



CR 2006/76 - Income tax: share buy-back: Coles Myer Ltd

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Class Ruling

Income tax: share buy-back: Coles Myer Ltd

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This publication provides you with the following level of protection:

This publication (excluding appendixes) 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

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

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- subsection 44(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 46H of the ITAA 1936;
- section 46I of the ITAA 1936;
- section 46M of the ITAA 1936;
- section 90 of the ITAA 1936;
- section 92 of the ITAA 1936;
- subsection 95(1) of the ITAA 1936;

- section 97 of the ITAA 1936;
- section 98A of the ITAA 1936;
- subsection 100(1) 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 IIIA of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 67 of the ITAA 1997;
- section 104-10 of the ITAA 1997;
- section 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;
- section 207-35 of the ITAA 1997;
- section 207-45 of the ITAA 1997;
- section 207-50 of the ITAA 1997;
- section 207-55 of the ITAA 1997;
- section 207-57 of the ITAA 1997; and
- paragraph 207-145(1)(a) of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are the shareholders of Coles Myer Ltd (CML), a publicly listed company, who disposed of shares under the 2006 CML off-market share buy-back of ordinary shares (the Buy-Back) which was announced by CML on 23 May 2006 and described in the Scheme part of this Ruling. In this Ruling, the shareholders of CML are collectively referred to as 'shareholders' or '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 13 to 29 of this Ruling.

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 Ruling applies to the income year (as defined in subsection 995-1(1) of the ITAA 1997) for a shareholder in which the shareholder disposes of shares under the 2006 Coles Myer off-market buy-back of ordinary shares described in the Scheme part of this Ruling. For participating shareholders who do not have a substituted accounting period, this will be the income year ended 30 June 2007. 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. Furthermore, the Ruling only applies to the extent that:

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

9. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

10. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

11. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

12. This Ruling is withdrawn and ceases to have effect after 30 June 2007. However, the Ruling continues to apply after its withdrawal in respect of the relevant provisions 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

13. The scheme that is the subject of this Ruling is described at paragraphs 13 to 29 of this Ruling. 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 31 March 2006;
- Correspondence dated 11 April 2006; 21 April 2006; 2 May 2006; 3 May 2006; 5 May 2006; 13 July 2006; 14 July 2006; and
- The Off Market Share Buy-Back Booklet issued by CML to shareholders dated 23 May 2006.

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

14. CML is an Australian incorporated company listed on the Australian Stock Exchange (ASX). On 23 May 2006 CML announced its intention to make an off-market Buy-Back of its own shares. CML announced it would buy-back up to \$1 billion worth of its ordinary shares (Buy-Back Limit). Under the terms of the Buy-Back, CML could choose to buy-back any number of shares up to the Buy-Back Limit, or none at all.

15. In the Off Market Share Buy-Back Booklet (23 May 2006), the Statement of Financial Position, as at 29 January 2006, disclosed total shareholder's equity of \$3.756 billion, consisting of \$2.162 billion contributed share capital, \$1.202 billion retained profits and \$392 million other equity.

16. The shareholders in CML are a mix of individuals, companies, superannuation funds and other institutional investors, some of whom are non-residents.

17. CML has stated that the Buy-Back forms part of CML's ongoing program of capital management and is expected to enhance earnings per share and return on equity, while enabling it to maintain a more efficient capital structure.

18. The Buy-Back was conducted through a tender process during a specified tender period (Buy-Back Tender Period) and was open to all CML ordinary shareholders (excluding employees holding shares restricted from sale) who were registered on the Record Date for the Buy-Back (2 June 2006). Shares acquired on the ASX on an ex-entitlement basis on or after the ex-entitlement date (29 May 2006) carried no entitlement to participate. Participation in the Buy-Back was voluntary. Hence, eligible shareholders not wishing to participate were not required to do anything. Non-participating shareholders did not receive any property, dividend or distribution by way of compensation.

19. The tender period opened on 8 June 2006 (Opening Date) and closed on 7 July 2006 (Closing Date). Under the tender process, shareholders were able to submit offers to sell their shares at specified discount percentages within a specified range of 5% to 14% per share, in 1% intervals. Shareholders could also have submitted tenders to sell different parcels of shares at different percentage discounts. Alternatively, shareholders could submit a Final Tender Price Tender under which they offered to sell their shares for the price determined by the tender process (Final Price Tender).

20. Shareholders were also provided with a choice to nominate a Minimum Buy-Back Price (Minimum Price) in addition to the required selection of a tender discount percentage. The available Minimum Prices ranged from \$7.60 to \$9.70 in \$0.70 steps. Shareholders who failed to nominate a discount percentage and who attempted to specify only a Minimum Price did not have their tenders accepted.

21. The relevant discount was applied to the volume weighted average price (VWAP) of CML shares over the last five trading days of the Buy-Back Tender Period, including the Closing Date.

22. Shareholders who tendered a discount percentage less than the accepted discount percentage determined by CML were not accepted. Shareholders who tendered a discount percentage greater than the accepted discount percentage or at the Final Price Tender (subject to the Minimum Price) were accepted and received the Buy-Back Price for each share bought back, even if they tendered a greater discount percentage.

23. Where shareholders elected to nominate a Minimum Price, their tender would be accepted, but only if their specified Minimum Price was equal to or less than the Buy-Back Price.

24. Where the number of shares tendered that satisfied the Buy-Back criteria exceeded the number of shares CML determined to buy back, shareholders with tenders equal to the accepted discount percentage would be scaled back on a pro-rata basis. A Priority Parcel of 500 shares would be bought back from each successful tendering shareholder before the scale back was applied.

25. In the event of a scale back, any shareholder who tendered all of their shares at or below the Buy-Back Price, or as Final Price Tender, and would have, unless otherwise determined, 200 or fewer shares as a result of the scale-back, would have all of the shares they tendered bought back in full. Shareholders who held 500 shares or less were only permitted to tender all of their holding, not just a proportion of their holding.

26. All shares bought back under the Buy-Back would be cancelled.

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

- (a) CML would not buy-back shares at a discount greater than 14% to the VWAP of CML shares over the five (5) trading days up to and including the closing day of the tender period (7 July 2006); and
- (b) the Buy-Back Price would not exceed the market value of CML shares determined in accordance with Taxation Determination TD 2004/22.

28. Under the Buy-Back, \$3.00 per share was debited to CML's untainted share capital account and the balance of the Buy-Back Price was debited to CML's retained profits.

29. On 10 July 2006, CML announced that:

- it had successfully completed the off-market share Buy-Back of 81.8 million CML shares;
- the total amount of capital repurchased under the Buy-Back was \$837.0 million, representing 6.4% of the issued capital of CML;
- the balance of the \$1 billion capital management program would be used to conduct an on-market share buy-back;
- the final price for the Buy-Back was set at \$10.23 per share (Buy-Back Price), representing a discount of 13% of the VWAP of CML shares over the 5 days up to and including the closing date of the Buy-Back;
- shares tendered at a discount greater than or equal to 13% or as a final price tender were accepted in full, subject to any minimum price condition;
- shares tendered at discounts from 5% to 12% were not accepted; and
- a scale-back mechanism was not applied.

Ruling

The Dividend Component

30. Participating shareholders are taken to have been paid a dividend of \$7.23 (the Dividend Component) for each share bought back under section 159GZZP of the ITAA 1936.

31. 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

Direct distributions

32. 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 under subsection 44(1) of ITAA 1936 and subsection 207-20(1) of the ITAA 1997. These shareholders will be entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend Component (tax offset), subject to being a 'qualified person': see paragraphs 46 to 48 of this Ruling.

Indirect distributions

Partnerships

33. 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.

34. 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

35. 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.

36. 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

37. 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

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

The Capital Component (Sale Consideration)

39. Participating shareholders are taken to have received \$4.19 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.

40. Taxation Determination TD 2004/22 outlines how to determine what would have been the market value of the share at the time of a 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 under the Buy-Back was less than what would have been the market value of the share if the Buy-Back did not occur and was never proposed to occur, then, 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 will be 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 \$3.00 per share. Accordingly, the sale consideration is \$4.19.

41. The treatment of the Sale Consideration for tax purposes will depend on whether the sale is on capital account (where the shares are held for investment) or on revenue account.

Shares held on capital account

42. The Sale Consideration of \$4.19 represents the capital proceeds for the 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 the share.

43. The shares are taken to have been disposed of for capital gains tax purposes on 10 July 2006 pursuant to section 104-10 of the ITAA 1997.

Shares held on revenue account

44. Where the shares are held as trading stock, the Sale Consideration of \$4.19 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 \$4.19 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 \$4.19 per share the difference will be an allowable deduction.

Non-resident shareholders

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

Qualified Person

46. For the purposes of Division 1A of Part IIIAA of the ITAA 1936 participating shareholders will be considered to satisfy the holding period rule under section 160APHO of the ITAA 1936 and therefore be qualified persons (as long as the related payments rule is also met) in relation to the Dividend Component received under the Buy-Back if:

- (a) the shares sold into the Buy-Back were acquired on or before 25 May 2006; and
- (b) during the period when the shares or interest in the shares were held the shareholders did not have 'materially diminished risks of loss or opportunities for gain' in respect of the shares or interest in the shares (as defined in section 160APHM of the ITAA 1936) for a continuous period of at least 45 days.

47. The 'last-in first-out' rule in subsection 160APHI(4) of the ITAA 1936 applies in relation to CML shares purchased before 29 May 2006, being the day from which CML's shares traded without the entitlement to participate in the Buy-Back.

48. 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 CML shares acquired on or after 29 May 2006 (the ex-entitlement date), as these shares did not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

49. 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.

50. 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 participating shareholders.

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

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.*

The Dividend and Capital Components

52. The purchase price received by a participating shareholder for each share bought back under the Buy-Back (the Buy-Back Price) comprises two components:

- a Dividend Component; and
- a Capital Component.

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

The Dividend Component

53. 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 against amounts standing to the credit of company's share capital account, is taken to be a dividend paid by the company to the seller on the day the buy-back occurs. In the case of CML, the Buy-Back Price was \$10.23 per share and \$3.00 of this was debited to the share capital account. Thus the Dividend Component is \$7.23 per share.

54. The Dividend Component of \$7.23 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.

55. Prior to 1 August 2005, the Asset Revaluation Reserve of CML constituted a 'disqualifying account' under section 46H of the ITAA 1936. At this time, the Retained Earnings account did not include any unrealised profits from the revaluation of assets and thus constituted a non-disqualifying account for the purposes of section 46H of the ITAA 1936.

56. CML became subject to International Financial Reporting Standards ('IFRS') with effect from 1 August 2005 and, as part of its transition to IFRS, it re-classified its existing Asset Revaluation Account as a General Reserve. Given the crediting of the General Reserve would constitute a transfer from one disqualifying account to another disqualifying account there would be no credit to CML's notional disqualifying account under section 46I of the ITAA 1936.

57. Also from that date, IFRS required certain assets to be re-valued to fair value and any increases or decreases to be taken to the profit and loss account. However, CML does not own any assets that need to be re-valued to fair value and, therefore, its retained earnings account currently does not include any unrealised profits from the revaluation of assets. As such, it will still constitute a non-disqualifying account for the purposes of section 46H of the ITAA 1936.

58. Although the General Reserve is a disqualifying account, the debit for the Dividend Component of the Buy-Back Price will be made wholly against retained earnings, which is not a disqualifying account. Further, CML's notional disqualifying account has a zero balance. Accordingly, section 46M of the ITAA 1936 has no application and paragraph 202-45(e) of the ITAA 1997 will not treat the Dividend Component of the Buy-Back Price as an unfrankable dividend.

Assessability of the Dividend Component and Tax Offset

Direct distributions

59. 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).

60. 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

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

62. 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.

63. 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.

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

Partnerships

65. 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.

66. 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).

67. 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

68. 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.

69. 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).

70. 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

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

Non-resident shareholders

72. 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 Consideration)

73. The participating shareholders will be taken to have disposed of those shares which are bought back by CML 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.

74. 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.

75. 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.

76. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the shareholder is taken to have received an amount equal to the purchase price (in this case the \$10.23 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.

77. 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.

78. For the purposes of determining the application of subsection 159GZZZQ(2) of the ITAA 1936 the following methodology has been proposed by CML and accepted by the Commissioner in accordance with TD 2004/22; the market value of each share is the VWAP of the shares over the last five trading days before the first announcement of the Buy-Back, adjusted for the percentage change in the S&P/ASX 200 Index from the commencement of trading on the date that the Buy-Back was announced on 23 May 2006 (Opening S&P/ASX 200 Index) to the close of trading on the day that the Buy-Back closed on 7 July 2006 (Closing S&P/ASX 200 Index).

79. Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$11.42. Thus, the shareholders are taken to have received \$11.42 for the sale of each share rather than \$10.23 (Deemed Consideration).

80. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the Deemed Consideration of \$11.42 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated under subsection 159GZZZQ(4) of the ITAA 1936. In the circumstances of the Buy-Back, the reduction amount is equivalent to the Dividend Component, that is, \$7.23.

81. Thus, the Sale Consideration determined under section 159GZZZQ of the ITAA 1936 is \$4.19 calculated as follows:

Deemed consideration (Market Value)	\$11.42
/less the reduction amount (Dividend Component)	\$ 7.23
Sale Consideration	\$ 4.19

82. 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 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.

Non-resident shareholders

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

Qualified Person

84. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend 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. Broadly speaking, to be a 'qualified person' in relation to the Dividend Component paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule.

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

86. 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 the day of disposal of the relevant shares are also not counted.

87. 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.

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

89. There are 45 clear days between 26 May 2006 and 10 July 2006, that is, the date the tender offer was accepted. Therefore, a shareholder who acquired shares on or before 25 May 2006 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A shareholder who acquired shares after 25 May 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 in respect of those shares for the purposes of Division 1A of Part IIIAA of the ITAA 1936.

90. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first: subsection 160APHI(4) of the ITAA 1936. The 45 day rule operates on a last-in-first-out basis, so that shareholders will be deemed to have disposed of their most recently acquired shares first for the purposes of applying the 45 day rule. Accordingly, shareholders who, on or after 26 May 2006, acquired any additional CML shares which conferred an entitlement to participate in the Buy-Back, may not qualify for the franking credits attached to the dividends paid on some or all of their shares sold into the Buy-Back.

The anti-avoidance provisions

Sections 45A and 45B of the ITAA 1936

91. 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 such a determination is that all or part of the distribution of capital received by the shareholder under the Buy-Back is treated as an unfranked dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

92. Section 45A of the ITAA 1936 is an anti-avoidance provision that applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of share capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

93. 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.

94. 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) of the ITAA 1936);
- (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) of the ITAA 1936); and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose), of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

95. In the case of the Buy-Back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of enabling the shareholder to obtain a tax benefit – by way of capital distribution – was not present.

96. Having regard to the 'relevant circumstances' of the scheme (the Buy-Back), as set out in subsection 45B(8) of the ITAA 1936, it is apparent that there was no requisite purpose, by way of capital distribution, of enabling the 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 CML in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA of the ITAA 1936

97. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes to obtain a tax advantage in relation to imputation benefits. In essence, it applies to schemes for the disposition of shares or an interest in shares, where a franked distribution is paid or payable in respect of the shares or an interest in shares. This would include a buy-back with a franked dividend component.

98. Specifically, subsection 177EA(3) of the ITAA 1936 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; 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 interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, 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.

99. In the present case the conditions of paragraphs 177EA(3)(a) to (d) of the ITAA 1936 are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of CML, its shareholders or any other relevant party, there is a purpose more than merely an incidental purpose of conferring an imputation benefit under the scheme. Under this arrangement the relevant taxpayer is the participating shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

100. 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) of the ITAA 1936. 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.

101. The Commissioner has come to the view that section 177EA of the ITAA 1936 applies to the Buy-Back. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the arrangement, as outlined in subsection 177EA(17). Among the circumstances of the Buy-Back reflected in those paragraphs are:

- the delivery of franking credits in excess of what would have otherwise been distributed in the ordinary course of dividend declaration;
- the greater attraction of the Buy-Back to resident shareholders who could fully utilise the franking credits than to non-resident shareholders who could not;
- the greater attraction of the Buy-Back to some resident shareholders with a low marginal tax rate than other resident shareholders (for example, whereas superannuation funds are taxed at 15% and corporations at 30% individuals can be taxed at a marginal tax rate up to 45%); and
- that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

102. Where section 177EA of the ITAA 1936 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

103. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an imputation benefit is, or apart from this section would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a) of the ITAA 1997);
- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); 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) of the ITAA 1997).

104. Relevantly, if section 204-30 of the ITAA 1997 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) of the ITAA 1997); or
- (b) that no imputation benefit is to arise in respect of any streamed distributions made to a favoured member and specified in the determination (paragraph 204-30(3)(c) of the ITAA 1997).

105. For section 204-30 of the ITAA 1997 to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than the members who do not participate in the Buy-Back. The words 'derives a greater benefit from franking credits' (imputation benefits) are defined in subsection 204-30(8) by reference to the ability of the members to fully utilise imputation benefits.

106. A significant portion of CML 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 in subsection 204-30(1) of the ITAA 1997 for the provision to apply are met. However, the Commissioner will not make a determination under section 204-30.

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Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22

Subject references:

- dividend streaming arrangements
- franked dividends
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