

CR 2004/112 - Income tax: off-market share buy-back: GRD NL

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Class Ruling

Income tax: off-market share buy-back: GRD NL

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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:
- sections 44, 45A, 45B and 45C of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - sections 159GZZZM, 159GZZZP and 159GZZZQ of the ITAA 1936;
 - section 177EA of the ITAA 1936;
 - section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - subsection 112-30 of the ITAA 1997;
 - Subdivision 115-A of the ITAA 1997;
 - sections 118-20 and 118-25 of the ITAA 1997;
 - Division 136 of the ITAA 1997; and
 - sections 204-30 and 995-1 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of GRD No Liability (GRD) who disposed of their GRD shares under the GRD off-market share buy-back which was first announced by GRD on 11 December 2003 and described in the arrangement part of this Ruling. In this Ruling they are referred to as participating shareholders.

4. This Class Ruling does not apply to GRD and does not deal with how the taxation law applies to GRD in relation to the buy-back. Furthermore, it should be noted that certain information which relates to the affairs of GRD, 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 in paragraphs 11 to 19.

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 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. 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 the Class ruling dated 6 February 2004 and the replacement Class ruling request received 1 June 2004 and subsequent correspondence;
- table showing the number of resident and non-resident shareholders with the number of shares held as at 31 December 2003;
- full financial statements for the year ended 31 December 2003;
- 31 December 2003 Annual Report;
- issued share capital and summary of rights;
- table of Shareholders spread at 31 December 2003 and Table of Top 20 shareholders at 31 December 2003;
- table of recent dividend history;
- chart of share price history over last 5 years;

- relevant ASX announcements (including Notice of Meeting and Explanatory Statement); and
- GRD buy-back booklet.

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

12. On Thursday 11 December 2003 GRD announced an off-market share buy-back under which it intended to buy-back up to 25 million GRD shares. It notified the ASX on 9 January 2004 that it was writing to shareholders regarding the proposed buy-back and included with the notification the Notice of Meeting, Explanatory Statement and Proxy Form. As at the record date (16 February 2004) for determination of entitlements to the buy-back offer, GRD had approximately 206 million ordinary fully paid shares and 7 million ordinary partly paid shares on issue.

13. In the Financial Statements for the year ended 31 December 2003, the GRD balance sheet disclosed total shareholders' equity of \$134 million, consisting of \$153 million contributed share capital, \$3 million reserves and \$22 million accumulated losses. These Statements also disclosed that there was a nil balance in the Franking Account.

14. The shareholders in GRD are a mix of individuals, companies, superannuation funds and non-residents.

15. The buy-back formed part of GRD's capital management strategy (GRD has not undertaken a similar off-market share buy-back prior to this one). As consideration for the buy-back GRD transferred shares it held in a subsidiary, Oceana Gold Limited (OGD) to participating GRD shareholders at the exchange rate of 2.4 OGD shares for each fully paid up GRD share. GRD did not undertake specific borrowings to finance the buy-back.

16. All GRD shareholders, as registered on 16 February 2004, could participate. Participation by shareholders was voluntary. Shareholders not participating in the buy-back were not required to do anything.

17. Shareholders who accepted an offer to participate in the buy-back returned a personalised acceptance form, nominating the number of shares (up to a maximum specified on the form) to be bought back. Holders of less than a marketable parcel of shares who wished to participate in the buy-back could do so by agreeing to have all of their shares bought back. The acceptance form was to be returned during the offer period that opened on 19 February 2004 and closed on 5 March 2004.

18. The buy-back offer included a scale back mechanism. As the buy-back offer was oversubscribed, the acceptances were scaled back on a *pro rata* basis. GRD announced the final terms on which participating shareholders' shares were bought back on 9 March 2004.

19. The market value of an OGD share at the time of the buy-back was \$1.00 per share. GRD shares have not traded on the ASX at prices which exceed \$2.40.

Ruling

The distribution is not a dividend

20. The return of share capital does not constitute a dividend for the purposes of both the ITAA 1936 and the ITAA 1997.

GRD shares – sale consideration

21. Participating shareholders are taken to have received \$2.40 as consideration in respect of the sale of each of their GRD shares for the purposes of section 159GZZZQ of the ITAA 1936. The tax consequences arising from the receipt of the sale consideration will depend on whether the sale is on capital account or on revenue account. Depending on whether the shares are held on capital or revenue account, the relevant tax consequences are as follows:

- (a) shares held on capital account:
- CGT event A1 in section 104-10 of the ITAA 1997 happens to each share that is bought back by GRD. The time of the CGT event is 9 March 2004.
 - To the extent that each share's cost base is less than \$2.40, the difference will be a capital gain. To the extent that each share's reduced cost base is greater than \$2.40, the difference will be a capital loss: subsection 104-10(4) of the ITAA 1997.
 - A capital gain made on a share that is bought back will be a discount capital gain if the share was acquired at least twelve months before the time of the CGT event, and the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.
 - Participating shareholders that are not residents of Australia will only make a capital gain or capital loss on the buy-back of their GRD shares if at any time during the five years before CGT event A1 happened to their shares they owned, together with their associates, at least 10% by value of the shares in GRD: section 136-10 of the ITAA 1997.
- (b) shares held on revenue account:
- To the extent that the cost of each share is less than \$2.40, the difference will be assessable income.

- If a participating shareholder held their GRD shares as trading stock, any capital gain or capital loss made on the buy-back is disregarded under section 118-25 of the ITAA 1997.
- Participating shareholders who have both an amount of income and a capital gain in respect of the buy-back of a GRD share can reduce the amount of the capital gain by the amount included in assessable income under section 118-20 of the ITAA 1997.

The anti-avoidance provisions

22. The Commissioner will not make a determination under either section 45A or 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.

23. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936.

24. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997.

Explanation

The purchase price in respect of the buy-back

25. The income tax consequences of an off-market share buy-back are worked out under Subdivision C of Division 16K of Part III of the ITAA 1936. Those consequences are based on the 'purchase price' of the share worked out under section 159GZZZM of the ITAA 1936.

26. Paragraph 159GZZZM(b) of the ITAA 1936 provides that if the seller of the share has received or is entitled to receive property other than money as a result of, or in respect of, the buy-back, the purchase price is the market value of that property in respect of the buy-back – 2.4 OGD shares for each GRD share bought back. The market value of each OGD share worked out at the time of the buy-back is \$1.00.

27. The purchase price may comprise two components:

- a dividend component; and
- a capital component.

The amount of each component is determined in accordance with sections 159GZZZP and 159GZZZQ of the ITAA 1936, having regard to how the company accounts for the off-market share buy-back.

The dividend component

28. Section 159GZZZP of the ITAA 1936 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 in respect of the buy-back of the share 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 occurs.

29. In this case, the entire purchase price of \$2.40 per share was debited to the share capital account. Consequently, there is no dividend amount to be included in a shareholder's assessable income under section 44 of the ITAA 1936.

The capital component (or sale consideration)

30. For the purposes of computing the amount of a gain or loss (on capital or revenue account), 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.

31. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the seller is taken to have received an amount equal to the purchase price in respect of the buy-back. However, this amount may be:

- increased under subsection 159GZZZQ(2) of the ITAA 1936 if the purchase price is less than the market value of the share at the time of the buy-back worked out as if the buy-back did not occur and was never proposed to occur; and/or
- reduced under subsection 159GZZZQ(3) of the ITAA 1936 to the extent that it is a dividend and included in the seller's assessable income of any income year.

32. In this case, the purchase price for the buy-back (\$2.40) is taken to exceed the market value of the GRD shares. Therefore, subsection 159GZZZQ(2) of the ITAA 1936 will not apply. Also as there is no dividend component, no other provision in section 159GZZZQ modifies the consideration in respect of the buy-back.

33. Therefore, the consideration determined under section 159GZZZQ of the ITAA 1936 is the buy-back price of \$2.40 per share.

34. The disposal may have different taxation implications for shareholders depending on how the shares were held, for instance:

- an investor who held his or her shares on capital account will be subject to the capital gains tax provisions; and
- a share trader who held his or her shares on revenue account will be subject to other income tax provisions.

35. If the shares are held as trading stock, any capital gain or capital loss made on the buy-back is disregarded under section 118-25 of the ITAA 1997.

36. Participating shareholders who have both an income tax and a capital gains tax liability in respect of the buy-back will generally have the amount of the capital gain reduced under section 118-20 of the ITAA 1997.

Capital gains tax consequences

Disposal of GRD shares

37. CGT event A1 in section 104-10 of the ITAA 1997 happens to each share that is transferred to GRD under the buy-back. The time of the CGT event is 9 March 2004, when GRD announced that it would accept the participants' offers: subsection 104-10(3).

38. To the extent that each GRD share's cost base is less than \$2.40, the difference will be a capital gain. To the extent that each share's reduced cost base is greater than \$2.40, the difference will be a capital loss. Participating shareholders, other than non-residents described in paragraphs 41 to 43, will include a capital gain or capital loss in working out their net capital gain or net capital loss for the year of income that includes the time of the CGT event.

39. A capital gain that is made by an individual, a complying superannuation entity, a trust or a life insurance company is a discount capital gain if the conditions in sections 115-10 to 115-25 of the ITAA 1997 are satisfied. One of those conditions is that the asset must have been acquired at least 12 months before the CGT event happens: section 115-25 of the ITAA 1997. Participating shareholders will satisfy this condition for shares in GRD that they had acquired at least 12 months before 9 March 2004.

40. The effect of a capital gain being a discount capital gain is that, in some circumstances it may be reduced by the discount percentage in section 115-100 of the ITAA 1997.

Non-resident shareholders

41. Non-resident shareholders will only make a capital gain or capital loss in respect of the disposal of their GRD shares under the buy-back if those shares have the necessary connection with Australia, as that term is explained in section 136-25 of the ITAA 1997.

42. An asset that is a share or an interest in a share, in a company that is an Australian resident, and a public company, for the income year in which a CGT event happens will have the necessary connection with Australia where at any time during the 5 years immediately before the time of the CGT event the taxpayer and/or associates of the taxpayer were the beneficial owners of not less than 10% by value of the shares of the company. The 10% ownership excludes any part of that share capital that carried no right to

participate beyond a specified amount in a distribution of either profits or capital.

43. GRD is an Australian resident and public company. Therefore, non-resident shareholders who participated in the buy-back will only make a capital gain or capital loss in respect of the disposal if they, together with their associates, are owners of not less than 10% by value of the shares of GRD (unless the 10% ownership was of share capital that carried no right to participate beyond a specified amount in a distribution of either profits or capital), at some time during the 5 years immediately preceding the time at which the buy-back happened.

Anti-avoidance provisions

Sections 45A and 45B of the ITAA 1936

44. Sections 45A and 45B of the ITAA 1936 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 dividend. Accordingly, the application of these two provisions to the buy-back must be considered.

45. Section 45A of the ITAA 1936 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.

46. 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 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.

47. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. Broadly, 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 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

48. Under the buy-back (which is a *scheme* within the broad meaning of that term under subsection 45B(10) of the ITAA 1936), GRD will provide a capital benefit to participating shareholders. The distribution of share capital, which is in the form of OGD shares, constitutes the provision of a capital benefit within the meaning conveyed by subsection 45B(5) of the ITAA 1936.

49. As some participating shareholders will derive either a capital gain or capital loss from the sale of their shares under the buy-back, they will pay less income tax than if the buy-back consideration had been a dividend. Some participating shareholders will therefore obtain a tax benefit within the meaning conveyed by subsection 45B(9) of the ITAA 1936.

50. In this buy-back, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of providing a shareholder with a capital benefit to obtain a tax benefit was not present.

51. Paragraph 45B(2)(c) of the ITAA 1936 requires a 'more than incidental' purpose of enabling a taxpayer to obtain a tax benefit. A reference to such a purpose is usually understood to include any main or substantial purpose of the scheme. Circumstances which are relevant in determining whether any person has the requisite purpose include the factors listed in subsection 45B(8).

52. Having regard to the 'relevant circumstances' of the scheme it is apparent that the inclusion of a capital element in the buy-back price was not inappropriate. The purpose of the arrangement is to reduce the company's asset base and while it may have the effect of providing capital benefits to some shareholders, any benefit is merely incidental.

53. Further, the capital component of the buy-back cannot be said to be attributable to GRD's profits, nor does the pattern of distributions that have been made by GRD in the past indicate that the capital component was being paid in substitution for a dividend.

Section 177EA of the ITAA 1936

54. 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 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.

55. Specifically, subsection 177EA(3) of the ITAA 1936 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 or a distribution franked with an exempting credit; and
- (d) except for this section, 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.

56. In this case, on the basis that GRD's Financial Statements for the year ended 2003 are correct in recording that there are no franking credits in the franking account, the Commissioner cannot exercise his discretion under the terms of the section.

Section 204-30 of the ITAA 1997

57. 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) the 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)).

58. On the basis that GRD's Financial Statements for the year ended 2003 are correct in recording that there are no franking credits in the franking account, the Commissioner cannot exercise his discretion under the terms of the section.

Detailed contents list

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Commissioner of Taxation

20 October 2004

Previous draft:

Not previously issued as a draft

- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZM(b)
- ITAA 1936 159GZZZP

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

- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1936 159GZZZQ(2)
- ITAA 1936 159GZZZQ(3)

Subject references:

- capital gains tax
- capital streaming
- dividend streaming arrangements
- dividends
- return of capital on shares
- share buy-backs

- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1936 177EA(5)(b)
- ITAA 1997 104-10
- ITAA 1997 104-10(3)
- ITAA 1997 104-10(4)
- ITAA 1997 112-30
- ITAA 1997 Subdiv 115-A

Legislative references:

- Copyright Act 1968
- TAA 1953 Pt IVAAA
- ITAA 1936 44
- 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 45B(8)
- ITAA 1936 45B(9)
- ITAA 1936 45B(10)
- ITAA 1936 45C

- ITAA 1997 115-10
- ITAA 1997 115-25
- ITAA 1997 115-110
- ITAA 1997 118-20
- ITAA 1997 118-25
- ITAA 1997 Div 136
- ITAA 1997 136-10
- ITAA 1997 136-25
- ITAA 1997 204-30
- ITAA 1997 204-30(1)(a)
- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 995-1

ATO references

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