

CR 2017/5 - Income tax: IMB Ltd - Off-market share buy-back



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Class Ruling

Income tax: IMB Ltd – Off-market share buy-back

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① 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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

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

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:
- subsection 44(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
 - section 45A of the ITAA 1936
 - section 45B of the ITAA 1936
 - section 45C of the ITAA 1936
 - section 90 of the ITAA 1936
 - subsection 95(1) of the ITAA 1936
 - paragraph 128B(3)(ga) of the ITAA 1936
 - section 159GZZZP of the ITAA 1936
 - section 159GZZZQ 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 104-165 of the ITAA 1997
- section 116-20 of the ITAA 1997
- section 118-20 of the ITAA 1997
- section 118-25 of the ITAA 1997
- section 202-5 of the ITAA 1997
- section 202-45 of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-35 of the ITAA 1997
- section 207-45 of the ITAA 1997
- section 207-145 of the ITAA 1997
- Division 230 of the ITAA 1997
- section 855-10 of the ITAA 1997, and
- section 855-15 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936, unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of IMB Ltd (IMB) who:

- disposed of their ordinary shares in IMB held at the Record Date of 24 October 2016 under the IMB off-market share buy-back (the Buy-Back) which was announced by IMB on 20 October 2016 and which is described in the Scheme section of this Ruling, and
- are not subject to the taxation of financial arrangement rules in Division 230 of the ITAA 1997 in relation to gains and losses on their ordinary shares in IMB.

(Note: Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, the shareholders belonging to this class of entities are referred to as 'Participating Shareholders'

Qualifications

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

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 8 to 46 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.

Date of effect

7. This Ruling applies from 1 July 2016 to 30 June 2017. The Ruling continues to apply after 30 June 2017 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

8. The following description of the scheme is based on information provided by the applicant and the IMB off-market share Buy-Back booklet (Buy-Back Booklet) dated 20 October 2016.

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

Corporate structure

9. IMB is an Australian resident unlisted public company limited by shares and guarantee.

10. IMB is a mutual Authorised Deposit-taking Institution.

11. IMB is regulated by the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investment Commission (ASIC).

12. On 1 August 2015, IMB announced that it would trade under the business name 'IMB Bank' following approval from APRA to change from a building society to a mutual bank.

13. The change to a mutual bank had no impact on IMB's ownership model, capital structure, balance sheet and capital management program.

14. On 11 May 2016, Sutherland Credit Union Limited (Sutherland) members approved a merger with IMB which resulted in the transfer of Sutherland's entire business in accordance with the *Financial Sector (Business Transfer and Group Restructure) Act 1999 (Cth)*.

15. On 1 July 2016, the merger took effect and Sutherland members became guarantee members of IMB. The former Sutherland members were not issued with ordinary shares in IMB and did not receive money or other consideration from IMB.

16. As a result of the transfer of Sutherland assets and liabilities to IMB under the merger, IMB's net assets increased. IMB's assets remained largely Australian cash and receivables.

17. On 28 September 2016, IMB announced a change to its dividend guidelines. However, IMB's capital management program remains the same.

IMB Members

18. The members of IMB are comprised of:

- by way of guarantee (Guarantee Members), and
- Guarantee Members who hold ordinary shares in IMB (Shareholders).

A person or an entity cannot become a member of IMB through shareholding alone.

19. A person may become a member of IMB by completing and lodging an application with IMB. Following approval, the person becomes a Member of IMB when their name is entered in the Register of Members.

20. As at 31 March 2016, IMB had approximately:

- 180,000 Guarantee Members (inclusive of Shareholder Members), and
- 3,662 Shareholder Members, of which 3,593 were eligible to vote (as they held at least 100 shares).

21. The current Shareholders of IMB are a mix of resident individuals, companies, nominee companies, trusts and superannuation funds, and a small number of non-residents.

22. The maximum permissible shareholding of an IMB Shareholder is 5%. Any excess is forfeited to IMB and the Shareholder is appropriately compensated.

23. All ordinary shares in IMB were acquired after 20 September 1985.

24. Immediately prior to the Buy-Back, IMB's share capital comprised 31,873,148 fully paid ordinary shares and its paid-up capital was \$37,459,593. IMB disclosed in its 2016 Annual Report that its Retained earnings were \$242,102,000 and its Reserves were \$29,017,000 as at 30 June 2016.

History of distributions

25. IMB limits its annual distributions on shares to less than 50% of its annual net profit after tax in accordance with ASIC Regulatory Guide 147.

26. Since ending its dividend reinvestment plan in August 2004, IMB has paid dividends totalling \$104,255,441 up to 31 March 2016. All dividends were fully franked.

Share trading

27. IMB operates a trading facility for its shares (IMB Shares) under an Australian Market Licence (IMB Ltd) 2005 and an Australian Clearing and Settlement Facility Licence (IMB Ltd) 2005 in accordance with the *Corporations Act 2001* (Corporations Act). IMB manually matches buyers and sellers at mutually accepted prices.

28. In holding the above licences, IMB is subject to disclosure obligations, including a requirement to disclose price sensitive information. IMB publishes weekly trading volumes and prices for IMB Shares on its website.

29. Approximately 5.5% of all IMB Shares were traded during the year ended 31 December 2015.

The Buy-Back

30. IMB completed three off-market share buy-backs in 2012, 2013 and 2015.

31. IMB made the following undertakings in respect of the Buy-Back:

- IMB will not purchase IMB Shares under the Buy-Back at a discount greater than 14% to the volume weighted average price (VWAP) of the shares over the five trading days up to and including the Closing Date of 7 December 2016, and

- The Buy-Back Price per IMB Share will not exceed the market value of an IMB Share determined in accordance with Taxation Determination TD 2004/22 *Income tax: for Off-Market Share Buy-Backs of listed shares, whether the buy-back price is set by tender process or not, what is the market value of the share for the purposes of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936?*.

32. IMB received approval from APRA to undertake the Buy-Back subject to meeting certain conditions.

33. IMB obtained from ASIC an exemption pursuant to subsection 257D(4) of the *Corporations Act 2001* to treat the Buy-Back as an equal access share buy-back.

34. On 20 October 2016 (the Announcement Date), IMB announced that it would undertake the Buy-Back of IMB Shares through a tender process.

35. IMB would buy-back a maximum of \$18 million of IMB Shares.

36. The Tender Period for the Buy-Back during which Eligible Shareholders were each invited to lodge, withdraw or amend a Tender commenced on 31 October 2016 (the Opening Date) and closed on 7 December 2016 (the Closing Date).

37. All eligible Shareholders (except Excluded Foreign Shareholders) whose names were on IMB's share register on 24 October 2016 (the Record Date) could tender their IMB Shares.

38. Participation in the Buy-Back was voluntary. Eligible Shareholders who did not wish to participate were not required to take any action and did not receive any property, dividends or distributions as compensation.

39. Shareholders were invited to submit offers to sell some or all of their IMB Shares at a Tender Discount at one of the specified discounts within the range of 0% to 14% inclusive (Tender Discount Range) at intervals of 2%, or as a Final Price Tender. All tender offers were on the terms and conditions set out in the Buy-Back Booklet.

40. If a Shareholder owned more than 250 IMB Shares, the Shareholder was entitled to tender the shares at different Tender Discounts and/or as a Final Price Tender, provided at least 100 IMB Shares were tendered at each selected Tender Discount or a Final Price Tender.

41. Shareholders that held 250 IMB Shares or less who wished to participate in the Buy-Back were required to tender all of their IMB Shares at a single Tender Discount or as a Final Price Tender.

42. For each IMB Share that IMB purchased under the Buy-Back, IMB debited \$1.18 to its Share Capital account and the balance of the Buy-Back Price to its Retained earnings.

43. Where more IMB Shares were tendered at the Buy-Back Price than IMB planned to purchase in the Buy-Back, IMB was entitled to

use a scale-back mechanism after ensuring that parcels of 250 or less shares were bought back in full and that no Eligible Shareholder that tendered all their shares had less than 100 Shares.

44. On 15 December 2016 (the Buy-Back Date), IMB announced that:

- it had successfully completed an off-market share buy-back of 3,487,037 IMB Shares representing approximately 10.9% of the issued capital of IMB
- all IMB Shares offered at a Tender Discount of 14% or as a Final Price Tender were accepted
- the Buy-Back Price was \$4.73 per IMB Share
- the total purchase price of IMB Shares bought back under the Buy-Back was \$16,493,685, and
- a scale back mechanism was not applied.

45. All IMB Shares purchased by IMB under the Buy-Back were cancelled.

46. IMB's share capital account (as defined in section 975-300 of the ITAA 1997) was not tainted for the purposes of section 197-50 of the ITAA 1997.

Ruling

Off-market purchase

47. For the purposes of Division 16K, the Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend Component

48. Participating Shareholders were paid a dividend of \$3.55 (the Dividend Component) for each IMB Share that IMB purchased under the Buy-Back pursuant to section 159GZZZP.

49. 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.

50. The difference between the Buy-Back Price and the Dividend Component per share (that is, the Capital Component of \$1.18) is not a dividend for income tax purposes.

Assessability of the Dividend Component and tax offset

Direct distributions

51. The Dividend Component of \$3.55 and an amount equal to the franking credit on the Dividend Component is included in the assessable income of a resident individual, superannuation fund and company Participating Shareholders under subsection 44(1), and under subsection 207-20(1) of the ITAA 1997, respectively in the income year in which the Buy-Back happened.

52. Participating Shareholders will be entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend Component, subject to being a 'qualified person'.

Indirect distributions

Partnerships

53. The Dividend Component of \$3.55 and an amount equal to the franking credit on the Dividend Component is included in the assessable income of a partnership that participates in the Buy-Back for the purposes of working out the net income of the partnership under section 90.

Trusts

54. The Dividend Component of \$3.55 and an amount equal to the franking credit on the Dividend Component is included in the assessable income of a trustee for the purposes of working out the net income of the trust under subsection 95(1).

Partners and Beneficiaries

55. Subsections 207-35(3) to (6) of the ITAA 1997 set out the circumstances in which a partner or beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution. Where the franked distribution flows indirectly (within the meaning of Subdivision 207-B of the ITAA 1997) through a trust or partnership to a resident that is an individual, a corporate tax entity (at the time the distribution flows indirectly to it) or a trustee mentioned in paragraphs 207-45(c), (ca) or (d) of the ITAA 1997, the entity will, subject to the qualified person rule, be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45 of the ITAA 1997).

Refundable tax offset

56. The tax offsets (franking credits) are subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided the

Participating Shareholder is not excluded by subsections 67-25(1A) to 67-25(1D) of the ITAA 1997.

Non-resident Participating Shareholders

57. As the Dividend Component is fully franked, non-resident Participating Shareholders are not liable to Australian withholding tax in respect of the Dividend Component (paragraph 128B(3)(ga)).

Sale Consideration

58. Participating Shareholders are taken to have received \$1.95 per IMB Share as consideration in respect of each share bought back under the Buy-Back (Sale Consideration) on [Date] in accordance with section 159GZZZQ, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

59. If the Buy-Back Price for each IMB Share purchased by IMB 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) applies to the Buy-Back.

60. The effect of this rule is that the difference between the Buy-Back Price and the market value will be included in the consideration received for the disposal of the IMB Share for ordinary income or capital gains tax (CGT) purposes. In this instance, the Sale Consideration is \$1.95 per IMB Share.

Capital gains tax

61. The IMB Shares are taken to have been disposed of for CGT purposes on 15 December 2016 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

62. The Sale Consideration of \$1.95 per IMB Share represents the capital proceeds for CGT purposes; see Note 3 following subsection 116-20(1) of the ITAA 1997, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

63. A Participating Shareholder (other than a partnership) will make a capital gain on the IMB Share if the Sale Consideration per share exceeds the cost base of the share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder (other than a partnership) will make a capital loss on an IMB Share if the Sale Consideration per share is less than the reduced cost base of the share. The capital loss is the amount of the difference (subsection 104-10(4) of the ITAA 1997).

Shares held as trading stock

64. Where IMB Shares were held as trading stock (as defined in subsection 995-1(1) of the ITAA 1997), the Sale Consideration of \$1.95 per share is included in assessable income pursuant to section 6-5 of the ITAA 1997, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

65. Any capital gain or capital loss made is disregarded if, at the time of the CGT event, the IMB Shares were held as trading stock (section 118-25 of the ITAA 1997).

Shares held as revenue assets

66. Where IMB Shares were held as revenue assets (as defined in section 977-50 of the ITAA 1997), but were not trading stock, the amount by which the Sale Consideration of \$1.95 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income pursuant to section 6-5 of the ITAA 1997.

67. Similarly, the amount by which the cost of each IMB Share held as a revenue asset exceeds the Sale Consideration of \$1.95, is an allowable deduction pursuant to section 8-1 of the ITAA 1997.

68. Any capital gain made by a Participating Shareholder that held IMB Shares on revenue account but not as trading stock is reduced by the amount otherwise included in assessable income (section 118-20 of the ITAA 1997). The reduced cost base for the corresponding CGT outcome is reduced by the amount of the allowable deduction (subsection 110-55(9) of the ITAA 1997).

Non-resident Participating Shareholders: CGT consequences

69. Any capital gain or capital loss made by Participating Shareholders that are non-residents is disregarded as the IMB Shares disposed of under the Buy-Back were not taxable Australian property (section 855-10 of the ITAA 1997).

Qualified persons

70. For the purposes of paragraph 207-145(1)(a) of the ITAA 1997 which refers to Division 1A of former Part IIIA, a Participating Shareholder will satisfy the holding period rule under former section 160APHO and therefore be a qualified person (as long as the related payments rule is also met) in relation to the Dividend Component if:

- the Shareholder acquired their IMB Shares on or before 24 October 2016, and
- during the period when the IMB Shares were held the Participating Shareholder had sufficient risks of loss or

opportunities for gain in respect of 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 Shareholder Members to offer to sell their IMB Shares nor the making of an offer by a Shareholder Member to IMB in respect of a share will affect whether the IMB Shares purchased under the Buy-Back are held 'at risk' for the purposes of Division 1A of former Part IIIAA.

71. The 'last-in first-out' rule in former subsection 160APHI(4) has no effect for the purposes of the Buy-Back for IMB Shares acquired after 24 October 2016 which did not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

72. The Commissioner will not make a determination under subsections 45A(2) or 45B(3) that section 45C applies to the whole, or any part, of the Capital Component of the Buy-Back Price received by Participating Shareholders.

73. The Commissioner will not make a determination under paragraph 177EA(5)(b) to deny the whole, or any part, of the imputation benefits received by Participating Shareholders in relation to the Dividend Component of the Buy-Back Price.

74. 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 by Participating Shareholders in relation to the Dividend Component of the Buy-Back Price.

Commissioner of Taxation

25 January 2017

Appendix 1 – Explanation

① *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.*

Off-market purchase

75. For the purposes of Division 16K, where a company buys a share in itself from a shareholder the purchase is a 'buy-back' (paragraph 159GZZZK(a)).

76. Division 16K categorises a buy-back as either an 'on-market purchase' or an 'off-market purchase'.

77. A buy-back is an on-market purchase if the share bought back is listed for quotation in the official list of a stock exchange in Australia or elsewhere, and the buy-back is made in the ordinary course of trading on that stock exchange (paragraph 159GZZZK(c)). A buy-back that is not an on-market purchase is an off-market purchase (paragraph 159GZZZK(d)).

78. IMB is an unlisted public company. Therefore, the Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend and Capital Components

79. The Buy-Back Price received by Participating Shareholders comprises two components:

- a Dividend Component, and
- a Capital Component.

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

The Dividend Component

81. Section 159GZZZP provides that where the buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price which is debited against amounts standing to the credit of the company's share capital account is taken to be a dividend paid by the company to the seller on 15 December 2016 being the day the buy-back occurred.

82. Under the Buy-Back, the Buy-Back Price was \$4.73 per IMB Share of which \$1.18 was debited to IMB's share capital account (Capital Component). Therefore, the Dividend Component is \$3.55 per IMB Share.

83. The Dividend Component of \$3.55 per IMB Share is frankable but only to the extent that the Buy-Back Price does not exceed the

market value of the IMB 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). Under the Buy-Back, the Buy-Back Price did not exceed the market value of the IMB Share. Therefore, the Dividend Component was entirely frankable, and was fully franked.

Assessability of the Dividend Component and tax offset

Direct distributions

84. For Participating Shareholders who are Australian residents (other than a partnership or a trust):

- the Dividend Component is included in the assessable income of each Participating Shareholder under subsection 44(1)

which is:

- subject to the 'qualified person' rule, the amount of the franking credit on the Dividend Component is included in the assessable income of each Participating Shareholder under subsection 207-20(1) of the ITAA 1997.

85. Subject to the 'qualified person' rule, Participating Shareholders are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend Component.

Indirect distributions

Partnerships

86. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of a partnership for the purposes of working out the net income of the partnership under section 90.

87. Subject to the 'qualified person' rule, pursuant to subsection 207-35(1) of the ITAA 1997, the amount of the franking credit on the Dividend Component is included in the assessable income of a partnership for the purposes of working out the net income of the partnership under section 90.

Trusts

88. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of a trustee for the purposes of working out the net income of the trust under subsection 95(1).

89. Subject to the 'qualified person' rule, pursuant to subsection 207-35(1) of the ITAA 1997, the amount of the franking credit on the Dividend Component is included in the assessable

income of a trustee for the purposes of working out the net income of the trust under subsection 95(1).

Partners and Beneficiaries

90. Subsections 207-35(3) to (6) of the ITAA 1997 set out the circumstances in which a partner or beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution.

91. Where the franked distribution flows indirectly (within the meaning of Subdivision 207-B of the ITAA 1997) through a trust or partnership to a resident that is an individual, a corporate tax entity (at the time the distribution flows indirectly to it) or a trustee mentioned in paragraphs 207-45(c), (ca) or (d) of the ITAA 1997, the resident entity will, subject to the qualified person rule, be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45 of the ITAA 1997).

Refundable tax offset

92. The tax offsets (franking credits) are subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided the Participating Shareholders are not excluded by subsections 67-25(1A) to 67-25(1D) of the ITAA 1997.

Non-resident Participating Shareholders

93. As the Dividend Component of the Buy-Back Price is fully franked, and no determination will be made in respect of the Dividend Component under either paragraph 204-30(3)(c) of the ITAA 1997 or paragraph 177EA(5)(b), non-resident Participating Shareholders are not liable for Australian withholding tax on the Dividend Component pursuant to paragraph 128B(3)(ga).

The Capital Component

Calculation of Sale Consideration

94. For the purposes of determining the amount of a gain or loss for IMB Shares held on capital account or revenue account (whether or not the shares were held as trading stock), the consideration received by a Participating Shareholder in respect of the disposal of a share (the Sale Consideration) under the Buy-Back is determined in accordance with section 159GZZZQ. The effect of section 159GZZZQ is to adjust the Capital Component in order to determine the Sale Consideration for CGT or revenue account treatment.

95. Subsection 159GZZZQ(1) provides that a shareholder is taken to have received an amount equal to the purchase price (in this case

the Buy-Back Price of \$4.73 for each IMB Share bought back) as consideration in respect of the sale of their shares to IMB.

96. Subsection 159GZZZQ(2) 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 (calculated as 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 of the share as consideration in respect of the sale of the share bought back.

97. IMB is an unlisted public company. Accordingly, for the purposes of determining the application of subsection 159GZZZQ(2), the following methodology was proposed by IMB and accepted by the Commissioner: The relevant market value of an IMB Share (referred as the Deemed Market Value in the Buy-Back Booklet) is the VWAP of an IMB Share over the last ten trading days period on which IMB shares traded prior to the Announcement Date of 20 October 2016, adjusted for movements in the S&P/ASX 200 Index from the Announcement Date of 20 October 2016 (Opening S&P/ASX 200 Index) to the close of the Tender Period on 7 December 2016 (Closing S&P/ASX 200 Index).

98. The ten trading days period in paragraph 97 above, excludes days where no IMB Shares are bought or sold.

99. Under this methodology, the market value of an IMB Share was calculated as \$5.50. As a result, Participating Shareholders are taken to have instead received consideration of \$5.50 for the sale of each IMB Share.

100. Pursuant to subsection 159GZZZQ(3), the deemed consideration of \$5.50 per IMB Share is reduced by a 'Reduction Amount'. The Reduction Amount is worked out pursuant to subsection 159GZZZQ(4). In the circumstances of the Buy-Back, the Reduction Amount is equal to the Dividend Component of \$3.55, unless a Participating Shareholder is a corporate tax entity to whom subsections 159GZZZQ(8) and (9) apply (see paragraph 101 below). As a result, the Sale Consideration for each IMB Share disposed of under the Buy-Back is \$1.95 (being \$5.50 less \$3.55).

101. However, where a Participating Shareholder is a corporate tax entity which is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the Dividend Component, an adjustment may be made to the Sale Consideration. Under subsection 159GZZZQ(8), if such a Participating Shareholder would also make either a capital loss or a deductible loss (or would increase such a loss) in respect of the sale of an IMB Share purchased by IMB under the Buy-Back, the Reduction Amount (that is, the Dividend Component) is itself reduced by so much of the off-settable amount, which is determined under subsection 159GZZZQ(9), that does not exceed the capital loss or the deductible loss.

102. The effect for a Participating Shareholder that is a corporate tax entity is a capital loss or a deductible loss is reduced to the extent of the Dividend Component.

Capital gains tax

103. Participating Shareholders are taken to have disposed of their IMB Shares purchased by IMB under the Buy-Back on 15 December 2016 (CGT event A1).

104. The Sale Consideration of \$1.95 per IMB Share represents the capital proceeds for CGT purposes; see Note 3 following subsection 116-20(1) of the ITAA 1997. The Sale Consideration may be adjusted where the Participating Shareholder is a corporate tax entity (see paragraph 101 above).

105. A Participating Shareholder (other than a partnership) will make a capital gain in respect of the disposal of a share if the Sale Consideration per IMB Share exceeds the cost base of the share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder (other than a partnership) will make a capital loss in respect of the disposal of an IMB Share if the Sale Consideration per share is less than the reduced cost base of the share (subsection 104-10(4) of the ITAA 1997).

106. While all Participating Shareholders are subject to CGT, any capital gain or capital loss made will be adjusted if they held their IMB Shares as trading stock, or as revenue assets that are not trading stock, as discussed in paragraphs 107 to 110 of this Explanation.

Shares held as trading stock

107. Where IMB Shares were held as trading stock (as defined in subsection 995-1(1) of the ITAA 1997), Participating Shareholders include the Sale Consideration of \$1.95 per share in assessable income (section 6-5 of the ITAA 1997). The Sale Consideration may be adjusted where the Participating Shareholder is a corporate tax entity (see paragraph 101 above). Any capital gain or capital loss made is disregarded at the time of the CGT event where the IMB Shares were held as trading stock (section 118-25 of the ITAA 1997). This CGT exemption extends to partners in a partnerships (paragraph 118-25(1)(b) of the ITAA 1997) and beneficiaries of a trust (paragraph 118-25(1)(c) of the ITAA 1997).

Shares held as revenue assets

108. Where IMB Shares were held as revenue assets (as defined in section 977-50 of the ITAA 1997) but were not trading stock, the amount by which the Sale Consideration of \$1.95 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income pursuant to section 6-5 of the ITAA 1997.

109. Similarly, the amount by which the cost of each share exceeds the Sale Consideration of \$1.95 per IMB Share is an allowable deduction pursuant to section 8-1 of the ITAA 1997. The Sale

Consideration may be adjusted where the Participating Shareholder is a corporate tax entity (see paragraph 101 above).

110. Any capital gain made because of the CGT event will be reduced by the amount otherwise included in assessable income (section 118-20 of the ITAA 1997). The reduced cost base for the corresponding CGT outcome is reduced by the amount of the allowable deduction (subsection 110-55(9) of the ITAA 1997). There are similar CGT adjustments for partners in partnerships (paragraph 118-20(1)(b), paragraph 118-20(2)(b) and subsection 118-20(3) of the ITAA 1997).

Non-resident Participating Shareholders: CGT consequences

111. A non-resident shareholder that participates in the Buy-Back disregards any capital gain or capital loss made in respect of an IMB Share bought back under the Buy-Back if the share is not 'taxable Australian property' under the tests in section 855-10 of the ITAA 1997. An IMB Share that was disposed of in the Buy-Back by a non-resident shareholder constituted taxable Australian property if the share:

- is an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997)
- was used by the non-resident in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997), or
- is a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a gain or loss on ceasing to be an Australian resident – item 5 of the table in section 855-15 of the ITAA 1997).

Qualified persons

112. Paragraph 207-145(1)(a) of the ITAA 1997 provides that for 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 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.

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

114. The holding period rule requires a Participating Shareholder to hold the IMB 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 Participating Shareholder has satisfied the holding period rule, any days during which there are materially diminished risks in relation to the IMB shares are not counted. The day of acquisition and the day of disposal of the relevant shares are also not counted.

115. Under former subsection 160APHM(2), a Participating Shareholder is taken to have materially diminished risks of loss and opportunities for gain with respect to the IMB Shares or interests in the IMB Shares if the 'net position' of the Participating Shareholder results in the Participating Shareholder having less than 30% of the risks and opportunities relating to the shares or interest in shares.

116. The Commissioner does not regard the announcement of the Buy-Back offer as affecting whether the IMB Shares or an interest in the IMB Shares were held at risk or not.

117. A Participating Shareholder who acquired IMB Shares on or before 24 October 2016 that were purchased by IMB under the Buy-Back satisfied the holding period rule as long as those shares were held at risk for at least 45 continuous days.

118. Shares acquired after 24 October 2016 did not confer entitlement to participate in the Buy-Back. That is, a shareholder of IMB will be entitled to tender in the Buy-Back only those shares acquired on or before 24 October 2016.

119. Generally, under the holding period rule a Participating Shareholder is deemed to have disposed of his or her most recently acquired IMB Shares first: former subsection 160APHI(4). The 45 day rule operates on a 'last-in first-out' basis. The 'last-in first-out' rule in former subsection 160APHI(4) has no effect for the purposes of the Buy-Back for IMB Shares acquired after 24 October 2016 which did not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

Sections 45A and 45B

120. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies. The effect of such a determination is that all or part of the distribution of capital received by the Participating Shareholders under the Buy-Back is treated as an unfranked dividend.

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

122. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) 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 Participating Shareholders and dividends to other shareholders. The Buy-Back is open to all eligible Shareholder Members; accordingly, section 45A will not apply to the Buy-Back.

123. Section 45B applies where certain capital payments are made to shareholders in substitution for dividends. In broad terms, there needs to be a scheme in which, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme for the provision of capital benefits did so for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit.

124. In the case of the Buy-Back, although the conditions of paragraphs 45B(2)(a) and 45B(2)(b) were met, the requisite purpose of enabling the Participating Shareholders to obtain a tax benefit – by way of a capital distribution – was not present.

125. Having regard to the 'relevant circumstances' of the scheme (the Buy-Back), as set out in subsection 45B(8):

- the Capital Component of the Buy-Back cannot be said to be attributable to the profits of IMB
- the pattern of IMB's distributions
- the adoption of the average capital per share method and therefore the inclusion of the Dividend Component in the Buy-Back Price, and
- the profile of IMB's shareholders,

it is apparent that the inclusion of the Capital Component as part of the Buy-Back Price was not inappropriate. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies

Section 177EA

126. Section 177EA is a general anti-avoidance provision that operates to prevent franking credit trading.

127. The conditions of paragraphs 177EA(3)(a) to (d) are satisfied as the Buy-Back is a scheme involving the disposal of IMB Shares in which there is a franked distribution and franking credits were received by eligible Shareholder Members who participated in the Buy-Back.

128. For section 177EA to apply, the requirements of paragraph 177EA(3)(e) must also be satisfied. In broad terms, paragraph 177EA(3)(e) requires that, in considering the relevant circumstances of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out 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.

129. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of IMB, its Shareholder Members or any other relevant party, there is a more-than-incidental purpose of conferring an imputation benefit under the scheme. Under the Buy-Back, the relevant taxpayer is the Participating Shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

130. In arriving at a conclusion the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17). The relevant circumstances listed in the subsection 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.

131. The Commissioner has come to the view that section 177EA applies to the Buy-Back having regard to all the relevant circumstances of the arrangement, as outlined in subsection 177EA(17). Among the circumstances of the Buy-Back reflected in the subsection, paragraph 177EA(17)(b) which is concerned with the greater attraction of the Buy-Back to resident shareholders who could fully use the franking credits rather than to non-resident shareholders is relevant.

132. Where section 177EA 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 Participating Shareholders pursuant to paragraph 177EA(5)(b).

133. The Commissioner will exercise his discretion in such a way that he will not make a determination that denies the imputation benefits obtained by Participating Shareholders under the Buy-Back pursuant to paragraph 177EA(5)(b).

Section 204-30

134. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends to its members in such a way that certain shareholders, referred to as favoured members, obtain imputation benefits, and other shareholders, referred to as disadvantaged members, obtain lesser or no imputation benefits, whether or not they receive other benefits. The favoured members are those that derive a greater benefit from imputation benefits than disadvantaged members.

135. For section 204-30 of the ITAA 1997 to apply, Participating Shareholders members must be those who derive a

greater benefit from franking credits than other shareholders who do not participate in the Buy-Back and are disadvantaged members. Some of the circumstances when a member of an entity 'derives a greater benefit from franking credits' than another member are listed in subsection 204-30(8) of the ITAA 1997 by reference to the ability of a member to fully use franking credits or otherwise.

136. The conditions for the application of section 204-30 set out in subsection 204-30(1) of the ITAA 1997 may be present in the Buy-Back to the extent any non-resident shareholders do not participate. However, the Commissioner will not make a determination under subsection 204-30(3) of the ITAA 1997.

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Income tax ~~ Capital management ~~ Franking credits /
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