


CR 2004/65 - Income tax: Share buy-back: Commonwealth Bank of Australia

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Class Ruling

Income tax: Share buy-back: Commonwealth Bank of Australia

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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 IVA 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 law(s) dealt with in this 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 90 of the ITAA 1936;
- section 95 of the ITAA 1936;
- section 128B of the ITAA 1936;
- Division 16K of the ITAA 1936;
- section 160APHO of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 67 of the ITAA 1997;
- section 104-10 of the ITAA 1997;

- section 118-20 of the ITAA 1997;
- Division 136 of the ITAA 1997;
- section 202-35 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 207-40 of the ITAA 1997;
- section 207-50 of the ITAA 1997;
- section 207-145 of the ITAA 1997;
- section 207-150 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 whom this Ruling applies is the shareholders holding ordinary shares of the Commonwealth Bank of Australia ('CBA') who dispose of shares under the CBA off-market share buy-back announced on 11 February 2004 ('the Buy-Back') and conducted during the period 8 March 2004 to 26 March 2004, and described in the Arrangement part of this Ruling.

4. The class of persons to which this Ruling applies does not include CBA. The Ruling does not deal with how the taxation law applies to CBA in relation to the Buy-Back. Furthermore, it should be noted that certain information which relates to the affairs of CBA, 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 in accordance with the arrangement described in paragraphs 11 to 31.

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

- the application for a Class Ruling dated 18 November 2003;
- letters and correspondence from Greenwoods & Freehills dated 17 December 2003, 5 February 2004 and 9 February 2004;
- letters and correspondence from CBA dated 18 December 2003, 7 January 2004, 27 January 2004, 28 January 2004, 6 February 2004 and 8 February 2004.

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

12. On 11 February 2004 CBA announced the Buy-Back under which it intended to buy back between \$450 million and \$550 million worth of ordinary shares ('Buy-Back Limit').

13. As at December 2003 CBA had approximately 1,261 million ordinary shares on issue. CBA ordinary shares are held by a mix of individuals, superannuation funds, companies and other institutional investors. CBA estimated that approximately 14.7% of its ordinary shares were held by non-residents.

14. The financial statements of CBA for the year ended 30 June 2003 show total share capital of approximately \$13,365 million and retained profits of approximately \$2,809 million. The franking account balance as at December 2003 was approximately \$337 million.

15. CBA explained in the Buy-Back Tender Booklet ('the Booklet') that the Buy-Back was undertaken as part of CBA's ongoing program of active capital management and was expected to enhance earnings per share and return on equity, while enabling it to maintain a more efficient capital structure.

16. The Booklet advised that the Buy-Back would be funded through CBA's normal liquidity management process.

17. The Buy-Back was a pro rata invitation to all CBA ordinary shareholders (excluding employees holding shares restricted from sale) to offer to sell in the Buy-Back up to 100% of their shares, as registered on the record date, subject to the Buy-Back Limit.

18. Participation by shareholders was voluntary, and shareholders not wishing to participate in the Buy-Back were not required to do anything. Non-participating shareholders did not receive any property, dividend or distribution by way of compensation.

19. The Buy-Back was implemented through a 'tender process'. The tender period opened on 8 March 2004 and closed on 26 March 2004. Under the tender process, shareholders were invited to tender up to 100% of their shareholding at any of the prices specified by CBA within a price range of between \$26.00 and \$31.25.

20. The top of the price range represented a 0.9% premium and the bottom of the price range a 16% discount to the closing price of CBA shares on the Australian Stock Exchange ('ASX') on 10 February 2004.

21. Shareholders holding more than 200 shares could submit tenders to sell different parcels of shares at different prices. Alternatively, shareholders could submit a 'Final Price Tender' under which they offered to sell their shares for the price as determined by the tender process. All Final Price Tenders would be accepted in full without scale back.

22. Tenders at prices at or below the Buy-Back Price would be accepted in full. Tenders at prices above the Buy-Back Price would not be accepted. All successful tenderers would receive the Buy-Back Price for each share bought back, even if they tendered shares at a lower price.

23. The Buy-Back Price would be the lowest price, within the price range, that would allow CBA to purchase the number of shares that it decided to buy back.

24. Subject to paragraphs 25 and 26, if more shares were tendered at the Buy-Back Price than CBA wished to repurchase, then tenders at the Buy-Back Price would be scaled back:

- a. on a pro-rata basis, following acceptance of the first 200 shares tendered by each shareholder ('Priority Acceptance'), if the Buy-Back Price was the lowest price in the range; or
- b. on a pro-rata basis, without any Priority Acceptance, if the Buy-Back Price was above the lowest price in the range.

25. Shareholders who tendered all of their shares at or below the Buy-Back Price, and who following any scale back would be left with 200 shares or less, would have all of their shares bought back in full.

26. Shareholders with 200 shares or less, who wished to participate in the Buy-Back were required to tender all of their shares.

27. A tender constituted an offer to sell the tendered shares and did not of itself constitute a binding contract for the sale of the shares. CBA's acceptance of a tender constituted a binding agreement between CBA and the shareholder.

28. Shareholders who tendered shares into the Buy-Back could withdraw some or all of the tenders, or could change the terms of their tender by notifying CBA no later than 7.00pm on 26 March 2004.

29. CBA advised that it does not intend to change its dividend policy as a result of the Buy-Back, and intends to continue fully franking all frankable distributions made by it.

30. CBA accounted for the Buy-Back Price for each Share bought back as follows:

- a. CBA debited \$11.00 against an amount standing to the credit of CBA's untainted share capital account; and
- b. CBA debited \$16.50 against an amount standing to the credit of the retained earnings account of the Bank.

31. The calculation of acceptances and possible scale back was completed on 29 March 2004. On that date CBA announced that:

- the Buy-Back had been completed, and CBA will buy back 19,360,759 shares at a total cost of \$532.4 million;
- the Buy-Back Price is \$27.50;
- all shares tendered at or below \$27.50, or as a Final Price Tender were accepted in full and no scale back was applied to any of the accepted tenders;
- the Buy-Back price includes a fully franked dividend of \$16.50 per share bought back; and
- for capital gains tax purposes, the deemed disposal price for each share bought back is \$13.92.

Ruling

The Dividend Component

32. Participating shareholders are taken to have been paid a dividend of \$16.50 for each share bought back on the day the Buy-Back occurred ('the Dividend Component') under section 159GZZZP of the ITAA 1936.

33. The whole amount of the Dividend Component constitutes a frankable distribution for the purposes of subsection 202-40(1) of the ITAA 1997.

Assessability of the Dividend Component and Tax Offset

Direct Distributions

34. The Dividend Component of \$16.50 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. These 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.

Indirect Distributions***Partnerships***

35. The Dividend Component of \$16.50 and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of a partnership that participates in the Buy-Back for the purposes of computing the net income of the partnership under section 90 of the ITAA 1936.

36. In a case where an individual partner, corporate partner, or a trustee partner specified by subparagraphs 207-50(b)(iii) or (iv) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) is assessable in respect of a share of the net income of the partnership, or allowed a deduction in respect of a share of the partnership loss, the partner will be entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component, provided that the whole or part of that share of the net income or partnership loss of the partnership is attributable to an amount included in the assessable income of the partnership because the Dividend Component is made to the partnership.

Trusts

37. The Dividend Component of \$16.50 and an amount equal to the amount of the franking credit on the Dividend Component (gross-up) is included in the assessable income of a trustee for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936.

38. In a case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified by subparagraphs 207-50(b)(iii) or (iv) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) is assessable in respect of a share of the net income of the trust, the beneficiary is entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component, provided that the whole or part of that share of the net income of the trust is attributable to an amount included in the assessable income of the trust because the Dividend Component is made to the trustee of the trust.

Refundable Tax Offset

39. The tax offsets will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997. Certain trustees and corporate tax entities are not entitled to the refundable tax offset rules because of subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident shareholders

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

Sale of Shares under the Buy-Back

41. Participating shareholders are taken to have received \$13.92 as consideration in respect of the sale of each of their shares bought back under the Buy-Back ('the Sale Consideration') pursuant to section 159GZZZQ of the ITAA 1936.

42. 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/D1]). Accordingly 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.

43. 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 (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

44. 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 a share if the capital proceeds of \$13.92 exceed the cost base of that share. The capital gain is the amount of the excess. Similarly, a shareholder will make a capital loss if the capital proceeds of \$13.92 are less than the reduced cost base of a share.

45. The shares are taken to have been disposed of for capital gains tax purposes on 29 March 2004.

Shares held on revenue account

46. Where the shares are held as trading stock, the Sale Consideration of \$13.92 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 \$13.92 exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$13.92 the difference is an allowable deduction.

Non-resident shareholders

47. 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 136-10 of the ITAA 1997. A CBA share will have the necessary connection with Australia if:

- at any time during the 5 years before 29 March 2004, the shareholder together with their associates owned 10% or more by value of the issued shares in CBA; or
- it was issued to the non-resident when the non-resident exchanged their interest in Colonial Limited under an arrangement for which that shareholder claimed Subdivision 124-M scrip for scrip roll-over.

Qualified Person

48. 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 in relation to the dividend received under the Buy-Back provided:

- the shares were acquired on or before 12 February 2004;
- the shareholder has no other positions (for example, an option) in relation to the shares sold into the Buy-Back; and
- the shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

49. A shareholder who acquired shares on or after 13 February 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***

50. The Commissioner will not make a determination under 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 distribution of share capital under the Buy-Back received by participating shareholders.

Section 204-30 of the ITAA 1997

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

Section 177EA of the ITAA 1936

52. 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.

Explanation

The Taxation Treatment of Buy-Backs

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

54. Paragraph 159GZZZK(d) 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. Any other buy-back is an off-market purchase. As CBA bought its shares back directly from shareholders, the buy-back is an off-market share buy-back.

55. 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 (in this Class Ruling described 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').

56. 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 buy-back.

The Purchase Price

57. 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'. This term is defined by section 159GZZZM of the ITAA 1936 to be the amount of money or other property received or receivable by the shareholder as a result of or in respect of the buy-back ('Purchase Price'). The CBA Buy-Back Price of \$27.50 is the Purchase Price pursuant to section 159GZZZM.

The Dividend Component

58. Section 159GZZZP 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 the seller on the day the buy-back occurs.

59. CBA debited \$11.00 of the Purchase Price against an amount standing to the credit of CBA's untainted share capital account. The Dividend Component determined under subsection 159GZZP(1) is therefore \$16.50, calculated as follows:

The Buy-Back Price (Purchase Price)	\$27.50
less amount debited to share capital account	<u>\$11.00</u>
Dividend Component	\$16.50

60. The Dividend Component of \$16.50 will be a distribution by CBA 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.

61. None of the paragraphs 202-45(a) to paragraph 202-45(j) in section 202-45 of the ITAA 1997 apply, and accordingly the distribution is a frankable distribution.

Assessability of the Dividend Component and tax offsets

Direct distributions

62. In the case of Australian resident shareholders (other than a partnership or trust) who participate in the Buy-Back and who directly receive the Dividend Component:

- the Dividend Component of \$16.50 is included in the assessable income of each shareholder under subsection 44(1) of the ITAA 1936; and
- an amount equal to the amount of the franking credit on the Dividend Component is included in the assessable income of each shareholder under subsection 207-20(1) of the ITAA 1997 (gross-up).

63. These shareholders are 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.

Indirect distributions

64. The franked distribution may flow indirectly to a partner in a partnership or a beneficiary of certain trusts.

65. In general terms, pursuant to subsection 207-35(2) of the ITAA 1997, a franked distribution will flow indirectly to a partner in a partnership where:

- the partner is assessable in respect of a share of the net income of the partnership, or allowed a deduction in respect of a share of the partnership loss; and
- all or part of the net income or partnership loss of the partnership is attributable to the distribution.

66. In general terms, pursuant to subsection 207-35(3) of the ITAA 1997, a franked distribution will flow indirectly to a beneficiary of a trust where:

- a share of the net income of the trust is included in the assessable income of a beneficiary; and
- all or part of that share of the net income of the trust is attributable to the distribution.

67. In the case of partnerships and certain trusts that participate in the Buy-Back the following income tax consequences arise.

Partnerships

68. Pursuant to subsection 44(1) of the ITTA 1936, the Dividend Component of \$16.50 is included in the assessable income of the partnership for the purposes of computing the net income of the partnership under section 90 of the ITAA 1936.

69. Pursuant to subsection 207-40(1) of the ITAA 1997, an amount equal to the amount of the franking credit on the Dividend Component is included in the assessable income of the partnership for the purposes of computing the net income of the partnership under section 90 of the ITAA 1936 (gross-up).

70. In the case where an individual partner, corporate partner, or a trustee partner specified by subparagraphs 207-50(b)(iii) or (iv) of the ITAA 1997 (that is, trustees liable to be assessed under section 98, 99 or 99A of the ITAA 1936, or certain superannuation funds, approved deposit funds and pooled superannuation trusts) is assessable in respect of a share of the net income of the partnership, or allowed a deduction in respect of a share of the partnership loss, the partner will be entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component pursuant to section 207-50 of the ITAA 1997. This is on the proviso stated in paragraph 207-35(2)(c) of the ITAA 1997 that the whole or part of that share of the net income or partnership loss of the partnership is attributable to an amount included in the assessable income of the partnership because the deemed dividend is made to the partnership (or flows indirectly to the partnership because of one or more previous applications of section 207-35 of the ITAA 1997).

Trusts

71. Pursuant to subsection 44(1) of the ITTA 1936, the Dividend Component of \$16.50 is included in the assessable income of a

trustee for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936.

72. Pursuant to subsection 207-40(2) of the ITAA 1997, an amount equal to the amount of the franking credit on the Dividend Component is included in the assessable income of the trustee for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936 (gross-up).

73. In the case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified by subparagraphs 207-50(b)(iii) or (iv) of the ITAA 1997 (that is, trustees liable to be assessed under section 98, 99 or 99A of the ITAA 1936, or certain superannuation funds, approved deposit funds and pooled superannuation trusts) is assessable in respect of a share of the net income of the trust, the beneficiary is entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component pursuant to section 207-50 of the ITAA 1997. This is on the proviso stated in paragraph 207-35(3)(c) of the ITAA 1997 that the whole or part of that share of the net income of the trust is attributable to an amount included in the assessable income of the trust because the deemed dividend is made to the trustee of the trust (or flows indirectly to the partnership because of one or more previous applications of section 207-35 of the ITAA 1997).

Refundable tax offset

74. The franking credit on the Dividend Component will be subject to the refundable tax offset rules in Division 67, provided the shareholders participating in the Buy-Back are not excluded by subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident shareholders

75. As the Dividend Component is fully franked, a non-resident shareholder is not liable to Australian withholding tax on the Dividend Component pursuant to paragraph 128B(3)(ga) of the ITAA 1936.

Gross-up and tax offset denied in certain circumstances

76. 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 of the ITAA 1997 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 IIIA 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.

77. Whether or not participating shareholders are 'qualified persons' in relation to the dividend received under the Buy-Back is discussed at paragraphs 89 to 94.

78. 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 102 to 114. In this case, no determinations will be made to deny imputation benefits received by participating shareholders under the Buy-Back.

Disposal of Shares under the Buy-Back

79. Participating shareholders are taken to have sold those shares accepted under the Buy-Back. The sale may have different taxation implications for shareholders depending on how the shares were held. For instance:

- an investor who held their shares on capital account will be subject to the capital gains tax provisions contained in Part 3-1 and 3-3 of the ITAA 1997; and
- a shareholder who held their shares on revenue account 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.

80. 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 of the ITAA 1997. If the shares are held as trading stock the capital gain or loss is disregarded under paragraph 118-25(1)(a) of the ITAA 1997.

81. 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.

82. 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.

83. 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.

84. For the purposes of determining the application of subsection 159GZZZQ(2) the market value of each CBA share is the volume weighted average price of the shares over the five trading days before 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/D1). Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$30.42. Thus, the shareholders are taken to have received \$30.42 for the sale of their shares rather than \$27.50.

85. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of \$30.42 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 CBA Buy-Back, the Reduction Amount is equivalent to the Dividend Amount.

86. Thus, the Sale Consideration determined under section 159GZZZQ is \$13.92, calculated as follows:

Deemed Consideration (Market Value)	\$30.42
less the Reduction Amount	<u>\$16.50</u>
Sale Consideration	\$13.92

Disposal for CGT purposes

87. For capital gains tax purposes, and pursuant to subsection 104-10(3), participating shareholders are taken to have disposed of their shares bought back on 29 March 2004.

Non-resident shareholders

88. Pursuant to section 136-10, a non-resident will make a capital gain or a capital loss from the sale of shares into the Buy-Back only if the shares have the necessary connection with Australia under the tests in section 136-10 of the ITAA 1997. Under categories 5 and 9 of the table set out in section 136-25 of the ITAA 1997, a CBA share will have the necessary connection with Australia if:

- at any time during the 5 years before 29 March 2004, the shareholder together with their associates owned 10% or more by value of the issued shares in CBA; or
- it was issued to the non-resident when the non-resident exchanged their interest in Colonial Limited under an

arrangement for which that shareholder claimed
Subdivision 124-M scrip for scrip roll-over.

Qualified Person

89. 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 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 IIIAA of the ITAA 1936, as in force on 30 June 2002. Broadly speaking, to be a qualified person in relation to the CBA 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.

90. The holding period rule requires a taxpayer 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 are materially diminished risks of loss or opportunities for gain in relation to the relevant shares or interest 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 also not counted.

91. 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 interest in shares.

92. The Commissioner does not regard the announcement of the CBA Buy-Back offer as affecting whether or not the shares or an interest in the 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 26 March 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 29 March 2004, and accordingly 28 March 2004 was the last clear day when the shares were held 'at risk'.

93. There are 45 clear days between 12 February 2004 and 29 March 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 12 February 2004;
- the shareholder has no other positions in relation to the shares sold into the Buy-Back; and
- the shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

94. A shareholder who acquired shares on or after 13 February 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 section 160APHO of the ITAA 1936 but may nonetheless be a qualified person if the shareholder satisfies the small shareholder exemption under section 160APHT of the ITAA 1936.

The Anti-Avoidance Provisions

Sections 45A and 45B of the ITAA 1936

95. It was noted at paragraph 30 that CBA debited \$11.00 of the Buy-Back Price to its share capital account. This amount is a distribution of share capital to participating shareholders.

96. Sections 45A and 45B of the ITAA 1936 are 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.

97. Section 45A of the ITAA 1936 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.

98. 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. Accordingly, section 45A has no application to the Buy-Back.

99. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, section 45B of the ITAA 1936 applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- 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

- 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)).

100. 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 capital distribution – was not present.

101. 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 appropriate. Further, the capital element 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 CBA in the past indicate that it was being paid in substitution for a dividend.

Section 204-30 of the ITAA 1997

102. Section 204-30 applies where a company streams the payment of franked distributions to its shareholders in such a way that the imputation benefits attaching to the distribution are received by those shareholders who derive a greater benefit from them and other shareholders receive lesser imputation benefits, or no imputation benefits.

103. If section 204-30 applies the Commissioner is vested with a discretion, pursuant to subsection 204-30(3), whether or not to make a determination to debit the company's franking account pursuant to paragraph 204-30(3)(a), or that no imputation benefit is to arise in respect of the dividend to those shareholders who derive a greater benefit pursuant to paragraph 204-30(3)(c).

104. 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.

105. Non-resident shareholders hold some 14% of CBA ordinary shares. Under the Australian tax system non-resident shareholders do not benefit from franking to the same extent as resident shareholders. The Commissioner holds the view that the structure of an off-market share buy-back is a means whereby franking credits may be streamed to resident shareholders as a class, who will receive a greater benefit from franking credits than non-resident shareholders as a class.

106. Although section 204-30 applies to the CBA share buy-back, the Commissioner will not make a determination pursuant to subsection 204-30(3). This is because the Commissioner will exercise his discretion under section 177EA. One of the relevant circumstances in the application of section 177EA is the fact that resident shareholders receive a greater benefit from franking credits than non-resident shareholders.

Section 177EA of the ITAA 1936

107. 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 buy-back with a franked dividend component.

108. Specifically, subsection 177EA(3) provides that section 177EA of the ITAA 1936 applies if:

- there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity;
- a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests or 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;
- the distribution was, or is expected to be, a franked distribution;
- 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
- 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.

109. 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 CBA, 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.

110. 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.

111. Where section 177EA applies the Commissioner is vested with a discretion, pursuant to subsection 177EA(5), whether to make a determination. If the company is a party to the scheme 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).

112. In this regard, the Commissioner has come to the view that the requisite purpose exists and thus that section 177EA applies to the Buy-Back. The allocation of the Buy-Back Price between share capital and retained profits and the structure of the Buy-Back, including the tender process and scale back mechanisms, are 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 those covered by paragraphs 177EA(17)(b), (c), (g) and (j).

113. Among the circumstances of the Buy-Back reflected in those paragraphs are: the proportion of dividend to capital in the Buy-Back Price; the structure of the Buy-Back, including the tender process and scale back mechanisms which direct franking credits to those shareholders that are able to take the greatest advantage of them; the delivery of franking credits in excess of what would otherwise have 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; and the fact that participating shareholders are more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

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

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