


CR 2008/11 - Income tax: off-market share buy-back: Sunraysia Television Limited

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Class Ruling

Income tax: off-market share buy-back: Sunraysia Television 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

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provisions 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 128B of the ITAA 1936;
- Division 16K of Part III of the ITAA 1936;
- section 159GZZZP of the ITAA 1936;
- section 159GZZZQ of the ITAA 1936;
- Division 1A of former Part IIIA of the ITAA 1936;

- section 160APHI of the ITAA 1936;
- section 160APHM of the ITAA 1936;
- section 160APHO 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 67-25 of the 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 202-45 of the ITAA 1997
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997; and
- section 855-15 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the shareholders of Sunraysia Television Limited (Sunraysia), who disposed of shares under the Sunraysia fixed price off-market share buy-back (Buy-Back) which was announced by Sunraysia on 25 October 2007 and is described in the Scheme part of this Ruling. In this Ruling, the shareholders of Sunraysia 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 30 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. For a participating shareholder, this Ruling applies to the income year (as defined in the ITAA 1997) in which that shareholder disposed of shares under the Buy-Back of ordinary shares described in the Scheme part of the Ruling. For participating shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 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.

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

13. The following description of the scheme is based on information provided by the applicant.

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

14. On 25 October 2007, Sunraysia formally announced its intention to make, and provided details of, a fixed price off-market share buy-back of its shares. Sunraysia announced it would spend \$145.72 million in purchasing all of its ordinary shares.

15. As at 30 June 2007, the share capital of Sunraysia was comprised of 11,425,000 fully paid ordinary shares. The financial statements of Sunraysia at 30 June 2007 show total share capital of \$15.381 million and retained profits of \$124.417 million.

16. The shareholders in Sunraysia are a mix of individuals, companies, trusts, superannuation funds and a small percentage of non-residents.

17. On 13 June 2007, Sunraysia sold its 100% interest in Swan Television and Radio Broadcasting Pty Ltd (Swan) to WIN Corporation Pty Ltd (WIN). Prior to the sale, Swan had contributed more than 95% of Sunraysia's earnings and assets. Following the sale, Sunraysia's only business interests involved investments.

18. Under the sale agreement with WIN, some of the purchase price is being held in escrow accounts to cover any potential warranty breaches. Release dates for the escrow accounts extend until 30 June 2012.

19. Sunraysia has not operated or acquired any business undertakings since the disposal of Swan to WIN. The purpose of the Buy-Back is to return the proceeds of the sale and other minor listed securities to shareholders, enable shareholders to exit their holdings, accelerate a de-listing of the company and reduce further listing and compliance costs.

20. As a result of the delayed release of the escrow amounts, shareholders who accepted the Buy-Back offer will receive payment of an initial amount and one or more further instalments. These further instalments will be payable as soon as practicable after the release of funds held in escrow.

21. Participating shareholders will receive an initial payment of \$12.127 per share as soon as practicable after 14 December 2007. Shareholders will receive a further \$0.44 as soon as practicable after release of the escrow amount on 30 September 2008. A final payment of \$0.26 per share will be paid to shareholders as soon as practicable after release of a further escrow amount on 30 June 2012.

22. The Buy-Back offer was open to all eligible ordinary shareholders who were registered on the Record Date for the Buy-Back being 23 November 2007. Sunraysia sought and was granted a waiver by the Australian Securities Exchange (ASX) from listing rule 7.40 and clause 9 of Appendix 7A permitting it to set the record date for determining entitlements to participate in the Buy-Back 5 business days before the shareholder's meeting seeking approval for the Buy-Back.

23. The offer period opened on 14 November 2007 and closed on 13 December 2007. Under the Buy-Back offer, participating shareholders had to nominate 100% of their shares to be bought back by Sunraysia. Participation in the Buy-back was voluntary. Hence, shareholders who did not wish to participate were not required to do anything.

24. On 30 November 2007, Sunraysia shareholders approved the off-market share Buy-Back.

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

- (a) Sunraysia would not buy-back shares at a discount greater than 14% to the volume weighted average price (VWAP) of Sunraysia shares over the five trading days immediately following the detailed announcement of the Buy-Back; and
- (b) the Buy-Back Price would not exceed the market value of Sunraysia shares determined in accordance with Taxation Determination TD 2004/22.

26. On 14 December 2007 and 19 December 2007, Sunraysia announced that:

- it had completed the Buy-Back of 11,309,181 Sunraysia shares, representing 98.99 % of the ordinary shares of Sunraysia;
- the Buy-Back first instalment will be \$12.127 per share;
- subsequent instalments will be \$0.44 and \$0.26 per share respectively; and
- the estimated total amount to be paid under the Buy-Back is \$145.063 million.

27. The Buy-Back Price of \$12.827 per share represented a discount of 9.6% to the VWAP calculated over the five trading days immediately following the announcement date of 25 October 2007.

28. Under the Buy-Back, \$1.35 per share was debited to Sunraysia's untainted share capital account and the balance of the Buy-Back Price of \$11.477 per share was debited to Sunraysia's retained earnings and reserves.

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

30. Sunraysia was removed from the official list of the ASX on 21 December 2007.

Ruling

The Dividend Component

31. Participating shareholders will be taken to have been paid a dividend of \$11.477 (the Dividend Component) on the day the Buy-Back occurred (14 December 2007) for each share bought back under section 159GZZP of the ITAA 1936.

32. 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. The Dividend Component is partially franked to 83.64%

33. 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

34. The Dividend Component of \$11.477 and an amount equal to the franking credit on the Dividend Component (gross-up) is included under subsection 44(1) of the ITAA 1936 and subsection 207-20(1) of the ITAA 1997 respectively in the assessable income of resident individual, superannuation fund and company shareholders who participate in the Buy-Back in the income year in which the Buy-Back occurred.

35. Participating shareholders who are individual 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.

Refundable tax offset

36. The tax offsets will be 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

37. As the Dividend Component is partially franked participating non-resident shareholders will be subject to Australian withholding tax on the unfranked portion of the Dividend Component (section 128B(1) of the ITAA 1936).

38. Participating non-resident shareholders are not liable for Australian withholding tax on the franked portion of the Dividend Component under paragraph 128B(3)(ga) of the ITAA 1936.

Sale consideration

39. Participating shareholders are taken to have received \$1.763 as consideration in respect of the sale of each of their shares bought back under the Buy-Back (Sale Consideration) on 14 December 2007 in accordance with section 159GZZZQ of the ITAA 1936.

40. In accordance with Taxation Determination TD 2004/22 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 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 \$1.35 per share debited to the share capital account (the Capital Component). Accordingly the sale consideration is \$1.763.

41. 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

42. The Sale Consideration of \$1.763 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.

43. The shares are taken to have been disposed of for capital gains tax purposes on 14 December 2007 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 \$1.763 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 \$1.763 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 \$1.763 per share the difference is an allowable deduction.

Foreign resident shareholders

45. A foreign resident shareholder that participates in the Buy-Back can disregard any capital gain or capital loss made in respect of a share bought back via the Buy-Back, if the share is not taxable Australian property under the tests in section 855-15 of the ITAA 1997. A Sunraysia share that is disposed of into the Buy-Back will only be taxable Australian property if the foreign resident has used the Sunraysia share in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997).

Qualified persons

46. 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 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:

- the shares sold via the Buy-Back were acquired on or before 29 October 2007; and
- 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 of the ITAA 1936) 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 Sunraysia shares nor the making of an offer by a shareholder to Sunraysia in respect of a Sunraysia 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 of the ITAA 1936.

47. A shareholder who acquired shares on or after 30 October 2007 that were subsequently accepted into the Buy-Back pursuant to the 'last-in first-out' rule is not a qualified person in relation to the Dividend Component under former section 160APHO of the ITAA 1936 unless certain exceptions are met.

48. The 'last-in first-out' rule in former subsection 160APHI(4) of the ITAA 1936 will have effect for the purposes of the Buy-Back to Sunraysia shares acquired after 29 October 2007 as these shares carry an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

49. The Commissioner will not make a determination under subsection 45A(2) or 45B(3) 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) 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.

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 of the Buy-Back Price by participating shareholders.

Commissioner of Taxation20 February 2008

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 participating shareholders comprises two components:

- a Dividend Component; and
- a Capital Component.

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

53. The purchase price in respect of the Buy-Back has been determined in accordance with paragraph 159GZZZM(a) of the ITAA 1936 and will be paid to participating shareholders in more than one instalment. A participating shareholder will receive \$12.127 as soon as practicable after 14 December 2007 together with an entitlement to receive a further \$0.70 payable by way of instalments as soon as practicable after the funds held in escrow are released. The purchase price, including both future instalments, is assessable to participating shareholders at the time of the buy-back (14 December 2007).

The Dividend Component

54. 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. For participating shareholders this will be 14 December 2007. In this case the purchase price was \$12.827 and \$1.35 of this was debited to the share capital account. Thus the Dividend Component is \$11.477 per share.

Assessability of the Dividend Component and Tax Offset

55. 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. The dividend is taken to be paid by Sunraysia on the day the buy-back occurs (14 December 2007) and accordingly is assessable in the tax year the buy-back occurs. 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.

56. The Dividend Component of \$11.477 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.

57. 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.

58. Subsection 159GZZP(2) of the ITAA 1936 provides that the difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes.

Refundable tax offset

59. The tax offsets will be 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

60. Section 128B(1) of the ITAA 1936 provides that dividends derived by a non-resident and paid by a resident company are subject to withholding tax.

61. As the Dividend Component of the consideration received under the Buy-Back is partially franked, participating non-resident shareholders are not liable for Australian withholding tax on the franked portion of the Dividend Component under paragraph 128B(3)(ga) of the ITAA 1936.

62. Participating non-resident shareholders will be subject to tax on the unfranked portion of the Dividend Component at the dividend withholding tax rate of 30%. This rate is generally reduced to 15% for countries which have a double tax agreement with Australia.

Sale consideration

63. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 14 December 2007. 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.

64. It should be noted that shareholders who have both an income tax and 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.

65. For the purpose 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.

66. 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 \$12.827 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.

67. 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. In the event that the Buy-Back Price for each share bought back under the Buy-Back exceeds the market value of the share at the time of the Buy-Back, no adjustment is made to the consideration on disposal of the share. Instead, that excess is taken to be an unfranked dividend.

68. For the purposes of determining market value under subsection 159GZZZQ(2) the following methodology has been adopted by the Commissioner in accordance with TD 2004/22:

- the market value of Sunraysia's shares on the ASX for the last sale of shares prior to the date of the announcement of the Buy-Back (25 October 2007); and
- adjusted for the percentage change in the S&P/ASX 200 Index from the commencement of trading on 25 October 2007 to the close of trading on 13 December 2007.

Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$13.24. Thus, the shareholders are taken to have received \$13.24 for the sale of each share rather than \$12.827.

69. The use of this methodology reflects Sunraysia's unique circumstances, particularly the fact that none of Sunraysia's shares were traded during the five day period prior to the date of the announcement of the Buy-Back. The VWAP over the last five days prior to the announcement of the Buy-Back (25 October 2007) cannot be calculated as no trades occurred. However, Sunraysia's share price had been constant at \$13.30 for the period 10 September 2007 to 25 October 2007 and as such the \$13.30 appropriately reflects Sunraysia's share price during the five day period prior to the date of the announcement of the Buy-Back.

70. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of \$13.24 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, \$11.477 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 \$1.763 (\$13.24 less \$11.477). This sale consideration includes the instalment amounts payable after September 2008 and June 2012: see paragraph 21 of this Ruling.

Foreign resident shareholders

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

72. A Sunraysia foreign resident shareholder will have an 'indirect Australian real property interest' if it holds a membership interest in Sunraysia, and the interest passes both the principal asset test (section 855-30 of the ITAA 1997), and the non-portfolio interest test (section 960-195 of the ITAA 1997).

73. A Sunraysia share will also be 'taxable Australian property' if the foreign resident shareholder has used their Sunraysia 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).

The Buy-Back process

74. Sunraysia conducted this Buy-Back by way of a fixed price off-market share buy-back. Moreover, full details of the Buy-Back were provided at announcement, including the capital/dividend split. In most tender process off-market share buy-backs, the Commissioner has applied the acceptable level of maximum discount to the VWAP of a company's shares over the five days up to and including the closing date of the buy-back. Sunraysia has agreed that the appropriate time to calculate any discount for this Buy-Back was over the five trading days immediately following the announcement: see paragraphs 25 and 27 of this Ruling.

75. Practice Statement Law Administration PS LA 2007/9 sets out the Commissioner's guidance in relation to share buy-backs. The Commissioner will generally consent to a buy-back timetable that allows shares to trade ex-entitlement for three clear business days after the announcement date and before the record date. This period may be extended up to seven business days. The ASX listing rules require there to be at least seven clear business days between the shareholders' meeting seeking approval of the buy-back and the record date.

76. The Buy-Back timetable reflects a period of 20 business days from the announcement date (25 October 2007) to the record date (23 November 2007), with the record date being 5 business days before the shareholders' meeting to approve the Buy-Back (30 November 2007). Whilst contrary to the Commissioner's practice, as set out in PS LA 2007/9, Sunraysia had sought and obtained ASX waiver of the listing rules permitting it to adopt a record date of 23 November 2007. Furthermore, Sunraysia had also made a public announcement on 31 October 2007, via an ASX Release, advising prospective shareholders that shares acquired after 29 October 2007 which are sold into the Buy-Back would be unlikely to have franking credits attached to the dividend component.

Qualified person

77. 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 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.

78. 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.

79. 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.

80. 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.

81. 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.

82. There are 45 clear days between 29 October 2007 and 14 December 2007, that is, the date the offer was accepted. Therefore, a shareholder who acquired shares on or before 29 October 2007 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 29 October 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.

83. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first.¹ 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 30 October 2007, acquired any additional Sunraysia 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

84. 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.

¹ Former subsection 160APHI(4) of the ITAA 1936.

85. 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.

86. 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 of the ITAA 1936 has no application to the Buy-Back.

87. 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 (the 'relevant 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).

88. 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.

89. 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 Sunraysia in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA

90. 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.

91. 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.

92. 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 Sunraysia, 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.

93. 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.

94. 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 has 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 that not to make an economic gain, but a loss for tax purposes, from their participation.

95. 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 discretion in such a way that does not make a determination that the imputation benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b).

Section 204-30

96. 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 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).

97. 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).

98. 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.

99. A small portion of Sunraysia's shareholding was held by non-residents who do not fully benefit from franking, a feature of the Buy-Back, to the same extent as resident shareholders. Thus, the conditions 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 of the ITAA 1997.

Appendix 2 – Detailed contents list

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Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22

Subject references:

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

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