

CR 2005/31 - Income tax: off-market share buy-back: Seek Limited

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Class Ruling

Income tax: off-market share buy-back: Seek Limited

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax laws, Class of persons and Qualifications** sections), **Date of effect, Withdrawal, Arrangement and Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

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

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- subsection 6(4) 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; and
- section 159GZZP of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders holding ordinary shares of Seek Limited (Seek) who disposed of shares under the Seek off-market share buy-back (the Buy-Back) announced on 23 March 2005 and completed on 20 April 2005, and described in the Arrangement part of this Ruling.

4. The class of persons to which this Ruling applies does not include Seek. The Ruling does not deal with how the taxation law applies to Seek in relation to the Buy-Back.

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 23.
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 - this Ruling may be withdrawn or modified.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 2005. 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 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

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 28 January 2005;
- An amended application for Class Ruling sent by PriceWaterhouseCoopers on 10 February 2005; and
- Correspondence from PriceWaterhouseCoopers dated 10, 16 and 28 February 2005, 1 March 2005 and 20 April 2005.

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

12. Seek was an unlisted public company with over 100 shareholders up until it listed on the Australian Stock Exchange on 18 April 2005. It carries on an online employment business.

13. On 23 March 2005 Seek announced its intention to participate in an off-market buy-back. Seek announced it would spend approximately \$140 million to buy-back up to 30% of the shares on issue as at 18 March 2005.

14. As at 30 June 2004 Seek's share capital was comprised of 88,393,822 issued shares, amounting to \$39.792 million. It had accumulated losses of \$2.488 million and its franking account balance was nil.

15. The shareholders in Seek are a mix of resident and non-resident individuals, companies and superannuation funds.

16. Approximately 6% of the issued share capital is held by non-residents.

17. Seek initiated an Initial Public Offer (IPO) process to raise new capital and to facilitate a sell-down by existing shareholders. The Buy-Back was contingent on the IPO successfully occurring. Linking the IPO with the sell-down avoids the legal and commercial complications of potential vendors offering shares direct to the market.

18. Prior to the Buy-Back a share split occurred providing a greater number of shares to the market for the IPO. The share split applied to all shareholders and did not change each shareholder's percentage holding in Seek.

19. Under the IPO arrangements, new shares were issued to the market and the cash raised was credited to a special purpose bank account.

20. The Buy-Back was an equal access off-market share buy-back, whereby registered shareholders as at 18 March 2005 had the option of selling up to 100% of their shareholdings, subject to an overall cap. Where the number of offers exceeded the cap, then all accepting shareholders were scaled back proportionately.

21. The price of the Buy-Back was determined by reference to the Institutional book-build that determined the price of the shares offered to the public and institutions, that is, it was determined by reference to the market price.

22. Under the Buy-Back, \$2.10 (the Buy-Back price) per share was debited to Seek's untainted share capital account.

23. On 20 April 2005, Seek announced:

- that it had completed the Buy-Back of 65.38 million Seek shares;
- the total amount of capital repurchased under the Buy-Back was \$137.30 million, representing 18.95% of the issued capital of Seek; and
- the final price for the Buy-Back was set at \$2.10 per share.

Ruling

24. Subsection 6(4) of the ITAA 1936 would apply to the amount debited to the share capital account to treat it as a dividend. However, subsection 159GZZZP(2) of the ITAA 1936 provides that the amount of the purchase price of a share in an off-market share buy-back that is debited to a share capital account is taken not to be a dividend for the purposes of the Act. Accordingly, no amount of the purchase price is a dividend in the hands of the participating shareholders.

25. The Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the distribution. The distribution will, therefore, not be taken to be a dividend for income tax purposes.

Explanation

Dividends

26. Subsection 44(1) of the ITAA 1936 includes in a resident shareholder's assessable income a dividend, as defined by subsection 6(1) of the ITAA 1936, that is paid to the shareholder out of company profits.

27. Excluded from this definition of a dividend are amounts debited against amounts standing to the credit of share capital account provided the money is not paid under any arrangement involving:

- a person paying or crediting any money or giving property to the company and the company crediting its share capital account with the amount of money or the value of the property; and
- the company paying or crediting any money or distributing property to another person and debiting its share capital account with the amount of the money or the value of property paid, credited or distributed (subsection 6(4) of the ITAA 1936).

28. Division 16K of Part III of the ITAA 1936 sets out the effect of share buy-backs. In particular, 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 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 shareholder out of profits derived by the company on the day of the buy-back. The remainder of the purchase price is not taken to be a dividend for the purposes of the ITAA 1936.

29. As the majority of money Seek raised from the IPO was used to fund a buy-back of shares held before the IPO, the arrangement is one that subsection 6(4) would apply to treat the amount debited to the share capital account as a dividend.

30. However, section 159GZZZP limits the amount of the dividend to zero (this being the difference between the purchase price of shares bought back and the amount which is debited against the company's share capital account).

31. Share capital account is defined in subsection 6(1) of the ITAA 1936 as having the meaning given by section 6D of the ITAA 1936, which in turn defines the term as an account which the company keeps of its share capital, or any other account created after 1 July 1998 where the first amount credited to the account was an amount of share capital.

32. Subsection 6D(3) states that an account is not a share capital account if it is tainted for the purposes of Division 7B of Part IIIAA of the ITAA 1936. An account, that would otherwise be a share capital account, is tainted for the purposes of Division 7B if an amount is transferred from another account except in the circumstances provided for by section 160ARDM of the ITAA 1936. Seek has confirmed that the share capital account is not tainted within the meaning of section 160ARDM of the ITAA 1936. It is also noted that the buy-back will be funded from a special bank account set up to receive the cash from the IPO.

33. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if either applies, allow the Commissioner to determine that all or part of a distribution is treated as an unfrankable dividend that is paid by the company out of profits.

Section 45A of the ITAA 1936 – streaming of dividends and capital benefits

34. In broad terms, for the Commissioner to make a determination under subsection 45A(2) of the ITAA 1936 that section 45C of the ITAA 1936 applies, a company must stream capital benefits to its advantaged shareholders and pay dividends to its disadvantaged shareholders, whether in the same income year or in different income years.

35. Under the arrangement, it is open to all of the ordinary shareholders to participate and, furthermore, the circumstances of the arrangement do not suggest that it is one whereby the company streams capital benefits to some shareholders in such a way that the capital benefits will be received by shareholders who would derive a greater benefit from the capital benefits than other shareholders who will receive dividends.

Section 45B of the ITAA 1936 – schemes to provide capital benefits in substitution for dividends

36. Section 45B of the ITAA 1936 applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
- 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) of the ITAA 1936); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

37. A distribution of capital constitutes the provision of a capital benefit under subsection 45B(5) and, as provided by subsection 45B(9), a taxpayer obtains a tax benefit if the tax payable on the capital benefit is less than it would have been had the capital benefit been a dividend, which would ordinarily be so. In this case, whilst the conditions of paragraphs 45B(2)(a) and (b) are met, the requisite purpose of enabling the shareholder to obtain a tax benefit (by way of a capital distribution) is not present.

38. However, having regard to the relevant circumstances of the scheme (the Buy-Back), as set out in subsection 45B(8), it cannot be concluded that a person would enter into, or carry out, the Buy-Back for a more than incidental purpose of enabling a Seek shareholder to obtain a tax benefit. The Buy-Back consideration cannot be said to be attributable to the profits of Seek, nor does the pattern of distributions that have been made by Seek in the past indicate that the Buy-Back is being paid in substitution of a dividend. As at 30 June 2004 Seek had accumulated losses of \$2.488 million. On 13 October 2004, Seek paid its first dividend, a fully franked dividend of 14 cents per share from the anticipated profits for the year ended 30 June 2005. After the payment of this dividend the balance of accumulated profits account for the year ended 30 June 2005 will be less than \$1 million.

39. Although the share buy-back constitutes a scheme by which the shareholders who participate in it are provided with a capital benefit and obtain a tax benefit, enabling them to obtain a tax benefit is merely an incident of the arrangement. In other words, having regard to the relevant circumstances of the scheme, it would not be concluded that the parties to the scheme entered into it or carried it out for the requisite purpose to attract the application of section 45B.

40. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the distribution.

Section 45C of the ITAA 1936 – deeming dividends to be paid where sections 45A or 45B determinations have been made

41. As the Commissioner will not make a determination under subsection 45A(2) of the ITAA 1936 or subsection 45B(3) of the ITAA 1936 in relation to the arrangement as described, section 45C will not deem any part of the return of capital distribution to be an unfranked dividend for the purposes of the ITAA 1936 or ITAA 1997.

Detailed contents list

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Commissioner of Taxation

11 May 2005

<i>Previous draft:</i>	- ITAA 1936 45A
Not previously issued as a draft	- ITAA 1936 45A(2)
	- ITAA 1936 45B
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(2)(a)
CR 2001/1; TR 92/1; TR 97/16	- ITAA 1936 45B(2)(b)
	- ITAA 1936 45B(2)(c)
	- ITAA 1936 45B(3)
<i>Subject references:</i>	- ITAA 1936 45B(5)
- share buy-backs	- ITAA 1936 45B(8)
	- ITAA 1936 45B(9)
<i>Legislative references:</i>	- ITAA 1936 45C
- Copyright Act 1968	- ITAA 1936 Pt III Div 16K
- TAA 1953 Pt IVAAA	- ITAA 1936 159GZZZP
- ITAA 1936 6(1)	- ITAA 1936 159GZZZP(2)
- ITAA 1936 6(4)	- ITAA 1936 Pt IIIAA Div 7B
- ITAA 1936 6D	- ITAA 1936 160ARDM
- ITAA 1936 6D(3)	
- ITAA 1936 44(1)	

ATO references

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