



# ***CR 2006/23 - Income tax: off-market share buy-back: St George Bank Limited***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 July 2005*



## Class Ruling

### Income tax: off-market share buy-back: St George Bank Limited

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Contents	Para
<b>BINDING SECTION:</b>	
What this Ruling is about	1
Date of effect	9
Withdrawal	10
Scheme	11
Ruling	32
<b>NON BINDING SECTION:</b>	
Appendix 1:	
Explanation	45
Appendix 2:	
Detailed contents list	97

#### **① This Ruling provides you with the following level of protection:**

This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the relevant taxation provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

#### **Relevant taxation provision(s)**

2. The tax provisions 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;
  - paragraph 128B(3)(ga) of the ITAA 1936;
  - Division 16K of Part III of the ITAA 1936;
  - Division 1A of Part IIIAA of the ITAA 1936;
  - section 177EA of the ITAA 1936;
  - Part 2-25 of the *Income Tax Assessment Act 1997* (ITAA 1997);
  - section 104-10 of the ITAA 1997;

- Subdivision 115-A of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- section 118-20 of the ITAA 1997;
- section 118-25 of the ITAA 1997;
- section 136-10 of the ITAA 1997;
- section 136-25 of the ITAA 1997;
- section 202-5 of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 202-45 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997; and
- section 207-145 of the ITAA 1997.

## **Class of entities**

3. The class of entities to which this Ruling applies is the shareholders of St George Bank Limited (St George), who disposed of shares under St George's off-market share buy-back of ordinary shares which was announced on 16 December 2005 and described in the Scheme part of the Ruling. In this Ruling these shareholders are referred to as 'Participating Shareholders'.

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

## **Qualifications**

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

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 11 to 31 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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## Date of effect

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9. This Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) for a Participating Shareholder in which that shareholder disposed of shares under the St George off-market share buy-back of ordinary shares described in the arrangement part of the Ruling. The arrangement will be completed within that income year. For Participating Shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2006. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by *Gazette*; or
- the relevant tax provisions are not amended.

## Withdrawal

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10. This Ruling is withdrawn and ceases to have effect after 30 June 2006. 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 scheme during the term of the Ruling subject to there being no change in the scheme or in the person's involvement in the scheme.

## Scheme

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11. The scheme 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 the description of the arrangement are:

- the application for a Class Ruling dated 14 October 2005; and
- correspondence from Greenwoods & Freehills dated 8 September 2005, 27 September 2005, 14 October 2005, 21 October 2005 and 26 October 2005 and 23 February 2006.

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

12. St George is an Australian incorporated company listed on the Australian Stock Exchange (ASX).

13. On 16 December 2005 St George announced its intention to make an off-market buy-back of its own ordinary shares ('the Buy-Back').

14. In its announcement, St George stated that it would spend around \$300 million in purchasing its own ordinary shares (although it could choose to buy-back a lesser amount or none at all).

15. The Consolidated Balance Sheet as at 30 September 2005 disclosed total shareholder's equity of \$5,333 million, consisting of \$4,105 million contributed share capital, \$781 million retained profits, and \$94 million reserves.

16. The shareholders in St George are a mix of individuals, companies, superannuation funds and other institutional investors, some of whom are non-residents. Certain employees and non-resident shareholders were not eligible to participate in the Buy-Back.

17. St George advised that the Buy-Back forms part of its continuing capital management strategy that aims to return capital that is surplus to its needs. St George anticipates that the Buy-Back will have positive effects in the longer term on earnings per share and returns on equity.

18. The Buy-Back was conducted through a tender process and was open to all eligible shareholders who were registered on the Record Date for the Buy-Back (29 December 2005). The tender period opened on 30 January 2006 and closed on 17 February 2006. Shares acquired on an ex-entitlement basis on or after the Ex-entitlement Date (21 December 2005) carried no entitlement to participate. Participation in the Buy-Back was voluntary, and eligible shareholders not wishing to participate were not required to do anything.

19. Under the tender process, shareholders submitted offers to sell up to 100% of their shareholding at specified discount percentages to the Market Price. Market Price was calculated by reference to the volume weighted average price (VWAP) of St George ordinary shares on the ASX over the five trading days up to and including the closing day of the tender period (17 February 2006). The discounts to Market Price were within the range of between 8% and 14% inclusive, in 1% intervals (subject to a maximum discount of 14%).

20. In addition to specifying a certain discount percentage, shareholders were also provided with an option to select a minimum buy-back price ('Minimum Buy-Back Price') as a condition of their tender.

21. Shareholders were also permitted to submit a final price tender which meant they offered to sell their shares for the price determined by St George under the tender process (Final Price Tender).

22. The price at which the Shares were purchased under the Buy-Back (the Buy-Back Price) was arrived at under a book-build process to determine the greatest discount to the Market Price that enabled St George to purchase the desired amount of capital.

23. Tenders made at a discount percentage less than the discount percentage determined by St George were not accepted. Tenders made at a discount percentage equal to or greater than the discount percentage or at the Final Price Tender were accepted in full. All shareholders whose tenders were successful received the Buy-Back Price.

24. Tenders made at a Minimum Buy-Back Price that was greater than the Buy-Back Price were not accepted.

25. The Buy-Back Price was subject to two overriding limits:

- (a) St George would not buy-back shares at a discount greater than 14% to the VWAP of St George shares over the five (5) trading days up to and including the closing day of the tender period (17 February 2006); and
- (b) The Buy-Back Price would not exceed the market value of St George shares determined in accordance with TD 2004/22.

26. Subject to paragraphs 27 and 28 of this Ruling, if more shares were tendered at or below the Buy-Back Price and at the Final Price Tender than the total number of shares St George wished to buy back, then these tenders were scaled-back.

27. Under the scale-back process, a priority allocation of 180 shares is bought back from each shareholder who tendered more shares than the priority allocation at the Buy Back Price. A shareholder who tenders a number of shares equal to or less than the priority allocation at the Buy Back Price has all of their shares tendered bought back.

28. Notwithstanding the scale-back, any shareholder who tendered all of their shares at or below the Buy-Back price, or as Final Price Tenders, and would following any scale-back be left with 70 shares or less, would have all of their shares tendered bought-back in full.

29. All shares bought back under the Buy-Back were cancelled.

30. Under the Buy-Back, \$6.54 was debited against the untainted share capital account of St George and the balance of the Buy-Back Price was debited against the retained earnings account of St George.

31. On 21 February 2006, St George announced that:

- it had successfully completed the off-market share buy-back of 11.677 million shares, representing 2.24% of the issued capital of St George;
- the total amount of capital repurchased under the Buy-Back was approximately \$300 million;
- the final price paid by St George for shares bought back under the Buy-Back was set at \$25.69 per share, representing a discount of 14% to the VWAP of St George shares over the 5 days up to and including the closing date of the Buy-Back;
- shares tendered at a discount of 14% or as a final price tender were accepted in full, subject to a scale-back (outlined in paragraphs 26-28 of this Ruling); and
- shares tendered above \$25.69 per share were not accepted.

## Ruling

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### The Dividend Component

32. Participating Shareholders will be taken to have been paid a dividend of \$19.15 ('the Dividend Component') for each share bought back under section 159GZZZP of the ITAA 1936.

33. The Dividend Component is a frankable distribution pursuant to section 202-40 of the ITAA 1997 and is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

### Assessability of the Dividend Component and Tax Offset

34. The Dividend Component and an amount equal to the franking credit on the Dividend Component ('gross-up'), is included in the assessable income of resident individual, superannuation fund and company shareholders who participate in the Buy-Back. Those shareholders will be entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend Component ('tax offset'), subject to being a 'qualified person' (see paragraph 41 of this Ruling).

**Non-resident shareholders**

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

**The Capital Component (Sale Consideration)**

36. Participating Shareholders are taken to have received \$10.59 as consideration in respect of the sale of each of their shares bought back under the Buy-Back ('Sale Consideration') in accordance with section 159GZZZQ of the ITAA 1936 (unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and (9) apply).

37. Where a Participating Shareholder is a corporate tax entity, which is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the Dividend Component, an adjustment may be made to the Sale Consideration in accordance with subsection 159GZZZQ(8) and subsection 159GZZZQ(9) of the ITAA 1936.

38. Taxation Determination TD 2004/22 provides a methodology to determine what would have been 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. If the Buy-Back Price for each share bought 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, in accordance with TD 2004/22, the market value rule in subsection 159GZZZQ(2) of the ITAA 1936 applies to the Buy-Back. The effect of this rule is that the difference between the Buy-Back Price and the market value determined in accordance with TD 2004/22, an amount of \$4.05, is included in the consideration received for the disposal of the share for ordinary income or capital gains tax purposes in addition to the capital amount of \$6.54 per share. Accordingly, the Sale Consideration is \$10.59.

39. The treatment of the Sale Consideration amount for tax purposes will depend 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 Sale Consideration represents the capital proceeds for CGT event A1 that happens if a share is bought back: note 3 to subsection 116-20(1) of the ITAA 1997. A shareholder will make a capital gain on a share if the capital proceeds of \$10.59 exceeds 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 \$10.59 are less than the reduced cost base of the share: subsection 104-10(4) of the ITAA 1997.



- The time of the CGT event is 21 February 2006: paragraph 104-10(3)(a) of the ITAA 1997.
- (b) Shares held on revenue account**
- Where the shares are held as trading stock, the Sale Consideration of \$10.59 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 \$10.59 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$10.59, the difference will be an allowable deduction.

## **Non-resident shareholders**

40. A non-resident shareholder that participates in the Buy-Back will only make a capital gain or capital loss if their share has the necessary connection with Australia under the tests in section 136-25 of the ITAA 1997. A St George share will have the necessary connection with Australia if, at any time during the 5 years before 21 February 2006, the shareholder together with their associates owned 10% or more by value of the issued shares in St George.

## **Qualified persons**

41. For the purposes of Division 1A of Part IIIAA of the ITAA 1936 Participating Shareholders will 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 6 January 2006 (however, it should be noted that shares acquired on or after the ex-entitlement date (21 December 2005) carried no entitlement to participate in the buy-back, and in order to participate a shareholder was required to be registered on the Record Date for the Buy-Back (29 December 2005)); and
- (b) during the period in which the shares or interests 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**

42. 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 Capital Component of the Buy-Back Price received by Participating Shareholders.

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

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

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**Commissioner of Taxation**12 April 2006

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## Appendix 1 – Explanation

**①** *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

### The Dividend and Capital Components

45. The purchase price received by Participating Shareholders (the Buy-Back Price) comprises two components:

- a Dividend Component; and
- a Capital Component.

46. 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 Buy-Back.

### The Dividend Component

47. Section 159GZZZP of the ITAA 1936 provides that where the buy-back of a share is an off-market purchase, the difference between the Buy-Back price and the part (if any) of the Buy-Back price which is debited against the 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 purchase price was \$25.69 per share and \$6.54 of this was debited against the share capital account. Thus, the dividend amount is \$19.15 per share.

48. The dividend amount of \$19.15 per share is a frankable distribution but only to the extent that the Buy-Back Price does not exceed 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: paragraph 202-45(c) of the ITAA 1997. TD 2004/22 outlines how to determine what would have been 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.

49. In this case, the Buy-Back Price did not exceed the market value of St George shares determined in accordance with TD 2004/22. The dividend is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997. St George fully franked the distribution and the amount of the franking credit was \$8.21 per share.

50. For Australian resident individual, superannuation funds and company shareholders, the dividend amount is included in their assessable income under subsection 44(1) of the ITAA 1936. Generally, an amount equal to the amount of the franking credit is included in their assessable income under subsection 207-20(1) of the ITAA 1997 (gross up). These shareholders are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 reflecting the franking credit attached to the dividend.

51. However, it should be noted that provisions exist which may deny a gross up or tax offset in certain circumstances. For example, paragraph 207-145(1)(a) of the ITAA 1997 requires that a shareholder be a 'qualified person for the purposes of Division 1A of Part IIIA of the ITAA 1936' to obtain a gross up or tax offset. Broadly speaking, to be a 'qualified person' in relation to the dividend a taxpayer must satisfy both the holding period rule (or certain alternative rules) and the related payments rule. See paragraphs 68 to 78 of this Ruling.

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

### **The Capital Component (Sale Consideration)**

53. Participating Shareholders are taken to have sold those shares accepted under the Buy-Back on 21 February 2006. The sale may have different taxation implications for shareholders depending on how the shares were held, for instance:

- 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 of Part 2-25 of the ITAA 1997; and
- an investor who held their shares on capital account will be subject to the capital gains tax provisions contained in Parts 3-1 and 3-3 of the ITAA 1997.

54. It should be noted that any capital gain will be reduced where the Participating Shareholder held the share on revenue account and included a gain from the share's sale in their assessable income: see section 118-20 of the ITAA 1997. If the shares are held as trading stock, the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

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

56. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the Participating Shareholder is taken to have received an amount equal to the Buy-Back Price as consideration in respect of the sale of the share bought back. However, this consideration is subject to certain adjustments in order to arrive at the Sale Consideration.

57. Subsection 159GZZZQ(2) of the ITAA 1936 is one of the adjusting provisions. It provides that if the Buy-Back 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 Participating Shareholder is taken to have received an amount equal to the market value as consideration in respect of the shares bought back.

58. For the purposes of determining the application of subsection 159GZZZQ(2) of the ITAA 1936 to the market value of each St George share, the following methodology has been proposed by St George and accepted by the Commissioner in accordance with TD 2004/22: the market value of each share is the VWAP of the company's share on the ASX over the last five trading days before the first announcement of the Buy-Back on 16 December 2005, adjusted for the percentage change in the S&P/ASX 200 Financials-x-Property Trusts Index from the commencement of trading on that date (the Opening S&P/ASX 200 Financials-x-Property Trusts Index) to the close of trading on 17 February 2006, the day the Buy-Back closes (the Closing S&P/ASX 200 Index).

59. Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$29.74. Thus, the Participating Shareholders are taken to have received \$29.74 for the sale of each share ('Deemed Consideration'), rather than the Buy-Back Price of \$25.69.

60. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the Deemed Consideration of \$29.74 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 Buy-Back, the Reduction Amount is equivalent to the Dividend Component, that is, \$19.15.

61. Thus, the Sale Consideration determined under section 159GZZZQ is \$10.59, calculated as follows:

Deemed Consideration (Market value)	\$29.74
less the Reduction Amount (Dividend Component)	<u>\$19.15</u>
Sale Consideration	\$10.59

62. However, it should be noted that where the Participating Shareholder is a corporate tax entity, which is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the Dividend Component, an adjustment may be made to the Sale Consideration. Under subsection 159GZZZQ(8) of the ITAA 1936 if that shareholder would otherwise incur either a capital loss or a deductible loss (or any increase in such a loss) in respect of a share bought back under the Buy-Back, the Sale Consideration is increased by so much of the offsetable amount (worked out in accordance with subsection 159GZZZQ(9) of the ITAA 1936) that does not exceed the capital loss or the deductible loss.

### **Sale of shares – CGT consequences**

63. CGT event A1 in section 104-10 of the ITAA 1997 will happen to each share that is disposed of to St George under the Buy Back. The time of the CGT event is 21 February 2006. This is the date on which a contract is formed between St George and each Participating Shareholder: paragraph 104-10(3)(a) of the ITAA 1997.

64. In working out the capital gain or capital loss on the disposal of each share, the capital proceeds for the disposal are equal to the Sale Consideration: see note 3 to subsection 116-20(1) of the ITAA 1997.

65. A Participating Shareholder will make a capital gain on the disposal of a share if the capital proceeds of \$10.59 exceeds the cost base of that share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder will make a capital loss if the capital proceeds of \$10.59 are less than the reduced cost base of the share: subsection 104-10(4) of the ITAA 1997.

66. A capital gain made on a share that is bought back will be a discount capital gain if the share was acquired at least twelve months before the time of the CGT event and the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.

### **Non-resident shareholders**

67. Pursuant to section 136-10 of the ITAA 1997, a non-resident Participating Shareholder will make a capital gain or a capital loss from the sale of a share under the Buy-Back only if the share has the necessary connection with Australia. Under category 5 of the table in section 136-25 of the ITAA 1997, a St George share will have the necessary connection with Australia if, at any time during the 5 years before 21 February 2006, the shareholder, together with their associates, owned 10% or more by value of the issued shares in St George.

### **Qualified person**

68. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked distribution made to an entity only 'a qualified person in relation to the distribution for the purposes of Division 1A of Part IIIA of the ITAA 1936' is entitled to a franking credit or tax offset.

69. In order to be a 'qualified person' in relation to the Dividend Component paid under the Buy-Back, the Participating Shareholders must satisfy the holding period rule and the related payments rule.

70. In general terms, a shareholder will not satisfy the related payments rule if the shareholder, or an 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.

71. The holding period rule requires the Participating Shareholders to hold the shares, or the interest in the shares, on which the dividend is paid at risk for a continuous period of 45 days. In determining whether a shareholder has satisfied the holding period rule, any days during which there is a materially diminished risk of loss or opportunities for gain in relation to the relevant shares are not counted. The day of acquisition and the day of disposal of the relevant shares are also not counted.

72. Under subsection 160APHM(2) of the ITAA 1936, a shareholder is taken to have materially diminished the risks of loss and opportunities for gain with respect to shares or interests in shares if the 'net position' of the shareholder results in the shareholder having less than 30% of the risks and opportunities relating to the shares or interest in shares.

73. In this case, the Commissioner does not regard the announcement of the Buy-Back offer as affecting whether the shares were held at risk or not.

74. There are 45 clear days between 6 January 2006 and 21 February 2006, (that is, the date the tender offer was accepted). Therefore, a shareholder who acquired shares on or before 6 January 2006 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A person who acquired shares after 6 January 2006 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.

75. Shares acquired on an ex-entitlement basis on or after the ex-entitlement date (21 December 2005) carried no entitlement to participate in the Buy-Back. In order to participate in the Buy-Back shareholders must be registered on the Record Date (29 December 2005).

76. Generally, under the holding period rule, the 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 the most recently acquired shares first for the purposes of applying the 45 day rule.

77. For the purposes of subsection 160APHI(4) of the ITAA 1936, St George shares acquired by Participating Shareholders which do not confer an entitlement to participate in the Buy-Back do not constitute 'related securities' to any St George shares held by the shareholder which do confer an entitlement to participate in the Buy-Back.

78. Accordingly, subsection 160APHI(4) of the ITAA 1936 will not apply in relation to shares disposed of into the Buy-Back where a Participating Shareholder acquired, on or after 6 January 2006, any additional St George shares that did not confer an entitlement to participate in the Buy-Back.

## **The anti-avoidance rules**

### ***Sections 45A and 45B of the ITAA 1936***

79. It was noted at paragraph 30 of this Ruling that St George debited \$6.54 of the Buy-Back Price to its untainted share capital account. This amount is a distribution of capital to Participating Shareholders.

80. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of the determination is that all or part of the distribution of capital received by the shareholder under the Buy-Back is taken to be an unfranked dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

81. 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 benefits and it is reasonable to assume the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

82. Although a capital benefit, as defined in paragraph 45A(3)(b), 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.

83. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. In broad terms, section 45B 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 or more 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).

84. In the case of the Buy-Back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, the requisite purpose of enabling the Participating Shareholder to obtain a tax benefit – by way of capital distribution – was not present.

85. Having regard to the 'relevant circumstances' of the scheme (the Buy-Back) as set out in subsection 45B(8), there was not a 'more than incidental' purpose, by way of capital distribution, of enabling the Participating Shareholders to obtain a tax benefit. Further, the Capital Component of the Buy-Back cannot be said to be attributable to the profits of the company, nor does the pattern of distributions that have been made by St George in the past indicate that the Capital Component was being paid in substitution for a dividend. Accordingly, section 45B has no application to the Buy-Back.



**Section 177EA of the ITAA 1936**

86. Section 177EA 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.

87. Specifically, subsection 177EA(3) provides that section 177EA applies if:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity;
- (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, to a person in respect of the interest in membership interests, as the case may be;
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit;
- (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.

88. In the present case, the conditions of paragraphs 177EA(3)(a) to (d) have been satisfied. Accordingly, the issue is whether having regard to the relevant circumstances of the scheme, it would be considered that, on the part of St George, 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 the St George Buy-Back arrangement, the relevant taxpayer is the Participating Shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

89. 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).

90. 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.

91. 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 these 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 lower 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 of 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.

92. 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).

### ***Section 204-30 of the ITAA 1997***

93. Section 204-30 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).

94. If section 204-30 applies, the Commissioner is vested with a 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); and
- (b) that no imputation benefit is to arise in respect of distributions made to a favoured member and specified in the determination: paragraph 204-30(3)(c).

95. 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 'derive 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.

96. A significant portion of St George's shareholding was held by non-residents who do not fully benefit from franking, a feature of the Buy-Back, to the same extent as resident shareholders. Thus, the conditions of subsection 204-30(1) for the provision to apply are met. However, the Commissioner will not make a determination under section 204-30.

## **Appendix 2 – Detailed contents list**

97. The following is a detailed contents list for this Ruling:

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Relevant taxation provision(s)	2
Class of entities	3
Qualifications	5
<b>Date of effect</b>	<b>9</b>
<b>Withdrawal</b>	<b>10</b>
<b>Scheme</b>	<b>11</b>
<b>Ruling</b>	<b>32</b>
The Dividend Component	32
Assessability of the Dividend Component and Tax Offset	34
Non-resident shareholders	35
The Capital Component (Sale Consideration)	36
Non-resident shareholders	40
Qualified persons	41
The anti-avoidance provisions	42
<b>Appendix 1 – Explanation</b>	<b>45</b>
The Dividend and Capital Components	45
The Dividend Component	47
The Capital Component (Sale Consideration)	53
Sale of shares – CGT consequences	63
Non-resident shareholders	67
Qualified person	68
The anti-avoidance rules	79
<i>Sections 45A and 45B of the ITAA 1936</i>	79
<i>Section 177EA of the ITAA 1936</i>	86
<i>Section 204-30 of the ITAA 1997</i>	93
<b>Appendix 2 – Detailed contents list</b>	<b>97</b>

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Not previously issued as a draft

### *Related Rulings/Determinations:*

TD 2004/22

### *Subject references:*

- dividend streaming arrangements
- share buy backs

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