


# ***CR 2007/46 - Income tax: off-market share buy-back: CMI Limited***

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## Class Ruling

### Income tax: off-market share buy-back: CMI Limited

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

## What this Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the relevant 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 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 44 of the ITAA 1936;
- section 45A of the ITAA 1936;
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- Division 16K of Part III of the ITAA 1936;
- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 110-25 of the ITAA 1997; and
- section 110-55 of the ITAA 1997.

All references are to the ITAA 1997, unless otherwise stated.

## **Class of entities**

3. The class of entities to which this Ruling applies are the resident shareholders of CMI Limited (CMI) who hold their ordinary shares on capital account and who sell their shares under the CMI off-market share buy-back (the Buy-Back) described in the Scheme part of this Ruling (participating shareholders). The class of entities excludes entities associated with CMI's Executive Chairman and the Executive Chairman.

## **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 25 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**

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8. This Ruling applies from 12 December 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities 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 entities involved in the scheme.

9. 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.

10. If this 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)).

11. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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.

12. 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).

## Scheme

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13. The following description of the scheme is based on information provided by the applicant. The documents, or relevant parts of them, form part of and are to be read with the description:

- the application for Class Ruling from KPMG dated 11 October 2006;
- correspondence received from KPMG between 11 October 2006 and 13 April 2007; and
- the CMI Prospectus dated 27 October 2006 provided to shareholders in respect of the proposed Buy-Back.

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

14. CMI is an Australian resident company listed on the Australian Stock Exchange (ASX). The shareholders of CMI are a mix of individuals, companies, trusts and superannuation funds both resident and non-resident.

15. For the year ended 30 June 2006, the CMI balance sheet disclosed total shareholders' equity of \$87 million, consisting of \$67 million contributed share capital.

16. On Thursday 31 August 2006, CMI announced an off-market share buy-back under which it intended to buy back up to 29,504,361 CMI ordinary shares. At the date of issue of the Prospectus CMI had 35,859,654 ordinary fully paid shares and 750,000 ordinary partly paid shares on issue.

17. The proposed off-market share buy-back was accepted at a meeting of CMI shareholders held on 28 November 2006.

18. The Buy-Back formed part of CMI's capital management strategy. The strategy includes reducing the total number of shares on issue and replacing part of the current equity funding with cheaper debt funding.

19. The offer by CMI was made to ordinary shareholders to buy-back up to 90% of each shareholder's ordinary shares in exchange for a consideration comprising cash and CMI Class A shares. The offer was not open to entities associated with CMI's Executive Chairman, the Executive Chairman, or to non-resident shareholders.

20. The consideration received by a participating shareholder under the Buy-Back was the sum of \$1.20 cash plus 1 Class A share for each two shares bought back, plus a rounding adjustment of an additional \$1.20 cash and 1 Class A share, for the additional share where an odd number of shares was bought back.

21. Shareholders who accepted an offer to participate in the Buy-Back returned a personalised acceptance form, nominating the number of shares (up to a maximum specified on the form) to be bought back. Acceptance forms were returned during the offer period that opened on 14 November 2006 and closed on 8 December 2006. Participation by shareholders was voluntary and shareholders not participating in the Buy-Back were not required to do anything.

22. Part 2.10 of the Prospectus provided that CMI had the right not to proceed with the Buy-Back at any time up to the date of allocation of the Class A shares.

23. On 12 December 2006, CMI announced to the ASX that it would proceed with the Buy Back. The ordinary shares were bought back, and Class A shares allocated, on 12 December 2006. The ordinary shares bought back were cancelled on 15 December 2006.

24. On 13 December 2006, CMI announced that:

- it had successfully completed the off-market share Buy-Back of 3,857,020 CMI ordinary shares;
- the total amount of capital repurchased under the Buy-Back was \$2,314,282.80;
- the final price for the Buy-Back was \$1.20 cash plus one Class A Share for every 2 ordinary shares for which the offer was accepted (subject to rounding where an odd number of shares was bought back); and
- CMI issued 1,928,569 Class A shares.

25. Under the Buy-Back \$0.60 per ordinary share was debited to CMI's untainted share capital account and the amount attributable to the Class A shares issued will involve a reallocation of amounts within the share capital account.

## **Ruling**

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### **The dividend component**

26. No amount of the consideration received by participating shareholders in the Buy-Back constituted a dividend, as defined under subsection 6(1) of the ITAA 1936, for the purposes of section 44 of the ITAA 1936.

### **Sale consideration**

27. Participating shareholders are taken to have received consideration in respect of the sale of each of their CMI ordinary shares equal to \$1.135 on the day of the day of the buy-back (12 December 2006) for the purposes of section 159GZZZQ of the ITAA 1936.

### **Capital component (sale consideration)**

28. Participating shareholders are taken to have received the sum of the cash and the market value of CMI Class A shares received (\$1.135) as consideration in respect of the sale of each of their CMI ordinary shares for the purposes of working out whether they make a capital gain or capital loss on that sale: section 159GZZZQ of the ITAA 1936.

29. A participating shareholder made a capital gain on the disposal of a CMI ordinary share if the capital proceeds (consideration) received for the disposal exceeded the cost base of the share. A participating shareholder made a capital loss if those capital proceeds were less than the share's reduced cost base: subsection 104-10(4).

### **Cost base of the CMI Class A shares**

30. A participating shareholder acquired the Class A shares when they were allocated on 12 December 2006: item 2 in the table in section 109-10.

31. The first element of the cost base and reduced cost base of a Class A share that a participating shareholder acquired under the arrangement was the total market value of their CMI ordinary shares bought back as at the date of acquisition, reduced by the total cash consideration received, divided by the number of Class A shares allocated: sections 110-25 and 110-55.

## **Anti-avoidance provisions**

32. The Commissioner will not make a determination under sections 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 purchase price received by participating shareholders.

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**Commissioner of Taxation**

30 May 2007

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## **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 component**

33. 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 the share capital account, in respect of the Buy-Back of the share, is taken to be a dividend paid by the company to the seller on the day the Buy-Back occurs.

34. As the total purchase price was debited against the share capital account of CMI, no part of the purchase price represented a dividend as defined in subsection 6(1) of the ITAA 1936. Consequently, there is no dividend amount to be included in a participating shareholder's assessable income under section 44 of the ITAA 1936.

### **Market value methodology**

35. The Commissioner accepted as the market value of a CMI ordinary share or a CMI Class A share the one day volume-weighted average price (VWAP) for those shares on 12 December 2006. The one day VWAP on 12 December 2006 for a CMI ordinary share was \$1.23, and the one day VWAP on 12 December 2006 for a CMI Class A share was \$1.07.

### **Purchase price in respect of the Buy-Back**

36. The consideration that is used to determine the income tax consequences of the disposal of a share under an off-market share buy-back is worked out under Subdivision C of Division 16K of Part III of the ITAA 1936. This is based on the 'purchase price' of the share worked out under section 159GZZZM of the ITAA 1936.

37. Paragraph 159GZZZM(c) of the ITAA 1936 provides for the calculation of the purchase price in respect of a buy-back of a share. The provision states that if the seller of the share has received or is entitled to receive, both an amount, or amounts of money, and property other than money as a result of or in respect of the Buy-Back – the sum of that amount or those amounts and the market value of that property at the time of the Buy-Back.

38. For each CMI ordinary share bought back, the purchase price was calculated as one half of the sum of the market value of a CMI Class A share, worked out at the time of the Buy-Back, plus the cash received of \$1.20.



## **Sale consideration**

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

40. Participating shareholders are taken to have received consideration in respect of the sale of each of their CMI ordinary shares equal to \$1.135 (\$0.60 cash plus one half of the market value of a CMI Class A share) for the purposes of section 159GZZZQ of the ITAA 1936.

## **Capital gains tax consequences**

### ***Disposal of CMI ordinary shares***

41. CGT event A1 in section 104-10 happens to each CMI ordinary share that is bought back by CMI under the Buy-Back. The time of the CGT event is 12 December 2006, the time when the Buy-Back became unconditional and CMI accepted the participants' offers: subsection 104-10(3).

42. To the extent that each CMI ordinary share's cost base was less than the capital proceeds (sale consideration), the difference is a capital gain. To the extent that each ordinary share's reduced cost base was greater than capital proceeds (sale consideration), the difference is a capital loss. Participating shareholders will include a capital gain or capital loss in working out their net capital gain or net capital loss for the year of income that includes the time of the CGT event: sections 159GZZZQ and 159GZZZM of the ITAA 1936.

### ***Cost base of Class A shares issued by CMI under the Buy-Back***

43. A participating shareholder acquired the CMI Class A shares that were issued under the arrangement when they were allocated on 12 December 2006: item 2 in the table in section 109-10.

44. The first element of the cost base of the shares was the money and market value of other property given, or required to be given in respect of the acquisition: paragraph 110-25(2)(b). The market value of the property was worked out as at the date of acquisition being 12 December 2006.

45. Under the terms of the Buy-Back, a participating shareholder made an expenditure (having their shares bought back) in exchange for a consideration comprising cash and CMI class A shares. In these circumstances, the first element of the cost base and reduced cost base of the CMI Class A shares will be limited to the part of the expenditure made by a participating shareholder that is reasonably attributable to their acquisition: subsection 112-30(1).

46. It is reasonable to attribute, as the first element of the cost base and reduced cost base of each CMI Class A share that a participating shareholder acquires under the arrangement, an amount equal to the market value as at 12 December 2006 of their CMI ordinary shares bought back, reduced by the total cash consideration received, divided by the number of CMI Class A shares allocated: sections 110-25 and 110-55. This formula method for working out the cost base of shares can be used irrespective of whether a participating shareholder has agreed to have odd or even number of shares bought back.

### **Anti-avoidance provisions**

#### ***Sections 45A and 45B***

47. Sections 45A and 45B of the ITAA 1936 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 dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

48. 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 capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

49. 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 there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Accordingly, section 45A of the ITAA 1936 has no application to the Buy-Back.

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

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- under the scheme, a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and

- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or 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)).

51. Under the Buy-Back (which is a scheme within the broad meaning of that term under subsection 45B(10) of the ITAA 1936), CMI provided a capital benefit to participating shareholders. The distribution of share capital, which was in the form of cash and CMI Class A shares, constituted the provision of a capital benefit within the meaning conveyed by subsection 45B(5) of the ITAA 1936.

52. As some participating shareholders derived either a capital gain or capital loss from the sale of their shares under the Buy-Back, they will pay less income tax than if the Buy-Back consideration had been a dividend. Some participating shareholders therefore obtained a tax benefit within the meaning conveyed by subsection 45B(9) of the ITAA 1936.

53. In this Buy-Back, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of providing a shareholder with a capital benefit to obtain a tax benefit was not present.

54. Paragraph 45B(2)(c) of the ITAA 1936 requires a 'more than incidental' purpose of enabling a taxpayer to obtain a tax benefit. A reference to such a purpose is usually understood to include any main or substantial purpose of the scheme. Circumstances which are relevant in determining whether any person has the requisite purpose include the factors listed in subsection 45B(8) of the ITAA 1936.

55. Having regard to the 'relevant circumstances' of the scheme, it is apparent that the inclusion of capital in the Buy-Back price was not inappropriate. The purpose of the arrangement was to restructure the company's asset base and while it may have the effect of providing capital benefits to some shareholders, any benefit was merely incidental.

56. Further, the capital component of the Buy-Back cannot be said to be attributable to CMI's profits, nor does the pattern of distributions that have been made by CMI in the past indicate that the capital component was being paid in substitution for a dividend.

57. Accordingly section 45B of the ITAA 1936 does not apply to the Buy-Back.

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

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

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## References

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*Previous draft:*

Not previously issued as a draft

*Subject references:*

- capital gains tax
- capital streaming
- dividend streaming arrangements
- dividends
- return of capital on shares
- share buy-backs

*Legislative references:*

- ITAA 1936 45B(8)
  - ITAA 1936 45B(9)
  - ITAA 1936 45B(10)
  - ITAA 1936 45C
  - ITAA 1936 Pt III Div 16K
  - ITAA 1936 159GZZZM
  - ITAA 1936 159GZZZM(c)
  - ITAA 1936 159GZZZP
  - ITAA 1936 159GZZZQ
  - ITAA 1997 104-10
  - ITAA 1997 104-10(3)
  - ITAA 1997 104-10(4)
  - ITAA 1997 109-10
  - ITAA 1997 110-25
  - ITAA 1997 110-25(2)(b)
  - ITAA 1997 110-55
  - ITAA 1997 112-30(1)
  - TAA 1953
  - TAA 1953 Sch 1 357-75(1)
  - Copyright Act 1968
  - ITAA 1936 6(1)
  - ITAA 1936 44
  - ITAA 1936 45A
  - ITAA 1936 45A(3)(b)
  - ITAA 1936 45B
  - ITAA 1936 45B(2)(a)
  - ITAA 1936 45B(2)(b)
  - ITAA 1936 45B(2)(c)
  - ITAA 1936 45B(5)
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ATO references

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