

CR 2006/6 - Income tax: off-market share buy-back: Westpac Banking Corporation

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Class Ruling

Income tax: off-market share buy-back: Westpac Banking Corporation

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ⓘ 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 under-paid 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

1. This Ruling sets out the Commissioner's opinion on the way in which the '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:
- sections 159GZZZP and 159GZZZQ (Effect of off-market buy-back of Shares) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 45A (Streaming of Dividends and Capital) of the ITAA 1936;
 - section 45B (Schemes to Provide Certain Benefits) of the ITAA 1936;
 - section 90 (Partnerships) of the ITAA 1936;
 - subsection 95(1) (Trust income) of the ITAA 1936;
 - paragraph 128B(3)(ga) (Liability to withholding tax) of the ITAA 1936;
 - sections 202-40 and 202-45 (Franking of distributions) of the *Income Tax Assessment Act 1997* (ITAA 1997);

- section 204-30 (Dividend Streaming) of the ITAA 1997;
- sections 207-20 and 207-57 (Distribution gross-up and tax offset) of the ITAA 1997;
- paragraph 207-145(1)(a) of the ITAA 1997 and Division 1A of Part IIIAA of the ITAA 1936 (Qualified Person); and
- section 177EA (Creation of franking debit or cancellation of franking credits) of the ITAA 1936.

Class of entities

3. The class of entities to which this Ruling applies is shareholders of Westpac Banking Corporation (Westpac) who disposed of shares under the Westpac off-market share buy-back (the Buy-Back) announced on 2 November 2005 and described in the Scheme part of this Ruling. In this Ruling they are referred to as 'participating shareholders'.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. 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 10 to 26.

6. 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

8. This Class Ruling applies to the income year (as defined in the ITAA 1997) for a participating shareholder in which that shareholder disposed of shares under the 2005 Westpac off-market buy-back of ordinary shares described in the Scheme part of the Ruling. 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 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

9. This Class 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 enter 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.

Scheme

10. The scheme 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 incorporated into this description of the arrangement are:

- the application for Class Ruling from Allens Arthur Robinson dated 15 September 2005;
- the Westpac Banking Corporation Buy-Back Tender Booklet provided to shareholders; and
- further information provided 4 October 2005, 11 October 2005, 21 October 2005, 24 October 2005, 31 October 2005, 2 November 2005 and 3 November 2005.

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

11. Westpac is an Australian resident listed company which had 1,868,520,761 shares on issue as at 30 September 2005 and 266,151 shareholders as at 5 October 2005.
12. On 2 November 2005 Westpac announced an off-market buy-back of its shares (the Buy-Back). The Buy-Back is an 'off-market purchase' as defined in paragraph 159GZZZK(d) of the ITAA 1936.
13. The financial statements of Westpac as at 30 September 2005 show total share capital of approximately \$5,296 million and retained profits of approximately \$7,636 million. The franking account balance as at 30 September 2005 was approximately \$583 million.
14. Westpac estimated that as at 30 September 2005 approximately 36% of its ordinary shares were held by individuals and 41% of the ordinary shares were held by companies and institutional investors (constituted by companies, funds, trusts etc). Westpac also estimated that approximately 77% of its ordinary shares were held by Australian residents.
15. Westpac has stated that its reason for undertaking the Buy-Back is to better align the growth in total cash earnings of the company with cash earnings per share.
16. The Buy-Back was implemented through a tender process. The Buy-Back tender period opened on 28 November 2005 and closed at 9pm on 16 December 2005. All ordinary shareholders of Westpac (excluding employees holding shares restricted from sale or subject to potential forfeiture and certain non-resident shareholders) were invited to tender up to 100% of their Westpac shares, as registered on the record date of 14 November 2005.
17. Under the tender process, shareholders were invited to submit offers to sell their shares at any of the specified discounts to the volume weighted average price of Westpac's ordinary shares over the 5 trading days up to and including the closing date of the Buy-Back tender period, excluding certain trades considered to be not at-market, (the VWAP). The tender discounts to the VWAP were within the range of 8% to 14%, inclusive, in 1% intervals.
18. Alternatively, shareholders were able to submit a 'Final Price Tender' (which means that the shareholder was willing to accept the Buy-Back Price, whatever it was determined to be). Participation by shareholders in the Buy-Back was voluntary.
19. In addition, shareholders also had the option of making their tender conditional on the Buy-Back Price being no less than one of several specified Minimum Prices. The effect of this was that if the Buy-Back Price was below the specified Minimum Price, the tender would be rejected.
20. Shareholders were able to revoke a tender up to and including 16 December 2005, the final day of the tender period.

21. Only shareholders who tendered shares at or below the Buy-Back Price (being the price determined through the tender process by applying the selected Buy-Back Discount to the VWAP) had their shares bought back. All shareholders whose tenders were successful received the same Buy-Back Price. Tenders at prices below the Buy-Back Price (including Final Price Tenders) were accepted in full.
22. The Buy-Back included a scale back mechanism. If more shares were tendered at and below the Buy-Back Price than Westpac wished to repurchase, then tenders at the Buy-Back Price were to be scaled back as follows:
- (i) if the Buy-Back Discount was 14%, the first 200 shares tendered by each shareholder at a 14% discount or as a Final Price Tender were to be accepted (*Priority Allocation*) with the balance of those tenders being scaled back on a pro-rata basis; or
 - (ii) if the Buy-Back Discount was between 8% and 13%, tenders at discounts greater than the Buy-Back Discount and Final Price Tenders were to be accepted in full, and tenders at the Buy-Back Discount were to be scaled back on a pro-rata basis without any Priority Allocation.
23. Participating shareholders who tendered all of their shares at or below the Buy-Back Price, and who following the scale back were left with 100 shares or less had all of their shares bought back in full. The terms of the Buy-Back provided that announcement of the Buy-Back Price constituted acceptance by Westpac of each successfully tendering shareholder's offer to have their shares bought back by Westpac.
24. Shareholders who did not participate in the Buy-Back tender have not and will not receive any dividend or other distribution from Westpac (or any associated party) by way of compensation.
25. On 19 December 2005, Westpac announced that it had bought back 52.3 million shares at a Buy-Back Price of \$19.13 per share. This price represents a 14 per cent discount to the VWAP.
26. In relation to each share bought back, Westpac debited \$4.00 of the Buy-Back Price to its untainted share capital account and debited the remaining \$15.13 to its retained profits.

Ruling

The Dividend Component

27. Participating shareholders are taken to have been paid a dividend of \$15.13 on the date that the Buy-Back occurred (the Dividend Component) under section 159GZZZP of the ITAA 1936.

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

Assessability of the Dividend Component and tax offset

Direct distributions

29. 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 participated in the Buy-Back under subsection 44(1) of ITAA 1936 and subsection 207-20(1) of the ITAA 1997. 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, subject to being a 'qualified person' (see paragraphs 42 to 45).

Indirect distributions

Partnerships

30. The Dividend Component 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.

31. In a case where an individual partner, corporate partner, or a trustee partner specified by paragraph 207-45(c) or (d) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) has an individual interest in the partnership's net income that is covered by paragraph 92(1)(a) or (b) of the ITAA 1936 or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or (b) of the ITAA 1936, and the partner has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the partner is entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Trusts

32. The Dividend Component 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 that participates in the Buy-Back for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936.

33. In a case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified by paragraph 207-45(c) or (d) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) has a share of the trust's net income that is covered by paragraph 97(1)(a) of the ITAA 1936 or has an individual interest in the trust's net income that is covered by paragraph 98A(1)(a) or (b) or paragraph 100(1)(a) or (b) of the ITAA 1936, and the beneficiary has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the beneficiary is entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Refundable tax offset

34. The tax offsets are 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

35. The Dividend Component received by non-resident participating shareholders are exempt from withholding tax pursuant to paragraph 128B(3)(ga) of the ITAA 1936.

The Capital Component: Sale Consideration per share

36. The Buy-Back Price for each share bought back under the Buy-Back was less than the amount that 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 (as determined under Taxation Determination TD 2004/22). 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, in addition to the Capital Component of \$4.00 is treated as consideration received for the disposal of the share for ordinary income or capital gains tax purposes.

37. Participating shareholders are taken to have received \$5.18 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.

38. The treatment of this consideration amount for tax purposes will depend on whether the sale is on capital account or on revenue account.

Shares held on capital account

39. The Sale Consideration of \$5.18 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 Sale Consideration per share 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 Sale Consideration per share is less than the reduced cost base of a share.

40. The shares are taken to have been disposed of for capital gains tax purposes on 19 December 2005 pursuant to section 104-10 of the ITAA 1997.

Shares held on revenue account

41. Where the shares are held as trading stock, the Sale Consideration of \$5.18 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 \$5.18 per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$5.18 per share the difference is an allowable deduction.

Qualified person

42. For the purposes of Division 1A of Part IIIAA of the ITAA 1936, as it was in force on 30 June 2002, participating shareholders are considered to satisfy the holding period rule under section 160APHO of the ITAA 1936 and therefore be qualified persons (as long as the related payments rule is also met) in relation to the dividend received under the Buy-Back if:

- (i) the shares sold into the Buy-Back were acquired on or before 3 November 2005 (see paragraph 43); and
- (ii) during the period when the shares or interest in the shares were held and, for at least a continuous 45 day period, the shareholders did not have 'materially diminished risks of loss and opportunities for gain' (as defined in section 160APHM of the ITAA 1936) in relation to the shares. Neither the announcement of the Buy-Back, the making of an invitation to shareholders to offer to sell their Westpac shares nor the making of an offer by a shareholder to Westpac in respect of a Westpac share will affect whether the shares bought back under the Buy-Back are held 'at risk' for the purposes of Division 1A.

43. The 'last-in first-out' rule in subsection 160APHI(4) applies in relation to Westpac shares purchased before 8 November 2005, the day from which Westpac shares traded without the entitlement to participate in the Buy-Back.

44. A shareholder who acquired shares on or after 4 November 2005 that were subsequently accepted into the Buy-Back pursuant to the 'last-in first-out' rule is not a qualified person in relation to the Dividend Component under section 160APHO unless certain exceptions are met.

45. The 'last-in first-out' rule in subsection 160APHI(4) of the ITAA 1936 does not apply for the purposes of the Buy-Back to Westpac shares acquired on or after 8 November 2005 (the ex-entitlement date), as these shares did not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

46. Section 45 of the ITAA 1936 will not apply to the Buy-Back, and the Commissioner will not make a determination under section 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Component of the Buy-Back Price received by participating shareholders.

47. 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 of the Buy-Back Price by participating shareholders.

48. 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 of the Buy-Back Price by participating shareholders.

Commissioner of Taxation

8 February 2006

Appendix 1 – Explanation

❶ ***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.***

49. The purchase price received by participating shareholders comprises two components:

- a Dividend Component; and
- a Capital Component.

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

The Dividend Component

50. Section 159GZZZP of the ITAA 1936 provides that where the buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price which is debited to the share capital account of the company is taken to be a dividend paid by the company on the day the buy-back occurs. In this case the purchase price was \$19.13 and \$4.00 was debited to the share capital account. Thus the dividend amount is \$15.13.

51. The dividend component of \$15.13 per share is fully frankable as 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 (refer to paragraphs 72 and 73).

Assessability of the Dividend Component and tax offset

Direct distributions

52. 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 is included in the assessable income of each shareholder under subsection 44(1) of the ITAA 1936; and
- subject to the ‘qualified person’ rule, 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).

53. Subject to the 'qualified person' rule, 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

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

55. In general terms, pursuant to subsection 207-50(2) of the ITAA 1997, a franked distribution will flow indirectly to a partner in a partnership where the partner:

- has an individual interest in the partnership's net income that is covered by paragraph 92(1)(a) or (b) of the ITAA 1936, or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or (b) of the ITAA 1936; and
- has a share of the franked distribution under section 207-55 of the ITAA 1997 that is a positive amount.

56. In general terms, pursuant to subsection 207-50(3) of the ITAA 1997, a franked distribution will flow indirectly to a beneficiary of a trust where the beneficiary:

- has a share of the trust's net income that is covered by paragraph 97(1)(a) of the ITAA 1936 or has an individual interest in the trust's net income that is covered by paragraph 98A(1)(a) or (b) or paragraph 100(1)(a) or (b) of the ITAA 1936; and
- has a share of the franked distribution under section 207-55 of the ITAA 1997 that is a positive amount.

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

Partnerships

58. Pursuant to subsection 44(1) of the ITAA 1936, 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.

59. Subject to the 'qualified person' rule, pursuant to subsection 207-35(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).

60. In the case where an individual partner, corporate partner, or a trustee partner specified by paragraph 207-45(c) or (d) 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) has an individual interest in the partnership's net income that is covered by paragraph 92(1)(a) or (b) of the ITAA 1936 or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or (b) of the ITAA 1936, and the partner has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the partner is, subject to the 'qualified person' rule, entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Trusts

61. Pursuant to subsection 44(1) of the ITAA 1936, the Dividend Component 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.

62. Subject to the 'qualified person' rule, pursuant to subsection 207-35(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).

63. In the case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified by paragraph 207-45(c) or (d) 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) has a share of the trust's net income that is covered by paragraph 97(1)(a) of the ITAA 1936 or has an individual interest in the trust's net income that is covered by paragraph 98A(1)(a) or (b) or paragraph 100(1)(a) or (b) of the ITAA 1936, and the beneficiary has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the beneficiary is, subject to the 'qualified person' rule, entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Refundable tax offset

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

Non-resident shareholders

65. As the Dividend Component of the consideration received under the Buy-Back is fully franked, a non-resident shareholder is not liable to Australian withholding tax on the Dividend Component (paragraph 128B(3)(ga) of the ITAA 1936).

The Capital Component: sale proceeds per share

66. The participating shareholders will be taken to have disposed of those shares which are bought back by Westpac under the Buy-Back. The disposal may have different taxation implications for participating shareholders depending on how the shares were held; for instance:

- an investor holding their shares on capital account will be subject to the capital gains tax provisions; and
- a share trader holding their shares on revenue account will be subject to the ordinary income provisions.

67. It should be noted that share traders who have both an income tax and a capital gains tax liability will generally have the amount of the capital gain reduced under the anti-overlap provisions in section 118-20 of the ITAA 1997. If the shares were held as trading stock the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

68. For the purposes of computing the amount of the gain or loss (on capital or revenue account) in these cases, 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.

69. The consideration determined under section 159GZZZQ is:

- the purchase price;
- adjusted in accordance to the market value rule in subsection 159GZZZQ(2); less
- the reduction amount (within the meaning of subsection 159GZZZQ(4)).

70. Participating shareholders are taken under subsection 159GZZZQ(1) of the ITAA 1936 to have received an amount equal to the purchase price (in this case \$19.13 received for each share bought back) as consideration in respect of the sale of the share bought back. However, this amount is subject to certain adjustments in order to arrive at the Sale Consideration for each share bought back under the Buy-Back.

71. 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.

72. For the purposes of determining market value under subsection 159GZZZQ(2) the following methodology has been proposed by Westpac and accepted by the Commissioner in accordance with TD 2004/22: the volume weighted average price over the five trading days before announcement of the Buy-Back, adjusted for the movement in the S&P/ASX 200 Banks 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.

73. Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$20.31. Thus under subsection 159GZZZQ(2), the shareholders are taken to have received \$20.31 for the sale of each share rather than \$19.13.

74. 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, \$15.13.

75. Thus, the Sale Consideration determined under section 159GZZZQ of the ITAA 1936 is \$5.18 calculated as follows:

Deemed consideration (market value)	\$20.31
less the reduction amount (Dividend Component)	<u>\$15.13</u>
Sale Consideration	<u>\$ 5.18</u>

76. 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), if that shareholder would otherwise incur either a capital loss or a deductible loss (or any increase in such a loss) in respect of the sale of a share bought back under the Buy-Back, the Sale Consideration is increased by an offsettable amount determined under subsection 159GZZZQ(9). The reduction amount is reduced by so much of the offsettable amount that does not exceed the capital loss or the deductible loss.

Qualified person

77. 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 IIIAA of the ITAA 1936' is entitled to a franking credit or tax offset. Broadly speaking, to be a qualified person in relation to the Westpac dividend paid 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.

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

79. A shareholder is taken to have materially diminished 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 under subsection 160APHM(2) of the ITAA 1936.

80. In this case the Commissioner does not regard the announcement of the Buy-Back as affecting whether shares bought back under the Buy-Back are held at risk.

81. There are 45 clear days between Thursday, 3 November 2005 and Monday, 19 December 2005 (the day the tender offer was accepted), not counting those dates. Therefore, a participating shareholder who acquired the shares subject to the Buy-Back on or before 3 November 2005 satisfies the holding period rule as long as those shares were held at risk at all times until they are bought back. A participating shareholder who acquired shares after 3 November 2005 that are 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 unless that shareholder meets an exception to the holding period rule. Where a participating shareholder holds more shares than are bought back under the Buy-Back the 'last-in first-out' rule in subsection 160APHI(4) of the ITAA 1936 determines which shares are bought back.

82. Westpac shares acquired by participating shareholders which did not confer an entitlement to participate in the Buy-Back (Ex-Entitlement Shares) which were purchased after Westpac shares that do confer an entitlement to participate in the Buy-Back (Cum-Entitlement Shares) will not be considered to take the place of tendered Cum-Entitlement Shares under an application of the 'last-in first-out' rule in subsection 160APHI(4) of the ITAA 1936. Ex-Entitlement Shares do not constitute 'related securities' for the purposes of subsection 160APHI(2) to any Cum-Entitlement Shares. Accordingly, where a participating shareholder acquired, on or after

8 November 2005 (the ex-entitlement date), any additional Westpac shares that did not confer an entitlement to participate in the Buy-Back, the 'last-in first-out' rule in subsection 160APHI(4) will not apply in relation to those shares.

83. However, shareholders who acquired any additional Westpac shares during the period 4 November 2005 to 7 November 2005 may not qualify for the franking credits attached to the dividends paid on some or all of their shares sold in the Buy-Back.

The anti-avoidance provisions

Sections 45A and 45B of the ITAA 1936

84. As discussed earlier, part of the proceeds received by a participating shareholder are taken not to be a dividend for the purposes of the Act.

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

86. Section 45A is an anti-avoidance provision that applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

87. 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.

88. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, the provision applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- (b) under the scheme a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, 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)).

89. In the case of the Buy-Back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, in this case, the requisite purpose of enabling the shareholder to obtain a tax benefit, by way of a capital distribution, is not present.

90. Having regard to the relevant circumstances of the scheme, set out in subsection 45B(8), it is apparent that the inclusion of a capital element in the Buy-Back price was not inappropriate. Further, the Capital Component of the Buy-Back cannot be said to be attributable to the profits of the company, nor do the pattern of distributions indicate that it is being paid in substitution for a dividend. Accordingly, section 45B has no application to the Buy-Back.

Section 204-30 of the ITAA 1997

91. 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 the 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 imputation benefits 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)).

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

- (a) the streaming entity will incur an additional franking debit in respect of each distribution paid or other benefit given to a disadvantaged member (paragraph 204-30(3)(a)); or
- (b) no imputation benefit is to arise in respect of any streamed distributions paid to a favoured member (paragraph 204-30(3)(c)).

93. For the section 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.

94. A significant proportion (approximately 23%) of Westpac's ordinary shares is held by non-residents. 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, who will receive a greater benefit from franking credits than non-resident shareholders.

95. Although section 204-30 applies to the Westpac 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 of the ITAA 1936. 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

96. 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 membership interests (such as shares), or an interest in membership interests, where a franked distribution is paid or payable in respect of the membership interests. This would include a buy-back with a franked Dividend Component.

97. Specifically, subsection 177EA(3) provides that the section applies where:

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interest, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the 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.

98. 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 (as provided for in subsection 177EA(17)), it would be concluded that, on the part of Westpac, its shareholders or any other relevant party, there is a purpose more than merely incidental, 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.

99. 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.

100. In this regard, the Commissioner has come to the view that the requisite purpose exists and 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, including:

- the structure of the Buy-Back, including the tender process and scale back mechanisms which enable those shareholders who can most use the franking credits to tender shares at the greatest discount;
- 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;
- the greater attraction of the Buy-Back to some resident shareholders with a low marginal tax rate than other resident shareholders (for example, whereas complying superannuation funds are taxed at 15% and corporations at 30% individuals can be taxed at a marginal tax rate up to 47%); and
- that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

101. Where section 177EA applies the Commissioner is vested with a discretion, pursuant to subsection 177EA(5), 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). 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).

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20; TD 2004/22

Subject references:

- capital benefit
- capital gains tax
- capital proceeds
- capital reduction
- CGT Event
- deemed dividends
- dividend income
- dividend streaming arrangements
- frankable dividends
- imputation system
- return of capital on shares
- share buy backs
- share capital

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NO: 2006/2067

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Capital Gains Tax ~~ CGT events G1 to G3
- shares

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Income Tax ~~ Assessable income ~~ dividend, interest
and royalty income