CR 2004/152 - Income tax: Off-Market Share Buy-back: Telstra Corporation Limited

Class Ruling

Income tax: Off-Market Share Buy-back: Telstra Corporation Limited

Contents Para

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 law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. 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;
- section 159GZZZM of the ITAA 1936;
- section 159GZZP of the ITAA 1936;
- section 159GZZZQ of the ITAA 1936;
- Division 1A of Part IIIAA of the ITAA 1936;
- section 177EA of the ITAA 1936;
- Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 136 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 207-20 of the ITAA 1997;
- section 207-145 of the ITAA 1997; and
- section 995-1 of the ITAA 1997.

Note: *Consequential amendments with effect from 1 July 2002 dealing with the simplified imputation system were introduced into Parliament on 18 November 2004 in Tax Laws Amendment (2004 Measures No. 6) Bill 2004. This ruling deals only with the laws as presently enacted and does not extend to the application of the proposed laws.*

Class of persons

3. The class of persons to which this Ruling applies consists only of the shareholders of Telstra Corporation Limited ('Telstra') who disposed of their Telstra shares under the Telstra off-market share Buy-back ('the Buy-back') the details of which were announced by Telstra on 27 September 2004 and described in the arrangement part of this Ruling.

4. This ruling does not apply to shareholders who acquired Telstra shares under either or both of Telstra Employee Share Ownership Plan (TESOP) No. 1 1997 or TESOP No. 2 1999 those shares being:

- TESOP 97 Loan Shares;
- TESOP 97 Extra Loan Shares;
- TESOP 97 Extra Non-Loan Shares;
- TESOP 99 Loan Shares;
- TESOP 99 Extra Shares';

and disposed of those shares by participating in the Buy-Back. The tax consequences for these shareholders are considered in another Class Ruling (which is due to issue shortly). This Class Ruling also does not apply to Telstra and does not deal with how the taxation law applies to Telstra in relation to the Buy-Back.

5. It should be noted that certain information which relates to the affairs of Telstra, 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

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

7. 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 12 to 24.

8. 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.

Date of effect

10. This Class Ruling applies to the year ended 30 June 2005. 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

11. This Class Ruling is withdrawn and ceases to have effect after 30 June 2005. 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

12. 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 a Class Ruling dated 23 July 2004;
- Submissions in relation to the Class Ruling dated 12 August 2004, 8 November 2004 and 15 November 2004 respectively; and
- The Buy-back tender booklet issued by Telstra to shareholders.

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

13. On Thursday, 12 August 2004 Telstra announced an off-market share Buy-back. Under the announced Buy-back, Telstra intended to buy back around $750 million worth of shares (although it could choose to buy back a lesser amount or none at all) ('the Buy-back Limit'). As at 8 October 2004 (that is, the Record Date for determination of entitlements to the Buy-back offer) Telstra had approximately 12,628 million ordinary shares on issue (and no other types of shares).

14. In the Tender Buy-back document the Consolidated Balance Sheet, as at 30 June 2004, disclosed total shareholders' equity of $15.359 billion, consisting of $6.073 billion contributed share capital, $105 million reserves and $9.391 billion retained profits.

15. The shareholders in Telstra are a mix of individuals, companies, superannuation funds, non-residents and the Commonwealth of Australia. The Commonwealth did not participate in the Buy-back.

16. The Buy-back formed part of Telstra's ongoing capital management strategy. It was hoped that this Buy-back would have positive effects on return on equity and earnings per share over the longer term. Telstra funded the Buy-back from surplus capital and accumulated retained profits. Telstra did not undertake specific borrowings to finance the Buy-back.

17. The Buy-back was a pro rata offer to all Telstra shareholders to buy back up to 100% of their ordinary shares, as registered on the Record Date for the Buy-back of Friday 8 October 2004, subject to the Buy-back Limit, and was implemented through a tender process. Participation by shareholders was voluntary. Shareholders not participating in the Buy-back were not required to do anything.

18. The tender period opened on Monday 25 October 2004 and closed on Friday 12 November 2004. Under the tender process shareholders were invited to tender up to 100% of their shareholding at specified prices within a specified price range of $4.05 to $4.65 per share ('the Tender Range'). Shareholders could also submit tenders to sell different parcels of shares at different prices. Alternatively, shareholders could submit a Final Tender Price under which they offered to sell their shares for the price as determined by the tender process.

19. At the end of the tender period, Telstra and its advisers would manage a reverse book build of the tenders to determine the Buy-back price, being the lowest specified price at which Telstra was able to repurchase the amount of capital it chose to buy back. Tenders at prices above the Buy-back price would not be accepted.

20. Under the Buy-back successful tenderers would receive $1.50 as a capital amount and the balance of the Buy-back price as a fully franked divided.

21. The Buy-back included a scale back mechanism. In the event that more shares were tendered at the Buy-back price than Telstra wished to repurchase, tenders at the Buy-back price were to be scaled back pro rata. If required, the scale back would be determined on 14 November 2004.

22. Shares offered into the Buy-back by any participating shareholder who, following the scale back under the Buy-back would be left with an unmarketable parcel of shares (600 shares or less), would have all their shares bought back.

23. Telstra's stated dividend policy to declare ordinary dividends of around 80% of operating profit after tax will not change as a consequence of the Buy-back. A shareholder who did not participate in the Buy-back did not receive any other dividend or distribution by way of compensation for not participating in the Buy-back.

24. On 15 November 2004 Telstra announced that:

- It had successfully completed its off-market Buy-back of approximately 185.3 million ordinary shares, representing around 1.5% of issued capital, at a price of $4.05 per share;
- The total amount of capital repurchased by it under the Buy-back was around $278 million. The balance, being around $472 million, would be paid out as a fully franked dividend.
- All shareholders who tendered shares into the Buy-back at $4.05 or as a final price tender, would receive $4.05 per share for all of those shares accepted after the scale back;
- Shares tendered into the Buy-back above $4.05 were not successful and would not be bought back;
- As the Buy-back was oversubscribed at the $4.05 price, there was a scale back of successful tenders by approximately 11.3%; and
- The Buy-back proceeds would be paid to successful tendering shareholders by 23 November 2004.

Ruling

The Dividend Component

25. Participating shareholders will be taken to have been paid a dividend component of $2.55 ('the Dividend Component') for each share bought back out of the profits of Telstra on the date the Buy-back occurred under section 159GZZZP of the ITAA 1936.

26. The Dividend Component is a frankable distribution and is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

27. Participating non-resident shareholders are not liable for withholding tax on the Dividend Component under paragraph 128B(3)(ga) of the ITAA 1936 because the Dividend Component is a frankable distribution pursuant to section 202-40 of the ITAA 1997, and was fully franked by Telstra.

The Capital Component

Note: *Consequential amendments with effect from 1 July 2002 dealing with the simplified imputation system were introduced into Parliament on 18 November 2004 in Tax Laws Amendment (2004 Measures No. 6) Bill 2004. This ruling deals only with the laws as presently enacted and does not extend to the application of the proposed laws.*

28. Participating shareholders are taken to have received $2.25 as consideration in respect of the sale of each of their Telstra shares on 14 November 2004 ('Sale Consideration') for the purposes of section 159GZZZQ of the ITAA 1936.

29. If the Buy-back price for each share bought back under the Buy-back was less than what would have been the market value of the share if the Buy-back did not occur and was never proposed to occur then the market value rule in subsection 159GZZZQ(2) applies to the Buy-back. The effect of this rule is that the difference between the Buy-back Price and the market value, if the Buy-back did not occur and was never proposed to occur, will be included in the consideration received for the disposal of the share for ordinary income or capital gains tax purposes.

30. The treatment of the Sale Consideration for tax purposes depends on whether the sale is on capital account (where the shares are held for investment) or on revenue account. In general, the relevant treatment should be as follows:

(a) **Shares held on capital account**

- The amount by which the sale consideration of $2.25 exceeds the cost base of each share will be a capital gain to the shareholder in the shareholder's assessable income. If the share's reduced cost base exceeds $2.25, the difference will be a capital loss.

(b) **Shares held on revenue account**

- Where the shares are held as trading stock, the sale consideration of $2.25 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 sale consideration of $2.25 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds $2.25, the difference will be an allowable deduction.

Qualified Person

31. 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 into the Buy-back were acquired on or before 29 September 2004; and

(b) during the period when the shares or interest in the shares were held the shareholders did not have 'materially diminished risks of loss or opportunities for gain' in respect of the shares or interest in the shares (as defined in section 160APHM of the ITAA 1936) for a continuous period of at least 45 days.

The Anti-avoidance Provisions

Sections 45A and 45B of the ITAA 1936

32. The Commissioner will not make a determination under 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.

Section 177EA of the ITAA 1936

33. 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 in relation to the Dividend Component received by participating shareholders.

Section 204-30 of the ITAA 1997

34. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997 to deny to whole, or any part of, the imputation benefits in relation to the Dividend Component received by participating shareholders.

Explanation

The Dividend and Capital Components

35. 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 of the ITAA 1936, having regard to how the company accounts for the off-market share Buy-back.

The Dividend Component

36. 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 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. In this case, the Buy Back price was $4.05 per share and $1.50 of this was debited to the share capital account. Thus the dividend amount is $2.55 per share.

37. The dividend amount of $2.55 per share is a frankable distribution and is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

38. For Australian resident individual and corporate tax entity shareholders, the amount of the dividend will be included in their assessable income under subsection 44(1) of the ITAA 1936. Generally, an amount equal to the amount of the franking credit will be included in their assessable income under subsection 207-20(1) of the ITAA 1997. Australian resident individual and corporate tax entity shareholders are generally also entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 reflecting the imputation benefit attached to the dividend.

39. However, it should be noted that provisions exist which may deny a franking credit or tax offset in certain circumstances. For instance, paragraph 207-145(1)(a) of the ITAA 1997 requires that the shareholder be a 'qualified person for the purposes of Division IA of Part IIIAA of the ITAA 1936' to obtain a franking credit or tax offset. 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. These two rules are discussed later in this Class Ruling.

40. 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 in accordance with paragraph 128B(3)(ga).

The Capital Component

Note: *Consequential amendments with effect from 1 July 2002 dealing with the simplified imputation system were introduced into Parliament on 18 November 2004 in Tax Laws Amendment (2004 Measures No. 6) Bill 2004. This ruling deals only with the laws as presently enacted and does not extend to the application of the proposed laws.*

41. Participating shareholders are taken to have disposed of those shares accepted under the Buy-back on 14 November 2004. 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 contained in Part 3-1 and Part 3-3 of the ITAA 1997; and
- a share trader who held his or her shares on revenue account will be subject to the ordinary income provisions and, if the shares were held as trading stock, the specific trading stock provisions in Part 2-25 of the ITAA 1997.

42. It should be noted that shareholders who have both an income tax and a capital gains tax liability in respect of the Sale Consideration will generally have the amount of the capital gain reduced under the anti-overlap provisions contained in section 118-20(1)(a) of the ITAA 1997. If the shares are held as trading stock the capital gain or loss is disregarded under section 118-25(1)(a) of the ITAA 1997.

43. For the purposes of computing the amount of the gain or loss (on capital or revenue account), the Sale Consideration in respect of the disposal of a share under a Buy-back is determined in accordance with section 159GZZZQ of the ITAA 1936.

44. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the shareholder is taken to have received an amount equal to the Buy Back price (in this case the $4.05 received for each share bought back) 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.

45. 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 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 bought back.

46. For the purposes of determining the application of sub-section 159GZZZQ(2) ITAA 1936 to the market value of each Telstra share, the following methodology has been proposed by Telstra and accepted by the Commissioner in accordance with TD 2004/22: the volume weighted average price over the five trading days before announcement of the buy-back, adjusted for the movement in the S&P/ASX 200 Telecoms Index (excluding Telstra) 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

47. The Commissioner considers the use of the S&P/ASX 200 Telecoms Index (excluding Telstra) to be an appropriate index for the purposes of calculating market value in the 2004 Telstra buy-back. Under this methodology, the market value of a share bought back under the buy-back was calculated to be $4.80. Thus, the vendor

shareholders are taken to have received $2.25 for the sale of each share rather than $1.50.

Market Value of a share bought back under the Buy-back	$4.80
less Reduction Amount	$2.55
Sale Consideration	$2.25

Qualified Person

48. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend made by an entity only 'a qualified person in relation to the distribution for the purposes of Division 1A of Part IIIAA of the ITAA 1936' is entitled to a franking credit or tax offset. Broadly speaking, to be a 'qualified person' in relation to the Telstra dividend ('the Dividend Component') paid under the Buy-back, the participating shareholder must satisfy both the holding period rule and the related payments rule.

49. Broadly, a shareholder will not satisfy the related payments rule if the shareholder, or associate of the shareholder, is under an obligation to make, or makes, a payment in respect of the dividend which effectively passes the benefit of the dividend to another person.

50. 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 an interest in the shares 'at risk', any days during which there are materially diminished risks of loss or opportunities for gain in relation to the relevant shares are not counted. Section 160APHO(2)(a) of the ITAA 1936 provides that the day of acquisition and the day of disposal of the relevant shares are also not counted.

51. Under subsection 160APHM(2) of the ITAA 1936, a shareholder 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 'net position' of the shareholder on that day results in the shareholder having less than 30% of the risks and opportunities relating to the shares or interest in shares.

52. In this case the Commissioner does not regard the announcement of the Buy-back offer as affecting whether the shares or an interest in the shares was held 'at risk' or not.

53. There are 45 clear days between 29 September 2004 and 14 November 2004 (that is, the date the tender offer was accepted). Therefore, a shareholder who acquired shares on or before 29 September 2004 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A shareholder who acquired shares after 29 September 2004 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 Division 1A of Part IIIAA of the ITAA 1936.

54. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first: subsection 160APHI(4) of the ITAA 1936. The 45 day rule operates on a last-in-first-out basis, so that shareholders will be deemed to have disposed of their most recently acquired shares first for the purposes of applying the 45 day rule. Accordingly, shareholders who, on or after 30 September 2004 acquired any additional Telstra shares which conferred an entitlement to participate in the Buy-back, may not qualify for the franking credits attached to the dividends paid on some or all of their shares sold into the Buy-back.

55. A shareholder is only entitled to tender shares in the Buy-back which are registered in the shareholders name on the Record Date.

56. Telstra shares acquired by participating shareholders which do not confer an entitlement to participate in the Buy-back do not constitute 'related securities' for the purposes of section 160APHI(4) of the ITAA 1936 with Telstra shares which do confer an entitlement to participate in the Buy-back.

The Anti-Avoidance Provisions

Sections 45A and 45B of the ITAA 1936

57. 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.

58. 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.

59. Although a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) is provided to participating shareholders under the Buy-back in accordance with section 45A(1)(a), 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.

60. Section 45B 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 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

61. In the case of the Buy-back, 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 capital distribution – was not present.

62. 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 was not inappropriate. Further, the Capital Component of the Buy-back price cannot be said to be attributable to the profits of the company, nor does the pattern of distributions that have been made by Telstra in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA of the ITAA 1936

63. 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.

64. 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 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.

65. 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, it would be concluded that, on the part of Telstra, 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.

66. In arriving at a conclusion the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17). The relevant circumstances listed 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.

67. The Commissioner has come to the view that section 177EA applies to the Buy-Back. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the arrangement, as outlined in subsection 177EA(17). Among the circumstances of the Buy-Back reflected in those paragraphs are:

- the delivery of franking credits in excess of what would have otherwise been distributed in the ordinary course of dividend declaration;

- the greater attraction of the Buy-Back to resident shareholders who could fully utilise the franking credits than to non-resident shareholders who could not;

- the greater attraction of the Buy-Back to some resident shareholders with a low marginal tax rate than other resident shareholders (for example, whereas superannuation funds are taxed at 15% and corporations at 30% individuals can be taxed at a marginal tax rate up to 47%; and
- that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

68. Where section 177EA applies the Commissioner has a discretion, pursuant to subsection 177EA(5) to make a determination to debit the company's franking account pursuant to paragraph 177EA(5)(a), or deny the imputation benefit to each shareholder pursuant to paragraph 177EA(5)(b). The Commissioner will exercise his discretion in such a way that he does not make a determination that the imputation benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b). It would be inappropriate, given the large and diverse shareholding of the company, to make a determination to deny franking imputation benefits in relation to each participating shareholder.

Section 204-30 of the ITAA 1997

69. 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)).

70. If section 204-30 applies the Commissioner is vested with discretion under subsection 204-30(3) to make a determination in writing either:

(a) that a specified franking debit arises in the franking account of the entity, for a specified distribution or other benefit to a disadvantaged member (paragraph 204-30(3)(a)); or

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

71. 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.

72. A significant portion of Telstra's ordinary shareholding was held by the Commonwealth and non-residents, shareholders who do not benefit from franking to the same extent as other resident shareholders. Thus, the conditions in subsection 204-30(1) for the provisions to apply are met. However, the Commissioner will not exercise his discretion under subsection 204-30(c) to deny imputation benefits that arise in respect of the Dividend Component of the Buy-back paid to participating shareholders.

Refundable Tax Offsets

73. The excess (if any) of the tax offset attributable to the franking credit on the Dividend Component will be subject to the refundable tax offset rules of Division 67 of the ITAA 1997.

Non-Resident Shareholders

74. Under section 136-10 of the ITAA 1997, non-residents are liable to capital gains tax if a CGT (capital gains tax) event happens and the relevant asset in respect of that event has the necessary connection with Australia under the ITAA 1997.

75. The meaning of assets that have the 'necessary connection with Australia' is set out in section 136-25 of the ITAA 1997.

76. Under section 136-25, an asset will have the necessary connection with Australia if it 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 the CGT event happens where at any time during so much of the period of 5 years immediately preceding the time at which the CGT event occurs 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.

77. 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.

78. As Telstra is an Australian resident and public company, a non-resident shareholder who participated in the Buy-back is liable to capital gains tax if the non-resident shareholder and/ or associates of the non-resident shareholder were the beneficial owners of not less

than 10% by value of the shares of Telstra (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 any time during so much of the period of 5 years immediately preceding the time at which the Buy-back happened.

Detailed contents list

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

Commissioner of Taxation
15 December 2004

Previous draft:
Not previously issued as a draft

Related Rulings/Determinations:
CR 2001/1; TD 2004/22;
TR 92/1; TR 92/20; TR 97/16

Subject references:
- dividend streaming arrangements
- share buy backs

Legislative references:
- Copyright Act 1968
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