# Conducting off-market share buy-backs and returns of capital

What you need to know

The Government has announced that from 7:30pm AEDST on 25 October 2022, there will no longer be a dividend component in respect of the price paid by a listed public company undertaking an off-market share buy-back. The entire buy-back price paid for the share will be treated as capital proceeds for a share held on capital account, or as the entire proceeds for a share held as trading stock or on revenue account (but not as trading stock).

Retrospective tax law changes have effect for a period before the date of enactment once the legislation is passed. See Administrative treatment of retrospective legislation.

This fact sheet contains information in relation to conducting off-market share buy-backs and returns of capital by Community Bank companies.

## What is an off-market share buy-back?

A share buy-back occurs when a company buys back its own shares from a shareholder. Australian Corporations legislation requires that the share is then cancelled.

If the shares are listed on a stock exchange in Australia or anywhere else, and the buy-back is made in the ordinary course of trading on that stock exchange, the buy-back is an on-market share buy-back.

A Community Bank company which is listed on the National Stock Exchange of Australia (NSX) may undertake an on-market buy back.

All other share buy-backs, whether conducted by an:

- NSX-listed Community Bank company (but not in the ordinary course of trading on the NSX), or
- unlisted Community Bank company,

are off-market share buy backs.

## What is the off-market buy-back price?

The off-market buy-back price is usually the cash amount paid for each share purchased by a Community Bank company from a participating shareholder.

The buy-back price consists of the capital component and, if any, the dividend component.

However, the tax treatment of either or both the components for participating shareholders may be affected by Australian income tax legislation and ATO rulings and guidance, as outlined below.

Where the buy-back price includes ‘property’ or ‘non-cash consideration’, the shareholder should seek professional advice or contact the ATO for guidance.

## How do I determine the capital component of the buy-back price?

The capital component is the amount debited against the Community Bank company’s share capital account.

In order to determine this amount, the ATO prefers the average capital per share methodology, calculated using the following formula:

$$\frac{\text{Share capital}}{\text{Number of shares on issue}}$$

If the capital component exceeds the average capital per share, the ATO may treat the excess as an unfrankable dividend.

## How do I determine the dividend component of the buy-back price?

The dividend component is the difference between the buy-back price and the capital component.

## What portion of the dividend component is frankable?

If the buy-back price per share is equal to or lower than the share’s market value, the dividend component is frankable.

However, where the buy-back price exceeds the market value of the share, the dividend component will not be frankable, to the extent of the excess.

## What do I need to take into consideration when determining the market value of Community Bank company shares?

The market value of the share is worked out as if the buy-back was neither announced nor happened.

- the appropriateness of the valuation method, including
  - the level of quality of inputs applied to the valuation process and whether there is historical data and analysis to support the inputs applied. Where a particular valuation method is adopted, the Community Bank company should keep records of the analysis and evidence that the method adopted is the most appropriate for valuing the company's shares
  - the assumptions used in the method. For example, whether the business is valued on a going concern basis
- the market value of the shares **will not** generally equate to the market value of the business itself
- the impact of the terms of a Community Bank company's Franchise Agreement on the market value of the shares, such as the restrictions on shareholders and the limit on distributions
- liquidity and recent trading history of the shares (the ATO acknowledges that some Community Bank companies may experience an illiquid market for their shares).
- the share prices of comparable Community Bank companies on the NSX can be considered in the valuation process, but **are not** determinative of the market value of the shares of another Community Bank company.
- the first announcement date – see below.

A Community Bank company should also consider leveraging off any valuation activity (which is usually concerned with its value as an enterprise or going concern) in order to obtain a share valuation which properly addresses factors including but not limited to liquidity, Franchise Agreement limits on any distributions, and on the numbers of shares held.

## When is the 'first announcement date'?

The 'first announcement date' is the date that the company first indicates to its shareholders that the buy-back is in serious contemplation. This may be earlier than when the company officially announces the buy-back details.

If the Community Bank company proposing the buy-back is unlisted, a market valuation is required.

Consideration should be given to the following when determining the market value of Community Bank company shares:

- where a valuer is being engaged, whether they have the relevant and sufficient knowledge, experience and expertise in this area to determine the market value

The first announcement date is necessary to determine the market value of the shares.

Community Bank companies should keep relevant documents such as meeting minutes and materials provided to shareholders to show when the 'first announcement date' was.

## Are there any tax consequences for the purchasing Community Bank company following an off-market share buy-back?

There are no income tax or CGT consequences for the purchasing Community Bank company that undertakes an off-market buy-back or cancels the shares following the buy-back.

Where the buy-back price includes a franked dividend, there will be a debit to the balance of the Community Bank company's franking account. In certain circumstances, there might be a further franking consequence.

## What information should the Community Bank company provide to its participating shareholders?

To assist participating shareholders to correctly assess their tax obligations as a result of an off-market share buy-back, a Community Bank company should provide the following information:

- the buy-back price
- the capital component
- any dividend component
- any connected franking credits
- the average capital per share
- the market value of the shares.

## What other non-tax considerations should be taken into account by a Community Bank company?

A Community Bank company should ensure its off-market share buy-back complies with the requirements of the following:

- *Corporations Act 2001*, including
  - that shareholder approval is obtained if the buy-back is a 'selective' buy-back, or if the Community Bank company will buy-back more than 10% of its shares within a 12-month period. Directors who hold shares should advise if they intend to participate or to not participate in the buy-back
  - that directors exercise their powers and discharge their duties in relation to the buy-back in the best interests of the Community Bank company
- ASIC forms – for notification of the buy-back and also for cancellation of shares following the buy-back
- where listed on the NSX, any relevant NSX requirements such as the NSX Listing Rules
- the Community Bank company's Franchise Agreement with Bendigo & Adelaide Bank, including any limits on distributions and on the number of shares a shareholder may hold, as well as the aims of the Community Bank model

## What is a return of capital?

A return of capital, or a share capital reduction, occurs when a company distributes share capital to a shareholder, other than in the case of a winding up.

Australian Corporations legislation specifies the circumstances in which a company may reduce its share capital, and the procedures which must be followed.

## What tax considerations does the shareholder need to be aware of when receiving a return of capital payment from a Community Bank company?

A shareholder's tax treatment of a return of capital payment from a Community Bank company will depend on whether the relevant shares have been cancelled by the Community Bank company or not. The Community Bank company should inform its shareholders whether or not the relevant shares have been cancelled.

If the relevant shares are cancelled by the Community Bank company, the shareholder may make a capital gain or loss, depending on the amount of the return of capital payment received and the cost base or reduced cost base of the share.

If the relevant shares are not cancelled by the Community Bank company, and the amount of the return of capital payment is not more than the shareholder's cost base for the share, the share's cost base or reduced cost base is reduced by the amount.

However, if the amount of the return of capital payment exceeds the shareholder's cost base for the share, the excess will give rise a capital gain in the income year in which the return of capital payment is received.

Alternatively, where the Commissioner considers a return of capital payment is paid to shareholders in substitution for dividends, some or all of the return of capital payment may be treated as an unfranked and unrebatable dividend, paid out of the Community Bank company profits. This would result in some or all of the payment as fully assessable to the shareholder as an unfranked dividend.

Law Administration Practice Statement PS LA 2008/10 *Application of section 45B of the Income Tax Assessment Act 1936 to share capital reductions* sets out the ATO practice as to the circumstances when section 45B of the *Income Tax Assessment Act 1936* applies to treat a return of capital payment as a dividend.

A general application of the principles in PS LA 2008/10 to a return of capital payment by a Community Bank company would likely result in the treatment of the payment as a dividend.


Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.

If you make an honest mistake trying to follow our information in this publication and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest. If correcting the mistake means we owe you money, we will pay it to you. We will also pay you any interest you are entitled to.

If you feel that this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.

This publication was current at November 2019.

© Australian Taxation Office for the Commonwealth of Australia.

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).



Published by:
Australian Taxation Office
Canberra

Australian Government
Australian Taxation Office

## More information

For more information in relation to off-market share buy-backs and return of capital payments, see:

- Law Administration Practice Statement PS LA 2007/9 *Share buy-backs*
- 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?*
- Class ruling applications – share buy-backs
- Applying the last-in first-out method under the holding period rule
- Class Ruling CR 2019/30 *Pinewood Community Financial Services Limited – off-market share buy-back*
- If you wish to discuss your circumstances, call us on 13 28 61.

Siebel reference: 1-JGSVFLW


Our commitment to you

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information in this publication and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we must still apply the law correctly. If that means you owe us money, we must ask you to pay it but we will not charge you a penalty. Also, if you acted reasonably and in good faith we will not charge you interest.

If you make an honest mistake trying to follow our information in this publication and you owe us money as a result, we will not charge you a penalty. However, we will ask you to pay the money, and we may also charge you interest. If correcting the mistake means we owe you money, we will pay it to you. We will also pay you any interest you are entitled to.

If you feel that this publication does not fully cover your circumstances, or you are unsure how it applies to you, you can seek further assistance from us.

This publication was current at November 2019.

© Australian Taxation Office for the Commonwealth of Australia.

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).



Published by:
Australian Taxation Office
Canberra

Australian Government
Australian Taxation Office