CR 2008/10 - Income tax: off-market share buy-back: Coca-Cola Amatil Limited

Class Ruling

Income tax: off-market share buy-back: Coca-Cola Amatil Limited

Contents Para

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

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;
- paragraph 128B(3)(ga) of the ITAA 1936;
- Division 16K of Part III of the ITAA 1936;
- Division 1A of former Part IIIAA of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);

- section 104-10 of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- section 202-5 of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997; and
- Division 855 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Coca-Cola Amatil Limited (CCA) a publicly listed company, who disposed of shares under the CCA Share Buy-Back 2007 (Buy-Back) which was announced by CCA on 5 December 2007 and described in the Scheme part of this Ruling.

4. In this Ruling, the shareholders of CCA to which this Ruling applies are collectively referred to as 'shareholders' or 'participating shareholders'.

Qualifications

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

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 27 of this Ruling.

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

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- this Ruling may be withdrawn or modified.

or posted at: http://www.ag.gov.au/cca

Date of effect

9. This 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 Buy-Back for ordinary shares as 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 2008. 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.

10. 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.

11. 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)).

12. 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.

13. 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

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

- the application for Class Ruling from CCA dated 18 October 2007; and

- correspondence received from CCA on 23 October 2007, 26 October 2007, 1 November 2007, 5 December 2007, 17 January 2008 and 29 January 2008.

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

15. On 5 December 2007, CCA announced its intention to undertake an off-market share buy-back of its own shares. CCA announced it would spend approximately $170 million**,** but retained the right to vary the size of the Buy-Back depending on demand.

16. As at 29 June 2007, CCA's share capital comprised 752,997,774 fully paid ordinary shares. The financial statements of CCA at 29 June 2007 show total share capital of $2,015.1 million, reserves of $41.6 million and retained profits of $197.5 million.

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

18. CCA envisaged that the Buy-Back would enable it to return surplus capital, optimise its capital structure through the achievement of more appropriate gearing levels and improve key measures of financial performance.

19. The Buy-Back was conducted through a tender process during a specified tender period (from 2 January 2008 to 25 January 2008) and was open to all shareholders in CCA (other than those to whom the Buy-Back invitation cannot lawfully be made under the law of the jurisdiction in which they are resident or other persons to whom CCA is not permitted to pay money pursuant to other applicable Acts, rules or regulations) who were on the register on the Record Date for the Buy-Back, 14 December 2007. Shares acquired on an ex-entitlement basis on or after the Ex-entitlement Date (10 December 2007) carried no entitlement to participate. Participation in the Buy-Back was voluntary. Hence, eligible shareholders who did not wish to participate were not required to do anything. Non-participating shareholders did not receive any property, dividend or distribution by way of compensation.

20. Under the tender process, shareholders registered on 14 December 2007 (the Record Date) were able to submit tenders to sell their shares at a specified discount (Tender Discount) to the Volume Weighted Average Price (VWAP) of CCA shares traded on Australian Securities Exchange (ASX) over the five trading day period up to and including the closing day of the tender period (25 January 2008). The Tender Discount percentages were within a specified range of 8% to 14% per share, in 1% intervals. In doing so, shareholders with more than 500 shares could also have submitted tenders to sell different parcels of shares at different tender discounts. Shareholders could also have submitted their tenders as a Final Price Tender which was the price as finally determined under the tender process.

21. Shareholders were also provided with a choice to nominate a 'Minimum Buy-Back Price' in addition to the required selection of a tender discount percentage. Shareholders who failed to nominate a discount percentage and who attempted to specify only a 'Minimum Buy-Back Price' were not accepted.

22. Where the number of shares tendered that satisfied the Buy-Back criteria exceeded the number of shares CCA determined to buy back, shareholders with tenders equal to the accepted discount percentage (including Final Price Tenders) were scaled back on a pro-rata basis. A priority allocation of 500 shares was bought back from each successful tendering shareholder before the scale back was applied.

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

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

(a) CCA would not buy back shares at a discount greater than 14% to the VWAP of CCA's shares over the five (5) trading days up to and including the closing day of the tender period (25 January 2008); and

(b) the Buy-Back Price would not exceed the market value of CCA's shares determined in accordance with Taxation Determination TD 2004/22.

25. On 29 January 2008, CCA announced that:

- It had successfully completed the Buy-Back of approximately 21.7 million CCA ordinary shares, representing 2.9 % of the issued capital of CCA.
- The total amount of capital repurchased under the Buy-Back was approximately $170 million.
- The final price for the Buy-Back was set at $7.84 per share, representing a discount of 14% to the VWAP of CCA's shares over the 5 days up to and including the closing date of the Buy-Back.
- A scale back of 60.38% was applied, subject to paragraphs 22 and 23 of this Ruling.

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

27. Under the Buy-Back, $2.67 per share was debited to CCA's untainted share capital account and the balance of the Buy-Back Price was debited to CCA's retained profits.

Ruling

The Dividend Component

28. Participating shareholders are taken to have been paid a dividend of $5.17 (Dividend Component) on the day the Buy-Back occurred (29 January 2008) for each share bought back under section 159GZZZP of the ITAA 1936.

29. 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.

30. The difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes.

Assessability of the Dividend Component and Tax Offset

31. The Dividend Component of $5.17 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 the ITAA 1936 and subsection 207-20(1) of the ITAA 1997 respectively in the income year in which the Buy-Back occurred.

32. Participating shareholders who are residents of Australia for tax purposes 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, subject to being a qualified person.

Non-resident shareholders

33. 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.

Sale Consideration

34. Participating shareholders are taken to have received $3.91 as consideration in respect of the sale of each of their shares bought back under the Buy-Back on 29 January 2008 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.

35. Taxation Determination 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. 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, in accordance with TD 2004/22, then 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 $2.67 per share debited to the share capital account (Capital Component). Accordingly, the Sale Consideration is $3.91.

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

Shares held on capital account

37. The Sale Consideration of $3.91 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.

38. The shares are taken to have been disposed of for capital gains tax purposes on 29 January 2008 pursuant to section 104-10 of the ITAA 1997.

Shares held on revenue account

39. Where the shares are held as trading stock, the Sale Consideration of $3.91 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 $3.91 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 $3.91 per share the difference is an allowable deduction.

Foreign resident shareholders

40. Under section 855-10 of the ITAA 1997, foreign resident shareholders that participate in the Buy-Back will only have CGT consequences if their shares bought back under the Buy-Back are 'taxable Australian property'. A CCA share that is disposed under the Buy-Back will only be taxable Australian property if the foreign resident has used the CCA shares in carrying on business through a permanent establishment in Australia (item 3 in the table in section 855-15 of the ITAA 1997).

Qualified persons

41. For the purposes of Division 1A of former Part IIIAA of the ITAA 1936, participating shareholders will be considered to satisfy the holding period rule under former 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 the ASX on or before Friday 7 December 2007 (noting that CCA's shares traded on the ASX on an ex-entitlement basis in relation to the Buy-Back from Monday 10 December 2007 (the Ex-entitlement Date)); and

(b) during the period when the shares or interest in the shares were held the shareholders had sufficient risks of loss or opportunities for gain in respect of the shares or interest in the shares (as defined in former section 160APHM) for a continuous period of at least 45 days. Neither the announcement of the Buy-Back, the making of an invitation to shareholders to offer to sell their CCA shares nor the making of an offer by a shareholder to CCA in respect of a CCA share will affect whether the shares bought back under the Buy-Back are held 'at risk' for the purposes of Division 1A of former Part IIIAA.

42. The 'last-in first-out' rule in former subsection 160APHI(4) of the ITAA 1936 has no effect for the purposes of the Buy-Back to CCA shares acquired after 7 December 2007, provided these shares did not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

43. 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.

44. 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.

45. 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.

Commissioner of Taxation
20 February 2008

Appendix 1 – Explanation

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

46. The purchase price received by participating shareholders comprised 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

47. Section 159GZZZP of the ITAA 1936 provides that where the buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price which is debited against the share capital account, is taken to be a dividend paid by the company to the seller on the day the buy-back occurs (29 January 2008). In this case the purchase price was $7.84 per share and $2.67 of this was debited to the share capital account. Thus the dividend component is $5.17 per share.

48. The Dividend Component of $5.17 per share is frankable but only to the extent that the Buy-Back Price does not exceed the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997). TD 2004/22 outlines how to determine what would have been the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur. In this case, the Buy-Back Price did not exceed the market value determined in accordance with TD 2004/22.

Assessability of the Dividend Component and Tax Offset

49. For Australian resident individual and corporate tax entity shareholders, and also for Australian complying superannuation funds, the Dividend Component is included in their assessable income under subsection 44(1) of the ITAA 1936. Generally, an amount equal to the amount of the franking credit is included in their assessable income under subsection 207-20(1) of the ITAA 1997 and they are also entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 reflecting the franking credit attached to the dividend.

50. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend made by an entity only 'a qualified person in relation to the distribution for the purposes of Division 1A of former 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 dividend paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule (or certain alternative rules) and the related payments rule. These two rules are discussed later in this Ruling.

Non-resident shareholders

51. 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).

Sale Consideration

52. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 29 January 2008. The disposal may have different taxation implications for shareholders depending on how the shares were held, for instance:

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

53. It should be noted that shareholders 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 contained in section 118-20 of the ITAA 1997. If the shares are held as trading stock the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

54. 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.

55. 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 $7.84 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.

56. 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.

57. For the purposes of determining the application of subsection 159GZZZQ(2) of the ITAA 1936, the Commissioner accepts the following methodology 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 (5 December 2007), adjusted for the percentage change in the S&P/ASX 200 Index from the commencement of trading on 5 December 2007 to the close of trading on 25 January 2008.

58. Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be $9.08. Therefore, the shareholders are taken to have received $9.08 for the sale of each share rather than $7.84.

59. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of $9.08 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, $5.17 unless the seller is a corporate tax entity to whom subsection 159GZZZQ(8) of the ITAA 1936 applies. Therefore, the Sale Consideration for each share disposed of under the Buy-Back is $3.91 ($9.08 less $5.17).

Foreign resident shareholders

60. A foreign resident shareholder can disregard any capital gain or capital loss made from the Buy-Back if their CCA shares bought back under the Buy-Back are not 'taxable Australian property' (section 855-10 of the ITAA 1997).

61. The term 'taxable Australian property' includes an 'indirect Australian real property interest' (item 2 in the table in section 855-15 and section 855-25 of the ITAA 1997). A CCA share is not an indirect real property interest. A CCA share will also be 'taxable Australian property' if the foreign resident shareholder has used their CCA share in carrying on a business through a permanent establishment in Australia (item 3 in the table in section 855-15 of the ITAA 1997).

Qualified person

62. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend made to an entity, only 'a qualified person in relation to the distribution for the purposes of Division 1A of former 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 Dividend Component paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule.

63. 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.

64. 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 during the qualification period. 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.

65. Under former 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.

66. 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 were held at risk or not.

67. There are 45 clear days between 14 December 2007 and 29 January 2008, that is, the date the tender offer was accepted. Therefore, a shareholder who acquired CCA shares before 10 December 2007 and disposed of those CCA shares pursuant to the Buy-Back is capable of satisfying 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 14 December 2007 that were subsequently bought back under the Buy-Back is not a qualified person in relation to the dividend paid under the Buy-Back for the purposes of Division 1A of former Part IIIAA of the ITAA 1936 except in certain circumstances. It is noted that CCA's shares traded on the ASX on an ex-entitlement basis in relation to the Buy-Back from 10 December 2007 (the Ex-entitlement Date).

68. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first; former 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. CCA shares acquired by participating shareholders which did not confer an entitlement to participate in the Buy-Back (ex-entitlement shares) which were purchased after CCA 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 former subsection 160APHI(4). Ex-entitlement shares do not constitute 'related securities' for the purposes of former subsection 160APHI(2) to any cum-entitlement shares. Accordingly, where a participating shareholder acquired, after 7 December 2007, any additional CCA shares that did not confer an entitlement to participate in the Buy-Back, the 'last-in first-out' rule in former subsection 160APHI(4) will not apply in relation to those shares.

The anti-avoidance provisions

Sections 45A and 45B

69. 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.

70. 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.

71. 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.

72. 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).

73. 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.

74. 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 CCA in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA

75. 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.

76. 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.

77. 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 CCA, its shareholders or any other relevant party, there is 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.

78. 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.

79. 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.

80. 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

81. 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).

82. 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).

83. For section 204-30 of the ITAA 1997 to apply, shareholders to whom distributions are streamed must derive a greater benefit from imputation benefits than the shareholders who did 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 shareholders to fully utilise imputation benefits.

84. A significant portion of CCA's shareholding was held by non-residents who do not fully benefit from franking, a feature of the Buy-Back, to the same extent as resident shareholders. Therefore, 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.

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22

Subject references:

- dividend streaming arrangements
- frankable dividends
- share buy-backs

Legislative references:

- ITAA 1936 44(1)
- 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(8)
- ITAA 1936 45C
- ITAA 1936 128B(3)(ga)
- ITAA 1936 Pt III Div 16K
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1936 159GZZZQ(2)
- ITAA 1936 159GZZZQ(3)
- ITAA 1936 159GZZZQ(4)
- ITAA 1936 159GZZZQ(8)
- ITAA 1936 159GZZZQ(9)
- ITAA 1936 Pt IIIAA Div 1A
- ITAA 1936 160APHI(2)
- ITAA 1936 160APHI(4)
- ITAA 1936 160APHM
- ITAA 1936 160APHM(2)
- ITAA 1936 160APHO
- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1936 177EA(3)(a)
- ITAA 1936 177EA(3)(b)
- ITAA 1936 177EA(3)(c)
- ITAA 1936 177EA(3)(d)
- ITAA 1936 177EA(5)
- ITAA 1936 177EA(5)(a)
- ITAA 1936 177EA(5)(b)
- ITAA 1936 177EA(17)
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 104-10
- ITAA 1997 116-20
- ITAA 1997 118-20
- ITAA 1997 118-25
- ITAA 1997 202-5
- ITAA 1997 202-40
- ITAA 1997 202-45(c)
- ITAA 1997 204-30
- ITAA 1997 204-30(1)
- ITAA 1997 204-30(1)(a)
- ITAA 1997 204-30(1)(b)
- ITAA 1997 204-30(1)(c)
- ITAA 1997 204-30(3)
- ITAA 1997 204-30(3)(a)
- ITAA 1997 204-30(3)(c)
- ITAA 1997 204-30(8)
- ITAA 1997 207-20
- ITAA 1997 207-20(1)
- ITAA 1997 207-20(2)
- ITAA 1997 207-145(1)(a)
- ITAA 1997 Div 855
- ITAA 1997 855-10
- ITAA 1997 855-15
- ITAA 1997 855-25
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968

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