taken to have been disposed of for capital gains tax purposes on 21 June 2004.

Shares held on revenue account

35. Where the shares are held as trading stock, the Sale Consideration of \$2.16 is included in assessable income under section 6-5 of the ITAA 1997. Where the shares are held as revenue assets, the amount by which the consideration of \$2.16 exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$2.16 the difference is an allowable deduction.

Non-resident shareholders

36. A non-resident shareholder that participates in the Buy-Back will only make a capital gain or capital loss if their shares have the necessary connection with Australia under the tests in section 136-25 of the ITAA 1997. An IAG share will have the necessary connection with Australia if, at any time during the 5 years before 21 June 2004, the shareholder together with their associates owned 10% or more by value of the issued shares in IAG.

Qualified person

37. For the purposes of Division 1A of Part IIIAA of the ITAA 1936 Participating Shareholders will be considered to satisfy the holding period rule under section 160APHO of the ITAA 1936 and therefore 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:

- (a) the shares sold under the Buy-Back were acquired on or before 6 May 2004;

- (b) the shareholder has no other positions (for example, an option) in relation to the shares sold into the Buy-Back; and
- (c) the shareholder or an associate of the shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

38. A Participating Shareholder who acquired shares on or after 7 May 2004 that were subsequently accepted into the Buy-Back is not a qualified person in relation to the Dividend Component.

The anti-avoidance provisions

Sections 45A and 45B of the ITAA 1936

39. The Commissioner will not make a determination under either section 45A or section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital component of the Buy-Back price received by Participating Shareholders.

Subdivision 204-D of the ITAA 1997

40. 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 under the Buy-Back in relation to the Dividend Component by Participating Shareholders.

Section 177EA of the ITAA 1936

41. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received under the Buy-Back in relation to the Dividend Component by Participating Shareholders.

Explanation

The taxation treatment of Buy-Backs

42. The tax effect of a share buy-back is determined under the specific provisions of Division 16K of the ITAA 1936.

43. Paragraph 159GZZZK(c) of the ITAA 1936 provides that if a share bought back is listed on a stock exchange in Australia or elsewhere, and the buy-back is made in the ordinary course of trading on that stock exchange, the buy-back is an on-market purchase. Under paragraph 159GZZZK(d), any buy-back that is not an on-market purchase is an off-market purchase. As IAG bought its shares directly from shareholders and not in the course of trading on the stock

exchange, the Buy-Back is an off-market purchase (described in this Class Ruling as an off-market share buy-back).

44. Subdivision C of Division 16K applies to off-market share buy-backs and provides that participating shareholders are taken to have been paid a dividend (described in this Class Ruling as the 'Dividend Component'), and are also taken to have received consideration in respect of each share bought back (in this Class Ruling described as 'the Sale Consideration').

The Purchase Price

45. A starting point in calculating the amount of both the Dividend Component and the Sale Consideration is the 'Purchase Price' in respect of the buy-back of a share. This term is defined by section 159GZZM of the ITAA 1936 to be the amount of money and/or other property received or receivable by the shareholder as a result of or in respect of the share buy-back. The IAG Buy-Back Price of \$4.40 is the Purchase Price pursuant to section 159GZZM.

The Dividend Component

46. Subsection 159GZZP(1) of the ITAA 1936 provides that 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 participating shareholders on the day that the buy-back occurs.

47. IAG debited \$1.78 of the Purchase Price against an amount standing to the credit of the company's share capital account. The Dividend Component determined under subsection 159GZZP(1) is therefore \$2.62, calculated as follows:

The Buy-Back Price (Purchase Price)	\$4.40
Less amount debited to the share capital account	<u>\$1.78</u>
Dividend Component	\$2.62

48. The Dividend Component of \$2.62 will be a distribution by IAG under item 1 of the table in subsection 960-120(1) of the ITAA 1997. Pursuant to subsection 202-40(1) of the ITAA 1997, a distribution is a frankable distribution to the extent that it is not made unfrankable under section 202-45 of the ITAA 1997.

49. None of the paragraphs (a) to (j) in section 202-45 of the ITAA 1997 applies and accordingly the distribution is a frankable distribution. The distribution is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

50. IAG has fully franked the distribution. The amount of the franking credit is \$1.12.

Assessability of the Dividend Component and Tax Offset

51. For Australian resident participating shareholders (other than a partnership or trust), the dividend amount will be included in the assessable income of each shareholder under subsection 44(1) of the ITAA 1936. Subsection 207-20(1) of the ITAA 1997 requires these shareholders to also include in their assessable income an amount equal to the amount of the franking credit on the Dividend Component (gross up). These shareholders will also 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.

Franking account

52. A Participating Shareholder that is a corporate tax entity will generally be required to credit its franking account with the amount of the franking credit on the dividend received from IAG (see Item 3 of the table to section 205-15 of the ITAA 1997).

Non-resident shareholders

53. While shareholders with a registered address outside Australia were not eligible to participate in the Buy-Back, this restriction did not extend to non-resident shareholders with a registered address in Australia.

54. Accordingly, as the Dividend Component of the consideration received under the Buy-Back is fully franked, a non-resident Participating Shareholder is not liable for Australian withholding tax on the Dividend Component in accordance with paragraph 128B(3)(ga) of the ITAA 1936.

Gross-up and tax offset denied in certain circumstances

55. Pursuant to Subdivision 207-F, the gross-up and tax offset are denied in respect of direct and indirect distributions in the circumstances stated by section 207-145 and section 207-150 of the ITAA 1997. These circumstances include the following:

- the entity receiving the distribution (either directly or indirectly) is not a qualified person for the purposes of Division 1A of Part IIIAA of the ITAA 1936;
- the Commissioner has made a determination under subsection 204-30(3) of the ITAA 1997 that no imputation benefit is to arise for the entity in respect of the distribution; and
- the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in respect of the distribution.

56. Whether or not participating shareholders are 'qualified persons' in relation to the dividend received under the Buy-Back is discussed at paragraphs 68 to 73.

57. The application of section 204-30 of the ITAA 1997 and section 177EA of the ITAA 1936 to the Buy-Back is discussed at paragraphs 81 to 92. In this case, no determinations will be made to deny imputation benefits received by participating shareholders under the Buy-Back.

Sale of shares under the Buy-Back

58. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on Monday 21 June 2004. The disposal may have different taxation implications for shareholders depending on how the shares were held, for instance:

- an investor who holds his or her shares on capital account will be subject to the capital gains tax provisions contained in Parts 3-1 and 3-3 of the ITAA 1997; or
- a shareholder who holds his or her shares on revenue account (for example, a share trader) will be subject to the ordinary income provisions and, if the shares are held as trading stock, the specific trading stock provisions in Part 2-25 of the ITAA 1997.

59. It should be noted that shareholders who held their shares on revenue account will be subject to both the ordinary income provisions and the capital gains tax provisions. These shareholders will generally have the amount of the capital gain reduced to the extent that it is included in assessable income under the anti-overlap provisions contained in section 118-20 of the ITAA 1997. If the shares are held as trading stock, the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

60. For the purposes of computing the amount of the gain or loss (on capital or revenue account) in these cases, the consideration in respect of the disposal of a share under a buy-back is determined in accordance with section 159GZZZQ of the ITAA 1936.

61. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the 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.

62. Subsection 159GZZZQ(2) of the ITAA 1936 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 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 as consideration in respect of the sale of the share in respect of the sale of the share bought back.

63. For the purposes of determining the application of subsection 159GZZZQ(2), the market value of each IAG share is the volume weighted average price of the shares over the five trading days before the announcement of the Buy-Back, adjusted for the movement in the S&P/ASX 200 Index from the commencement of trading on the announcement date to the close of trading on the day the Buy-Back closed, and further adjusted on an ex-dividend basis (Taxation Determination TD 2004/22). Under this methodology, the market value of a share bought back was calculated to be \$4.78. Thus, the shareholders are taken to have received \$4.78 for the sale of their shares, instead of the Purchase Price of \$4.40.

64. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of \$4.78 is reduced by a 'Reduction Amount'. The 'Reduction Amount' is an amount calculated under subsection 159GZZZQ(4) of the ITAA 1936. In the circumstances of the IAG Buy-Back, the 'Reduction Amount' is equivalent to the Dividend Component.

65. Thus, the deemed consideration determined under section 159GZZZQ is \$2.16, calculated as follows:

Deemed Consideration (Market value)	\$4.78
<i>less</i> the Reduction Amount	<u>\$2.62</u>
Consideration received on each share	\$2.16

Disposal for CGT purposes

66. For capital gains tax purposes and pursuant to subsection 104-10(3) of the ITAA 1997, participating shareholders are taken to have disposed of their shares bought back on 21 June 2004.

Non-resident shareholders

67. Pursuant to section 136-10 of the ITAA 1997, a non-resident will make a capital gain or a capital loss from the sale of shares under the Buy-Back only if the shares have the necessary connection with Australia under the tests in section 136-25. Under category 5 of the table set out in section 136-25 of the ITAA 1997, an IAG share will have the necessary connection with Australia if, at any time during the 5 years before 21 June 2004, the shareholder together with their associates owned 10% or more by value of the issued shares in IAG.

Qualified person

68. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked distribution, an entity that is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of Part IIIAA of the ITAA 1936 is denied a gross-up and a tax offset. A person is a 'qualified person' as defined in subsection 995-1(1) of the ITAA 1997 in relation to a distribution, if the person would have been

a qualified person in relation to the distribution under Division 1A of Part IIIA of the ITAA 1936, as in force on 30 June 2002. Broadly speaking, to be a qualified person in relation to the IAG dividend received under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule. This Class Ruling only addresses the holding period rule under section 160APHO of the ITAA 1936.

69. The holding period rule requires shareholders to hold the shares or the interest in the shares on which the dividend is paid 'at risk' for a continuous period of at least 45 days. In determining whether a shareholder has held the shares or interest 'at risk', any days during which there is materially diminished risks of loss or opportunities for gain in relation to the relevant shares or interests are not counted. Paragraph 160APHO(2)(a) of the ITAA 1936 provides that the day of acquisition and the day of disposal of the relevant shares are not counted.

70. Pursuant to subsection 160APHM(2) of the ITAA 1936, a taxpayer is taken to have materially diminished the risks of loss and opportunities for gain on a particular day with respect to shares or interests in shares if the taxpayer's 'net position' on that day has less than 30% of the risks and opportunities relating to the shares or interests in shares.

71. The Commissioner does not regard the announcement of the IAG Buy-Back offer as affecting whether or not the shares or an interest in shares were held 'at risk'. A tendering shareholder does not take a position with respect to their tendered shares until they are no longer able to withdraw the tender, being 18 June 2004 (section 160APHJ of the ITAA 1936). Furthermore, the net position in relation to the tendered shares at this time is such that the shareholder cannot be taken to have materially diminished the risks of loss or opportunities for gain from the shares to the extent required by subsection 160APHM(2) of the ITAA 1936. The scale back and acceptances and Buy-Back Price were determined on 21 June 2004, and accordingly 20 June 2004 was the last clear day when the shares were held 'at risk'.

72. There are 45 clear days between 6 May 2004 and 21 June 2004 (not counting those dates). Therefore, a shareholder will be a qualified person in relation to the Dividend Component provided:

- the shares are acquired on or before 6 May 2004;
- the shareholder has no other positions (for example, an option) in relation to the shares sold into the Buy-Back; and
- the shareholder or an associate of the shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

73. A shareholder who acquired shares on or after 7 May 2004¹ that were subsequently bought back under the Buy-Back is not a qualified person in relation to the dividend paid under the Buy-Back for the purposes of section 160APHO of the ITAA 1936, but may nonetheless be a qualified person if the shareholder makes an election under section 160APHR of the ITAA 1936 or satisfies the small shareholder exemption under section 160APHT of the ITAA 1936.

The anti-avoidance provisions

Sections 45A and 45B of the ITAA 1936

74. It was noted at paragraph 21 that IAG debited \$1.78 of the Buy-Back Price to its untainted share capital account. This amount is a distribution of share capital to participating shareholders.

75. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies in relation to the distribution of capital received under the Buy-Back, with the result that either the whole or a part of the distribution is taken to be an unfranked dividend. Accordingly, the application of those two provisions to the Buy-Back must be considered.

76. Section 45A of the ITAA 1936 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.

77. Although a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) is provided to participating shareholders under the Buy-Back, the circumstances of the Buy-Back indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders in the manner contemplated by section 45A. Accordingly, section 45A has no application to the Buy-Back.

78. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, section 45B of the ITAA 1936 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, who entered into or carried out the scheme or any part of the scheme did so for a purpose

¹ IAG shares acquired on the ASX on or after 6 May 2004 will not confer an entitlement to participate in the Buy-Back.

(whether or not the dominant purpose but not including an incidental purpose) of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

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

80. Having regard to the ‘relevant circumstances’ of the scheme (the Buy-Back), as set out in subsection 45B(8) of the ITAA 1936, it is apparent that the inclusion of a capital element in the Buy-Back price through a return of share capital was appropriate. Further, the capital element of the Buy-Back cannot be said to be attributable to the profits of IAG, nor does the pattern of distributions that have been made by IAG in the past indicate that the capital element was paid in substitution for a dividend.

Section 204-30 of the ITAA 1997

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

82. If section 204-30 applies, the Commissioner is vested with a discretion under subsection 204-30(3) where he may make one or more of the following determinations:

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

83. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than the members who do not participate in the Buy-Back. The words, ‘derives a greater benefit from franking credits’, (imputation benefits)

are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

84. Having regard to the information provided by IAG, it cannot be said that there exists, in relation to the shareholders of IAG, a group of shareholders that have a greater ability to use the franking credits than other shareholders within the meaning of those words of subsection 204-30(8). There are no identifiable characteristics attaching to the shareholding of IAG that would suggest one part of that shareholding would benefit more or less from franking credits. Non-resident shareholders hold approximately 0.16% of IAG's shares. IAG has indicated that it expects to continue to be in a position to fully frank any dividends for the foreseeable future. Accordingly, section 204-30 does not apply to the dividend component of the Buy-Back.

Section 177EA of the ITAA 1936

85. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes to obtain a tax advantage in relation to imputation benefits. In essence, it applies to schemes for the disposition of membership interests or an interest in membership interests, where a franked distribution is paid or payable in respect of the membership interest or an interest in membership interests. This includes a share buy-back with a franked dividend component.

86. Specifically, subsection 177EA(3) provides that section 177EA of the ITAA 1936 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; and
- (d) except for section 177EA, a 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.

87. 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(17)), it would be concluded that, on the part of IAG, its shareholders or any other relevant party, there is a purpose more than merely an incidental purpose of conferring an imputation benefit under the scheme. Under this arrangement, the relevant taxpayer is the participating shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

88. 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), whether to make a determination. 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.

89. Having regard to the relevant circumstances of the scheme, the Commissioner has come to the view that the requisite purpose exists and thus that section 177EA of the ITAA 1936 applies to the Buy-Back. The structure of the Buy-Back (including the tender process and scale back mechanisms) was such as to reflect a purpose, more than incidental, of enabling the participating shareholders to obtain an imputation benefit. In coming to this conclusion, the Commissioner had regard to all the relevant circumstances of the arrangement, in particular paragraphs 177EA(17)(b), (c), (f), (g) and (j).

90. 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.

91. Where section 177EA of the ITAA 1936 applies, the Commissioner has a discretion, pursuant to subsection 177EA(5), as to whether or not to make a determination. If the company is a party to the scheme, the Commissioner 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 imputation benefit to each shareholder pursuant to paragraph 177EA(5)(b).

92. Given the large and diverse shareholding of IAG, it would be inappropriate to make a determination to deny franking imputation benefits in relation to each participating shareholder. Accordingly, the Commissioner will not make a determination that the imputation benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b).

Example

93. Sally is an Australian resident. On the demutualisation of NRMA on 19 June 2000 she received 500 shares. Sally is taken to have acquired those shares at a cost of \$1.78 per share. Sally held the shares as part of her investment portfolio to derive dividend income.

94. In June 2004, Sally applied to participate in a buy-back offer to dispose of her 500 shares. IAG (formerly NRMA) approved the buy-back and, on 28 June 2004 paid Sally \$2,200 (500 shares × \$4.40). The proceeds include a distribution of a fully franked dividend of \$1,310.

95. Sally has no other capital gain or capital loss in 2003-2004 and no capital losses carried forward from previous years.

96. In Sally's tax return for the 2003-2004 income year, she includes in her assessable income a total franked dividend of \$1,310 and the franking credit attached to the dividend of \$561.43. The franking credit is allowed as a tax offset, which reduces her tax payable.

97. For capital gains tax purposes, Sally is taken to have disposed of her IAG shares for \$890 plus the amount by which the tax value exceeded the buy-back price, that is \$190 (500 × \$0.38) totalling \$1,080 (500 × \$2.16): refer to paragraphs 31 and 65 of this Ruling.

98. As Sally has owned the IAG shares for more than 12 months and acquired them after 21 September 1999, she uses the discount method to work out her capital gain:

Capital proceeds	(500 × \$2.16)	\$1,080
Less cost base	(500 × \$1.78)	<u>\$890</u>
Capital gain		\$190
Less capital losses		<u>Nil</u>
		<u>\$190</u>
Less CGT discount	(50% × \$190)	<u>\$95</u>
Net capital gain		<u>\$95</u>

99. Sally includes \$95 as a capital gain in her assessable income.

Detailed contents list

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