

CR 2018/24 - Income tax: off-market share buy-back: Virgin Australia Holdings Limited

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Class Ruling

Income tax: off-market share buy-back: Virgin Australia Holdings 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, 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.

Summary – 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 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
- subsection 44(1) of the ITAA 1936
- section 45A of the ITAA 1936
- section 45B of the ITAA 1936
- section 45C of the ITAA 1936
- Division 16K of the ITAA 1936
- section 159GZZZK of the ITAA 1936
- section 159GZZZP of the ITAA 1936
- section 159GZZZQ of the ITAA 1936

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 8-1 of the ITAA 1997
- section 104-10 of the ITAA 1997
- section 106-5 of the ITAA 1997
- section 116-20 of the ITAA 1997
- section 118-25 of the ITAA 1997
- section 855-10 of the ITAA 1997
- section 975-300 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 Virgin Australia Holdings Limited (VAH) who:

- disposed of their ordinary shares in VAH under the off-market share buy-back (the 'Buy-Back') which VAH announced on 28 February 2018 and which is described in paragraphs 7 to 23 of this Ruling, and
- are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their VAH shares.

(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, these ordinary shareholders of VAH are referred to as 'Participating Shareholders'.

Qualifications

4. 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 7 to 23 of this Ruling.

5. 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

6. This Ruling applies from 1 July 2017 to 30 June 2018. The Ruling continues to apply after 30 June 2018 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

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

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

8. VAH is a public company incorporated in Australia and listed on the Australian Securities Exchange (ASX).

9. The total issued share capital of VAH, comprised of fully paid ordinary shares and shares held in an employee share trust, for the half-year ended 31 December 2017 was \$2,243.8 million. VAH had 8,458.1 million ordinary shares on issue at that time.

10. As at 31 December 2017 VAH had retained losses of \$745.1 million.

11. VAH does not have a recent history of paying dividends.

12. VAH's ordinary shareholders are a mix of individuals, companies, trusts, partnerships and superannuation funds, some of whom are non-residents.

13. As at 28 February 2018, VAH had approximately 38,000 shareholders of which approximately 21,000 shareholders held parcels of shares worth less than \$500.

Share buy-back arrangement

14. On 28 February 2018, VAH announced its intention to undertake a capital-only off-market share buy-back of unmarketable parcels of its shares (Buy-Back). An unmarketable parcel of shares (Unmarketable Parcel) was a shareholding in VAH valued at less than \$500, being a shareholding that comprised of 1,666 shares or less as at 7:00pm Sydney time on 6 March 2018 (the Record Date), based on the buy-back price.

15. VAH fixed the buy-back price at \$0.30 per share (Buy-Back Price). The Buy-Back Price was set by the Board after taking into account recent trading and the performance of the VAH Group.

16. Shareholders who participated in the Buy-Back did not have to pay any brokerage or handling fees associated with the buy-back of their shares.

17. VAH proposed the Buy-Back to give the shareholders which held Unmarketable Parcels the ability to sell their shares at an appropriate price and in a convenient, cost-effective manner and to alleviate the associated compliance and administrative costs to VAH of the Unmarketable Parcels.

18. Shareholders whose names were on VAH's share register on the Record Date and held Unmarketable Parcels participated in the Buy-Back and had their shares bought back in full by VAH, unless they chose to opt-out of participation in the Buy-Back.

19. Notification of an eligible shareholder's decision to opt-out of the Buy-Back was due by 7:00pm Sydney time on 13 April 2018.

20. On 16 April 2018, VAH announced that:

- 12,900,841 VAH shares (representing approximately 0.15% of the issued capital of VAH) would be bought back from shareholders who participated in the Buy-Back
- the Buy-Back Price was \$0.30 per VAH share, and
- the Buy-Back date would be 23 April 2018.

21. All shares bought back under the Buy-Back were cancelled on 23 April 2018.

22. Under the Buy-Back, \$0.30 per VAH share bought back was debited to VAH's share capital account.

23. VAH'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

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

Distribution is not a dividend

25. No part of the proceeds received by Participating Shareholders as a result of the Buy-Back is a dividend under subsection 159GZZZP(1) or under subsection 6(1).

Sale Consideration

26. A Participating Shareholder is taken to have received \$0.30 per share as consideration (Sale Consideration) in respect of each share bought back under the Buy-Back on 23 April 2018 in accordance with section 159GZZZQ.

27. The treatment of the Sale Consideration for tax purposes will depend on whether a Participating Shareholder held the sold shares on capital account (where the shares are held for investment) or on revenue account (as trading stock or revenue assets other than trading stock).

Shares held on capital account

28. The shares are taken to have been disposed of for CGT purposes on 23 April 2018 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

29. The Sale Consideration of \$0.30 per share is the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997.

30. A Participating Shareholder (other than a partnership) makes a capital gain on a share if the Sale Consideration exceeds the cost base of the share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder (other than a partnership) makes a capital loss on a 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).

31. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each share sold into the Buy-Back by the partnership (subsection 106-5(2) of the ITAA 1997). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of shares into the Buy-Back.

Shares held on revenue account

32. Where shares were held as trading stock the Sale Consideration of \$0.30 per share is included in a Participating Shareholder's assessable income pursuant to section 6-5 of the ITAA 1997. A Participating Shareholder (other than a partnership) who held shares as trading stock also makes a capital gain or capital loss calculated as discussed at paragraph 30 of this Ruling. However, any capital gain or capital loss made is disregarded if at the time of the CGT event the shares were held by a Participating Shareholder as trading stock (subsection 118-25(1) of the ITAA 1997). There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

33. Where shares were held as revenue assets, but were not held as trading stock, the amount by which the Sale Consideration of \$0.30 per share exceeds the cost of the share is included in a Participating Shareholder's assessable income under section 6-5 of the ITAA 1997. Correspondingly, if the cost of each share exceeds the Sale Consideration per share the difference is an allowable deduction under section 8-1 of the ITAA 1997. Where the Sale Consideration per share exceeds the cost base of the share, the Participating Shareholder (other than a partnership) will also make a capital gain. However any capital gain the Participating Shareholders made is reduced if, because of the disposal, an amount has otherwise been included in assessable income (subsection 118-20 of the ITAA 1997). The capital gain is reduced to zero if the capital gain does not exceed the amount otherwise included in assessable income (subsection 118-20(2) of the ITAA 1997). If the capital gain exceeds the amount otherwise included in assessable income, the capital gain is reduced by the amount otherwise included in assessable income (subsection 118-20(3) of the ITAA 1997). There is a similar reduction for partners in partnerships (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating shareholders: CGT consequences

34. Under section 855-10 of the ITAA 1997, foreign resident shareholders who participate in the Buy-Back will only have CGT consequences if the shares purchased under the Buy-Back are 'taxable Australian property'.

The anti-avoidance provisions

35. 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 Sale Consideration received by a Participating Shareholder.

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.*

Off-market purchase

36. 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)).

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

38. 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)).

39. Although VAH's ordinary shares are listed for quotation in the official list of the ASX, the Buy-Back was not made in the ordinary course of trading on the ASX. As a result, for the purposes of Division 16K, the Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

Distribution is not a dividend

40. The Buy-Back Price was debited entirely against VAH's share capital account. Therefore, no part of the Buy-Back price is taken to be a dividend for income tax purposes under section 159GZZZP.

41. Subsection 44(1) includes in a shareholder's assessable income any dividends, as defined in subsection 6(1), paid to the shareholders out of profits derived by the company from any source (if the shareholder is a resident of Australia) and from an Australian source (if the shareholder is a non-resident of Australia).

42. The term 'dividend' is defined in subsection 6(1) and includes any distribution made by a company to any of its shareholders. However, paragraph (d) of the definition of 'dividend' excludes a distribution from the meaning of 'dividend' if the amount of the distribution is debited against an amount standing to the credit of the company's share capital.

43. The term 'share capital account' is defined in section 975-300 of the ITAA 1997 as an account which the company keeps of its share capital, or any other account created on or after 1 July 1998 where the first amount credited to the account was an amount of share capital. However, if the company's share capital account is tainted, within the meaning given in section 197-50 of the ITAA 1997, that account is taken not to be a share capital account (subsection 975-300(2) of the ITAA 1997).

44. In this case, the distribution was recorded as a debit to VAH's untainted share capital account.

45. Paragraph (d) of the definition of 'dividend' in subsection 6(1) will apply. Accordingly, no part of the Buy-Back Price is a dividend, as defined in subsection 6(1).

Sale Consideration

46. For the purpose of computing the amount of the gain or loss (on capital or revenue account) on the sale of shares under the Buy-Back, the consideration in respect of the disposal of a share under an off-market share buy-back is determined in accordance with section 159GZZZQ.

47. Pursuant to subsection 159GZZZQ(1) a Participating Shareholder is taken to have received an amount equal to the purchase price (in this case the \$0.30 received for each share bought back) as consideration in respect of the share bought back.

48. Participating Shareholders are taken to have disposed of their shares accepted under the Buy-Back on 23 April 2018. 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 CGT provisions, and
- a share trader who held their shares on revenue account will be subject to the ordinary income provisions.

Shares held on capital account

49. CGT event A1 happened when a Participating Shareholder disposed of VAH shares under the Buy-Back (section 104-10 of the ITAA 1997).

50. The time of the CGT event A1 was the date on which the Buy-Back was completed. This occurred on 23 April 2018.

51. The Sale Consideration of \$0.30 per share represents the capital proceeds for CGT purposes pursuant to subsection 116-20(1) of the ITAA 1997.

52. 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 VAH 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 a VAH 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).

53. Where the Participating Shareholder is a partnership, any capital gain or loss will be made by the partners individually (subsection 106-5(1) of the ITAA 1997). Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each share sold into the Buy-Back by the partnership (subsection 106-5(2) of the ITAA 1997). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of shares into the Buy-Back.

Shares held on revenue account

54. Where shares were held as trading stock, the Sale Consideration of \$0.30 per share is included in assessable income under section 6-5 of the ITAA 1997. Participating Shareholders (other than partnerships) who disposed of shares held as trading stock will also make a capital gain or capital loss. However, as the shares were held as trading stock, the capital gain or loss is disregarded pursuant to section 118-25 of the ITAA 1997. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

55. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$0.30 per share exceeds the cost of each share is included in assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$0.30 per share, the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of the share these Participating Shareholders (other than partnerships) will also make a capital gain. However, Participating Shareholders who held their shares as revenue assets other than as trading stock will have the amount of the capital gain reduced under the CGT anti-overlap provisions contained in section 118-20 of the ITAA 1997. There is a similar reduction for partners in partnerships (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating shareholders: CGT consequences

56. A foreign resident shareholder that participated in the Buy-Back disregards any capital gain or capital loss made in respect of a VAH 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. A VAH share that was disposed of in the Buy-Back by a

non-resident shareholder constituted taxable Australian property if the share:

- 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 for 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).

The anti-avoidance provisions: Sections 45A and 45B

57. 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.

58. 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.

59. 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 shareholders and dividends to other shareholders. Under the Buy-Back, all Participating Shareholders received a distribution of share capital based on the number of shares they sold into the Buy-Back. Accordingly, section 45A has no application to the Buy-Back.

60. Section 45B 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))
- (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)), 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 the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

61. While the conditions of paragraphs 45B(2)(a) and (b) were met in respect of the Buy-Back, the requisite purpose of enabling a person to obtain a tax benefit as a result of the capital distribution was not present.

62. Having regard to the 'relevant circumstances' (as set out in subsection 45B(8)) of the Buy-Back, it is apparent that:

- the distribution of share capital of \$0.30 per share could not be said to be attributable to the profits of VAH
- the pattern of distributions of VAH did not indicate that the distribution of share capital of \$0.30 per share was paid in substitution of a dividend, and
- as a consequence of the Buy-Back, the distribution of share capital resulted in the cancellation of ordinary shares in VAH held by Participating Shareholders and a corresponding loss of dividend, voting and other rights.

63. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to treat all or part of the distribution of share capital of \$0.30 per share as an unfranked dividend paid by VAH.

Appendix 2 – Detailed contents list

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References

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- Not previously issued as a draft
- Related Rulings/Determinations:*
- TR 2006/10; TD 2004/22
- Legislative references:*
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 - ITAA 1936 44(1)
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 - ITAA 1936 45A(2)
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