

CR 2003/103 - Income tax: Share Buy-Back: Woolworths Limited

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Class Ruling

Income tax: Share Buy-Back: Woolworths Limited

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings TR 92/1** and **TR 97/16** together explain when a **Ruling** is a ‘public ruling’ and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax law(s)’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Class Ruling are:
- sections 44, 45A, 45B and 45C of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - sections 159GZZZM, 159GZZZP and 159GZZZQ of the ITAA 1936;
 - section 160APHO of the ITAA 1936;
 - section 177EA of the ITAA 1936;
 - Division 67 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - Division 136 of the ITAA 1997; and
 - sections 202-5, 202-40, 202-45, 204-30, 207-20, 207-40, 207-50, 207-145, 207-150 and 995-1 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of Woolworths Limited ('Woolworths') who disposed of shares under the Woolworths off-market share buy-back ('the Buy-Back') which was announced by Woolworths on Monday 24 February 2003.

4. The class of persons to which this Ruling applies does not include Woolworths. The Ruling does not deal with how the taxation law applies to Woolworths in relation to the Buy-Back. Furthermore, it should be noted that certain information which relates to the affairs of Woolworths, but is not in the public domain, has been taken into account in determining the application of certain anti-avoidance provisions in this Ruling. This information cannot be disclosed in the Ruling.

Qualifications

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

6. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out was carried out in accordance with the arrangement described in paragraphs 11 to 22.

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

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

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Date of effect

9. This Class Ruling applies to the year ended 30 June 2003. However, 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 (see paragraphs 21 and 22 of Taxation Ruling TR 92/20). Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by Gazette;
- it is not taken to be withdrawn by an inconsistent later public ruling; or
- the relevant tax laws are not amended.

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2003. However, the Ruling continues to apply after its withdrawal in respect of the tax laws ruled upon, to all persons within the specified class who entered into the specified arrangement during the term of the Ruling, subject to there being no change in the arrangement or in the person's involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- The application for a Class Ruling dated 5 November 2002;
- Letter from Greenwoods & Freehills dated 28 November 2002;
- Letter from Woolworths dated 17 December 2002; and
- The Buy-Back tender booklet issued by Woolworths to shareholders.

These documents or relevant parts thereof form part of and are to be read with this description.

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

12. On Monday 24 February 2003 Woolworths announced a selective off-market share buy-back ('the Buy-Back'). Under the Buy-Back Woolworths intended to buy back around \$500 to \$600 million worth of shares (although it could choose to buy back a lesser amount or none at all). As at 5 March 2003 (the Record Date for determination of entitlements to the Buy-Back offer) Woolworths had approximately 1,059 million ordinary shares on issue (and no other types of shares).

13. The Buy-Back formed part of Woolworths' ongoing capital management strategy (Woolworths has undertaken similar off-market share buy-backs in early 2000 and 2001) under which Woolworths aimed to make its capital structure more efficient by reducing the number of shares on issue and distributing shareholders funds to participating shareholders. Further, it was hoped that this would have positive effects on return on equity and earnings per share over the longer term. The Buy-Back was funded by drawing down existing debt facilities at existing interest rates in those facilities.

14. The Buy-Back was to be a *pro rata* offer to all Woolworths shareholders to buy back up to 100% of their ordinary shares as registered on the record date for the buy-back tender of Wednesday 5 March 2003, subject to the Buy-Back Limit, and was to be implemented through a tender process. Participation by shareholders was voluntary. Shareholders not wishing to participate in the Buy-Back were not required to do anything.

15. The tender period opened on Monday 17 March 2003 and closed on Friday, 11 April 2003. Under the tender process shareholders were invited to tender up to 100% of their shareholding at any price within a specified price range (between \$9.50 and \$12.00). At the end of the tender period, Woolworths and its advisers determined the Buy-Back price being the lowest specified price at which Woolworths was able to repurchase the amount of capital it chose to buy back.

16. Tenders at prices below the Buy-Back Price would be accepted in full. Tenders at prices above the Buy-Back Price would not be accepted. All successful tenderers would receive the Buy-Back price for each share bought back, even if they tendered shares at a lower price.

17. Under the Buy-Back offer successful tenderers would receive \$2.88 as a capital amount and the balance of the Buy-Back price as a fully franked dividend. In its Buy-Back tender booklet Woolworths noted that as a result of the Buy-Back it will distribute to shareholders around \$170 million of its surplus franking credits.

18. The Buy-Back offer included a scale back mechanism. Thus, in the event that more shares were tendered at the Buy-Back Price than Woolworths wished to repurchase, tenders at the Buy-Back Price were to be scaled back *pro rata* (after a priority allocation). The scale back, if required would be determined on the 12 April 2003.

19. Shares offered into the Buy-Back by any participating shareholder who, following any scale-back under the Buy-Back would be left with an unmarketable parcel, would be bought back.

20. On Monday 14 April 2003 Woolworths announced that:

- Woolworths had successfully completed its off-market buy-back tender of approximately 46.7 million ordinary shares, representing around 4.4% of issued capital, at a price of \$11.40 per share;
- the total amount of capital repurchased by Woolworths under the Buy-Back was around \$532 million;
- all shareholders who tendered shares into the Buy-Back at any of the specified prices from \$9.00 to \$11.40 (inclusive), or as a final price tender, would receive \$11.40 per share for all of those shares;
- shares tendered into the Buy-Back at the specified price of \$11.70 were not successful and would not be bought back;
- there would be no scale back of successful tenders;
- as agreed with the Australian Taxation Office, the \$11.40 Buy-Back Price was comprised of a fully franked dividend of \$8.52 per share and a capital component of \$2.88 per share; and
- the Buy-Back proceeds would be mailed to successful tendering shareholders on Thursday 24 April 2003.

21. At the time that the Buy-Back was proposed the Consolidated Balance Sheet, as at 12 January 2003, disclosed equity attributable to members of \$1,623.4 million, consisting of \$663.2 million contributed share capital, \$185.7 million reserves and \$774.5 million retained profits. The franking account balance as at 12 January 2003 was approximately \$298.6 million.

22. The shareholders in Woolworths are a mix of individuals, companies, superannuation funds and non-residents.

Ruling

The Dividend Component

23. Participating shareholders will be taken to have been paid a dividend of \$8.52 ('the Dividend Component') for each share bought back out of the profits of Woolworths on the date the Buy-Back occurred.

24. 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. However, this is only to the extent that the Buy-Back Price does not exceed the market value (as normally understood) of Woolworths shares at the time of the Buy-Back, that market value being determined on the assumption that the Buy-Back did not take place and was never proposed to take place.

25. Participating shareholders who are individuals or companies will include in their assessable income for the income year in which the distribution is made, the Dividend Component under section 44 of the ITAA 1936 and an amount equal to the franking credit on the Dividend Component under sub section 207-20(1) of the ITAA 1997. They will be entitled to a tax offset for the income year in which the distribution is made equal to the amount of the franking credit on the Dividend Component pursuant to sub section 207-20(2).

26. Participating shareholders who are partnerships will include in their assessable income for the income year in which the distribution is made, the Dividend Component under section 44 of the ITAA 1936 and an amount equal to the franking credit on the Dividend Component under sub section 207-40(1) of the ITAA 1997 for the purposes of working out the net income of the partnership under section 90 of the ITAA 1936. Therefore, where an individual, corporate or certain trustee partners in the partnership are the ultimate recipients of the Dividend Component the partners will be entitled to a tax offset for the income year in which the distribution is made equal to the partner's share of the franking credit on the Dividend Component under section 207-50 of the ITAA 1997.

27. Participating shareholders who are trusts will include in their assessable income for the income year in which the distribution is made, the Dividend Component under section 44 of the ITAA 1936 and an amount equal to the franking credit on the Dividend Component under sub section 207-40(2) of the ITAA 1997 for the purposes of working out the net income of the trust under section 95 of the ITAA 1936. Therefore, where an individual, corporate or certain trustee beneficiaries in the trust are the ultimate recipients of the Dividend Component the beneficiaries will be entitled to a tax offset for the income year in which the distribution is made, equal to

the beneficiary's share of the franking credit on the Dividend Component under section 207-50 of the ITAA 1997.

The Capital Component

28. Participating shareholders are taken to have received \$2.88 ('the Capital Component') as consideration in respect of the sale of each of their Woolworths shares on Sunday 13 April 2003 for the purposes of section 159GZZZQ of the ITAA 1936. The treatment of this 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 (where the shares are turned over in the course of business). In general, the relevant treatment should be as follows:

(a) Shares held on capital account

- The amount by which the Capital Component of \$2.88 exceeds the cost of each share will be a capital gain to the shareholder in the shareholder's assessable income. If the share's reduced cost base exceeds \$2.88, the difference will be a capital loss.

(b) Shares held on revenue account

- The amount by which the Capital Component of \$2.88 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$2.88, the difference will be an allowable deduction.

Qualified Person

29. For the purposes of Division 1A of Part IIIAA of the ITAA 1936 participating shareholders are considered to satisfy the holding period rule under section 160APHO of the ITAA 1936 and therefore be qualified persons (as long as the related payments rule is also met) in relation to the Dividend Component received under the Buy-Back if:

- (a) the shares sold into the Buy-Back were acquired on or before Tuesday 25 February 2003; and
- (b) during the period when the shares or interest in the shares were held the shareholders did not have 'materially diminished risks of loss or opportunities for gain in respect of the shares or interest' in the shares (as defined in section 160APHM of the ITAA 1936) for a continuous period of at least 45 days.

30. The Commissioner does not regard the announcement of the Buy-Back as affecting whether the shares or an interest in shares was held at risk or not.

The Anti-avoidance Provisions

31. The Commissioner will not make a determination under section 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the Capital Component of the Buy-Back price received by participating shareholders.

32. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936 to deny the whole, or any part, of the imputation benefits received in relation to the Dividend Component under the Buy-Back by participating shareholders.

33. 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 under the Buy-Back by participating shareholders.

Refundable Tax Offset

34. The excess (if any) of the tax offset attributable to the franking credit on the Dividend Component will be subject to the refundable tax offset rules of Division 67 of the ITAA 1997.

Non-resident Shareholders

35. A non-resident shareholder who has participated in the Buy-Back will not make a capital gain or loss in relation to the sale of their shares under the Buy-Back under section 136-10 of the ITAA 1997, provided that the non-resident shareholder and its associates beneficially owned less than 10% by value of the shares of Woolworths at any time during the 5 years before sale of the relevant shares under the Buy-Back.

Explanation

The Dividend and Capital Components

36. 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.

The Dividend Component

37. 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 in respect of the buy-back of the share 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 the day the buy-back occurs. In this case the purchase price was \$11.40 per share and \$2.88 of this was debited to the share capital account. Thus the dividend amount is \$8.52 per share.

38. Under the imputation rules effective from 1 July 2002, resident corporate tax entities that receive a franked distribution such as a franked dividend apply the franking credit on the distribution in the same way as resident individuals and superannuation entities using the gross-up and credit approach that applies.

39. For Australian resident individual and corporate tax entity shareholders, the amount of the dividend will be included in their assessable income under subsection 44(1) of the ITAA 1936. An amount equal to the amount of the franking credit will be included in their assessable income under subsection 207-20(1) of the ITAA 1997. Australian resident individual and corporate tax entity shareholders will also be entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 reflecting the imputation benefit attached to the dividend.

40. Under section 90 of the ITAA 1936, in the case of a partnership which participated in the Buy-Back, for the purposes of calculating the partnership's net income, the assessable income of the partnership includes an amount equal to the franking credit on the Dividend Component pursuant to subsection 207-40(1) of the ITAA 1997. In a case where an individual, corporate or certain trustee partners in the partnership are ultimate beneficiaries of the Dividend Component the partner will be entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component under section 207-50 of the ITAA 1997 for the income year in which the distribution (the Dividend Component) is made.

41. Under subsection 95(1) of the ITAA 1936, for the purposes of calculating the net income of a trust which participated in the Buy-Back, the assessable income of the trustee, for the income year in which the distribution (the Dividend Component) is made, includes an amount equal to the franking credit on the Dividend Component under

subsection 207-40(2) of the ITAA 1997. In a case where an individual, corporate or certain trustee beneficiaries in the trust are the ultimate recipients of the Dividend Component the beneficiaries will be entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component under section 207-50 of the ITAA 1997 for the income year in which the distribution (the Dividend Component) is made.

42. It should be noted that provisions exist which may deny a franking credit or tax offset in certain circumstances. For instance, paragraph 207-145(1)(a) of the ITAA 1997 requires that the shareholder be a 'qualified person for the purposes of Division IA of Part IIIA of the ITAA 1936' to obtain a franking credit or tax offset. Broadly speaking, to be a qualified person in relation to a dividend a taxpayer must satisfy both the holding period rule (or certain alternative rules) and the related payment rule. The holding period rule is discussed later in this Class Ruling.

43. Sections 204-30 of the ITAA 1997 and 177EA of the ITAA 1936 are anti-avoidance provisions concerned with striking down arrangements which inappropriately provide imputation benefits to a relevant taxpayer. These provisions allow the Commissioner to make determinations denying all or a part of a shareholder's entitlement to imputation benefits. In this case, no determinations will be made to deny imputation benefits received by participating shareholders under the Buy-Back. A discussion of these provisions appears later in this Class Ruling.

The Capital Component

44. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on Sunday 13 April 2003. The disposal may have different taxation implications for shareholders depending on how the shares were held, for instance:

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

It should be noted that shareholders who have both an income tax and a capital gains tax liability will generally have the amount of the capital gain reduced under the anti-overlap provisions contained in section 118-20 of the ITAA 1997. If the shares are held as trading stock the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

45. For the purposes of computing the amount of the gain or loss (on capital or revenue account) in these cases, the consideration in respect of the disposal of a share under a buy-back is determined in accordance with section 159GZZZQ of the ITAA 1936.

46. The consideration determined under section 159GZZZQ is:

- The buy-back price; less
- The reduction amount (within the meaning of subsection 159GZZZQ(4) of the ITAA 1936).

For the purposes of calculating the profit or loss on disposal of the shares, under either the income or capital gains tax provisions, participating shareholders are taken to have received \$2.88 per share as consideration in respect of the sale of their shares under the Buy-Back.

Qualified Person

47. 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 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 Woolworths dividend ('the Dividend Component') paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule. This Class Ruling only addresses the holding period rule. Shareholders who have concerns about whether they are a qualified person for the purposes of the Buy-Back should apply for a private ruling in relation to their own particular circumstances.

48. 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.

49. 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. For example, a shareholder would have materially diminished risks of loss and opportunities for gain with respect to shares or an interest in shares if the shareholder has a

contract to sell the shares or an interest in shares to a person at a future time for a certain price.

50. 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 was held at risk or not. The Buy-Back was subject to a limit of \$500 to \$600 million worth of shares and in previous Buy-Backs conducted by Woolworths the limit was significantly over-subscribed by participating shareholders. Therefore, having regard to the pattern of significant over-subscription and that the circumstances of this Buy-back did not indicate otherwise, there was a high likelihood that less than 70% of the offered shares would be bought back by the company. Thus, until scale back was determined the shareholders were at risk. The scale back was determined on 12 April 2003, thus 11 April 2003 was the last clear day where the shares were held at risk.

51. There are 45 clear days between Tuesday, 25 February 2003 and Saturday, 12 April 2003. Therefore, a shareholder who acquired shares on or before 25 February 2003 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 25 February 2003 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 Part IIIAA of the ITAA 1936 unless that shareholder meets an exception to the holding period rule.

The Anti-Avoidance Provisions

Sections 45A and 45B of the ITAA 1936

52. As previously discussed above, part of the proceeds received by a shareholder in return for participating in a buy-back are taken not to be a dividend for the purposes of the ITAA 1936. Such part of the proceeds is instead treated as a distribution of share capital by the company to the shareholder (the Capital Component).

53. Sections 45A and 45B of the ITAA 1936 are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C 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.

54. 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 capital and it is reasonable to

assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

55. Although a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) is provided to participating shareholders under the Buy-Back, the circumstances of the Buy-Back indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Accordingly, section 45A has no application to the Buy-Back.

56. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, section 45B of the ITAA 1936 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, 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 a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

57. 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.

58. 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 the inclusion of a capital element in the Buy-Back price was not inappropriate. 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 Woolworths in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA of the ITAA 1936

59. 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.

60. Specifically, subsection 177EA(3) provides that section 177EA of the ITAA 1936 applies if:

- (a) there is a scheme for a disposition of shares, or an interest in shares, in a company; and
- (b) a frankable dividend has been paid, or is payable or expected to be payable, in respect of the shares or a distribution has been paid, or is payable or expected to be payable, in respect of the interest, as the case may be; and
- (c) the dividend or distribution was, or is expected to be, franked; and
- (d) except for this section, a person (the ‘**relevant taxpayer**’) would receive, or could reasonably be expected to receive, franking credit benefits as a result of the dividend or 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 a franking credit benefit.

61. In the present case the conditions of paragraphs 177EA(3)(a) to (d) 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 Woolworths, its shareholders or any other relevant party, there is a purpose 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.

62. 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 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.

63. Where section 177EA applies the Commissioner is vested with a discretion, pursuant to subsection 177EA(5), whether to make a determination. If the company is a party to the scheme he has a

choice as to whether that determination is to debit the company's franking account pursuant to paragraph 177EA(5)(a), or to deny the imputation benefit to each shareholder pursuant to paragraph 177EA(5)(b).

64. The Commissioner has come to the view that section 177EA applies to the Buy-Back. The allocation of the Buy-Back price between share capital and retained profits was such as to reflect a purpose, more than incidental, of enabling the participating shareholders to obtain a franking credit benefit. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the arrangement.

65. Among the circumstances of the Buy-Back reflected in those paragraphs are: the proportion of dividend to capital in the Buy-Back price; 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; and the fact that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

66. In regard to the discretion pursuant to subsection 177EA(5), however, it would be inappropriate, given the large and diverse shareholding of the company, to make a determination to deny franking imputation benefits in relation to each participating shareholder. Accordingly, the Commissioner will exercise his discretion in such a way that he does not make a determination that the imputation benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b).

Section 204-30 of the ITAA 1997

67. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) an imputation benefit is, or apart from this section would be, received by a member of the entity as a result of the distribution or distributions (paragraph 204-30(1)(a));
- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)); 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)).

68. If section 204-30 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)); 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)).

69. For section 204-30 to apply, members to whom distributions are streamed must derive a greater benefit from imputation benefits than the members who do 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 members to fully utilise imputation benefits.

70. A significant portion of Woolworths' ordinary shareholding was held by non-residents who do not benefit from franking – a feature of the Buy-Back – to the same extent as resident shareholders. The Buy-Back was structured in such a way that it would be more attractive to resident shareholders who were able to fully utilise the franking credits. It was therefore a means by which franking credits could be streamed to residents and away from non-residents. Thus, the conditions in subsection 204-30(1) for the provision to apply are met. However, in regard to the discretion pursuant to subsection 204-30(3), it would be inappropriate, given the large and diverse shareholding of the company, to deny imputation benefits to the favoured members. Accordingly, the Commissioner will exercise his discretion in such a way that he will not make a determination under subsection 204-30(c) that no imputation benefits are to arise in respect of the Dividend Component of the Buy-Back paid to participating shareholders.

Refundable Tax Offsets

71. Under Division 67 of the ITAA 1997, refunds are available for excess franking offsets (rebates) which arise where the amount of a franking offset exceeds tax payable. This applies to individuals, beneficiaries, trustees assessed on a resident beneficiary's share of trust income, complying superannuation funds and Approved Deposit Funds, life insurance companies, friendly societies, Pooled Superannuation Trusts (those generally entitled to franking rebates),

taxpayers entitled to venture capital franking rebates and tax-exempt registered charities and gift deductible organisations. Companies (other than life insurance companies) are not entitled to a refund.

72. Registered organisations and gift-deductible charities, which are tax-exempt, are given a hypothetical entitlement to the franking rebate, or they would not be entitled to a refund.

73. The trustee of a trust and a beneficiary of that trust cannot claim a refund of the same excess imputation credits. Where the trustee is assessed under section 98 of the ITAA 1936, the beneficiary and not the trustee is entitled to the refund of any excess franking rebates; where a trustee is assessed under section 99 of the ITAA 1936, the trustee is eligible for the refund.

Non-Resident Shareholders

74. Under section 136-10 of the ITAA 1997, non-residents are liable to capital gains tax if a CGT (capital gains tax) event happens and the relevant asset in respect of that event has the necessary connection with Australia under the ITAA 1997.

75. The meaning of assets that have the 'necessary connection with Australia' is set out in section 136-25 of the ITAA 1997.

76. Under section 136-25, an asset will have the necessary connection with Australia if it is a share or an interest in a share, in a company that is an Australian resident and public company, for the income year in which the CGT event happens where at any time during so much of the period of 5 years immediately preceding the time at which the CGT event occurs the taxpayer and/or associates of the taxpayer were the beneficial owners of not less than 10% by value of the shares of the company.

77. The 10% ownership excludes any part of that share capital that carried no right to participate beyond a specified amount in a distribution of either profits or capital.

78. As Woolworths is an Australian resident and public company a non-resident shareholder who participated in the Buy-Back is liable to capital gains tax if the non-resident shareholder and/or associates of the non-resident shareholder were the beneficial owners of not less than 10% by value of the shares of Woolworths (unless the 10% ownership was of share capital that carried no right to participate beyond a specified amount in a distribution of either profits or capital), at any time during so much of the period of 5 years immediately preceding the time at which the Buy-Back happened.

Detailed contents list

79. Below is a detailed contents list for this Class Ruling:

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Commissioner of Taxation

26 November 2003

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*Related Rulings/Determinations:*CR 2001/1; TR 92/1; TR 92/20;
TR 97/16*Subject references:*

- dividend streaming arrangements
- share buy backs

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