


CR 2004/82 - Income tax: share buy-back: Westpac Banking Corporation

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Class Ruling

Income tax: share buy-back: Westpac Banking Corporation

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Preamble

*The number, subject heading, **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 IVA 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 apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- Sections 159GZZP and 159GZZQ of Division 16K (Effect of off-market buy-back of shares) of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - Section 45A (Streaming of Dividends and Capital) of the ITAA 1936;
 - Section 45B (Schemes to provide capital benefits) of the ITAA 1936;
 - Section 204-30 (Dividend Streaming) of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - Section 177EA (Creation of franking debit or cancellation of franking credits) of the ITAA 1936;
 - Paragraph 207-145(1)(a) of the ITAA 1997 and Division 1A of Part IIIA of the ITAA 1936 (Qualified Person); and
 - Subsection 139CC(3) of the ITAA 1936.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of Westpac Banking Corporation ('Westpac') who disposed of shares under the Westpac off-market share buy-back ('the Buy-back') announced on 6 May 2004 and described in the Arrangement part of this Ruling.
4. The class of persons to which this Ruling applies does not include Westpac. The Ruling does not deal with how the taxation law applies to Westpac in relation to the Buy-back. Furthermore, it should be noted that certain information which relates to the affairs of Westpac, 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 is carried out in accordance with the arrangement described in paragraphs 11 to 21.
7. If the arrangement actually carried out is 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 2004 unless and until it is withdrawn. 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).

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after 30 June 2004. 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 enter 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 the 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 from Allens Arthur Robinson dated 14 November 2003;
- letter from Allens Arthur Robinson dated 22 January 2004;
- letter from Allens Arthur Robinson dated 26 March 2004;
- letter from Allens Arthur Robinson dated 2 April 2004;
- the Westpac Banking Corporation Buy-back Tender booklet provided to Westpac shareholders; and
- letter from Allens Arthur Robinson dated 21 June 2004.

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

12. On 6 May 2004 Westpac announced that it intended to buy back approximately \$500 million worth of ordinary shares (representing approximately 2% of its issued shares). The actual amount bought back was \$558.6 million worth of shares, which is approximately 2.1% of its issued shares.

13. As at 30 September 2003 Westpac had approximately 1,787 million ordinary shares on issue and 212,587 ordinary shareholders. Westpac estimated that as at 30 September 2003 approximately 34% of its ordinary shares were held by individuals and 39% of the ordinary shares were held by companies and institutional investors (constituted by companies, funds, trusts etc). Westpac also estimated that approximately 74% of its ordinary shares were held by Australian residents.

14. The financial statements of Westpac as at 30 September 2003 show total share capital of approximately \$3,972 million and retained profits of approximately \$7,271 million. The franking account balance as at 30 September 2003 was approximately \$604 million.

15. The Buy-back formed part of Westpac's capital management program. Westpac has stated that its reason for undertaking the Buy-back was to better align the growth in total cash earnings of the company with earnings per share. The Buy-back was also expected to improve Westpac's future cash earnings per share and return on equity ratios. The Buy-back was funded from general working capital and existing debt facilities.

16. The Buy-back was implemented through a tender process. Under the Buy-back all ordinary shareholders of Westpac (excluding employees holding shares restricted from sale and persons to whom invitations could not lawfully be made or whose participation in the Buy-back was prohibited by law) were invited to tender up to 100% of their Westpac shares, as registered on the record date of 18 May 2004. Participation by shareholders in the Buy-back was voluntary.

17. The tender period opened on 31 May 2004 and closed on 18 June 2004. Under the tender process shareholders were invited to tender up to 100% of their shareholding at specified prices within a price range of \$14.00 to \$18.00 per share. In doing so, shareholders could also submit tenders to sell different parcels of shares at different prices. Alternatively, shareholders could submit a 'Final Price Tender' under which they offered to sell their shares for the price as determined by the tender process. Shareholders could withdraw offers to tender shares at any time up to the close of the tender period but not thereafter.

18. 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.

19. The Buy-back Price would be the lowest price, within the price range, that would allow Westpac to purchase the number of shares that it decided to buy back. The number of shares that Westpac bought back depended on a range of factors, including the price level of tenders received and market conditions.

20. Westpac debited \$4.00 of the Buy-back Price for each share bought back to its share capital account and the remaining amount to retained profits.

21. On 21 June 2004 Westpac announced that:

- Westpac had completed the Buy-back of 38,522,487 million ordinary shares, representing 2.1% of the ordinary shares on issue to the value of \$558.6 million;
- all shareholders who tendered shares into the Buy-back at the prices of \$14.00 or \$14.50 (or as a Final Price Tender) would receive \$14.50 per share;
- shares tendered into the Buy-back at the specified price of \$15.00 or above would not be bought back; and
- the Buy-back Price consisted of a fully franked dividend of \$10.50 per share and a capital component of \$4.00 per share.

Ruling

The Dividend Component

22. Participating shareholders are taken to have been paid a dividend of \$10.50 for each share bought back on the date the Buy-back occurred ('the Dividend Component') under section 159GZZZP of the ITAA 1936.

23. The Dividend Component is a frankable distribution pursuant to section 202-40 of the ITAA 1997.

Assessability of the Dividend Component and Tax Offset

Direct Distributions

24. The Dividend Component of \$10.50 and an amount equal to the franking credit on the Dividend Component ('gross-up') is included in the assessable income for the year of income ended 30 June 2004 of resident individual, superannuation fund and company shareholders who participated in the Buy-back. These 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*

25. The Dividend Component of \$10.50 and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income for the year of income ended 30 June 2004 of a partnership that participates in the Buy-back for the purposes of computing the net income of the partnership under section 90 of the ITAA 1936.

26. In a case where an individual partner, corporate partner, or a trustee partner specified by paragraph 207-45(c) or (d) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) has an individual interest in the partnership's net income that is covered by paragraph 92(1)(a) or (b) of the ITAA 1936 or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or (b) of the ITAA 1936, and the partner has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the partner is entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Trusts

27. The Dividend Component of \$10.50 and an amount equal to the amount of the franking credit on the Dividend Component (gross-up) is included in the assessable income for the year of income ended 30 June 2004 of a trustee that participates in the Buy-back for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936.

28. In a case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified by paragraph 207-45(c) or (d) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) has a share of the trust's net income that is covered by paragraph 97(1)(a) of the ITAA 1936 or has an individual interest in the trust's net income that is covered by paragraph 98A(1)(a) or (b) or paragraph 100(1)(a) or (b) of the ITAA 1936, and the beneficiary has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the beneficiary is entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Refundable Tax Offset

29. The tax offsets will be subject to the refundable tax offset rules in Division 67 of the ITAA 1997. Certain trustees and corporate tax entities are not entitled to the refundable tax offset rules because of subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident Shareholders

30. As the Dividend Component is fully franked, participating non-resident shareholders are not liable for Australian withholding tax under paragraph 128B(3)(ga) of the ITAA 1936.

Sale of Shares under the Buy-back

31. Participating shareholders are taken to have received \$7.21 as consideration in respect of the sale of each of their shares bought back under the Buy-back ('the Sale Consideration') pursuant to section 159GZZZQ of the ITAA 1936.

32. The Buy-back Price for each share bought back under the Buy-back was less than the market value of the share at the time of the Buy-back (the market value of the shares being determined as if the Buy-back did not occur and was never proposed to occur: Taxation Determination TD 2004/22). Accordingly the market value rule in subsection 159GZZZQ(2) applies to the Buy-back. The effect of this rule is that the difference between the Buy-back Price and the market value will be treated as consideration for ordinary income or capital gains tax purposes.

33. The treatment of the Sale Consideration for tax purposes depends 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).

Shares held on capital account

34. The Sale Consideration represents the capital proceeds for capital gains tax purposes pursuant to section 116-20 of the ITAA 1997. A shareholder will make a capital gain on a share if the capital proceeds of \$7.21 exceed the cost base of that share. The capital gain is the amount of the excess. Similarly, a shareholder will make a capital loss if the capital proceeds of \$7.21 are less than the reduced cost base of a share.

35. The shares are taken to have been disposed of for capital gains tax purposes on 21 June 2004.

Shares held on revenue account

36. Where the shares are held as trading stock, the Sale Consideration of \$7.21 is included in assessable income under section 6-5 of the ITAA 1997. Where the shares are held as revenue assets, the amount by which the consideration of \$7.21 exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$7.21 the difference is an allowable deduction.

Employee share plan participants

37. In respect of those participating employee shareholders who:

- hold shares under an employee share plan;
- used the deferral concession available under section 139E of Division 13A;
- withdrew their shares from the plan, the time of withdrawal being the 'cessation time' for the particular plan for the purposes of Division 13A; and
- dispose of their shares under the Buy-back within 30 days of withdrawal,

the consideration received on disposal of their plan shares for the purposes of subsection 139CC(3) of Division 13A of Part III of the ITAA 1936 is \$7.21.

Qualified person

38. For the purposes of Division 1A of Part IIIAA of the ITAA 1936 a participating shareholder will be considered to satisfy the holding period rule under section 160APHO of the ITAA 1936 and therefore be a qualified person in relation to the dividend received under the Buy-back provided:

- the shares sold into the Buy-back were acquired on or before 6 May 2004;
- the shareholder has no other positions (for example, an option) in relation to the shares sold into the Buy-back; and
- the shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

39. A shareholder who acquired shares on or after 7 May 2004 that were subsequently accepted into the Buy-back is not a qualified person in relation to the Dividend Component unless certain exceptions are met.

The Anti-avoidance Provisions

Sections 45A and 45B of the ITAA 1936

40. The Commissioner will not make a determination under section 45A or section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the distribution of share capital under the Buy-back received by participating shareholders.

Section 204-30 of the ITAA 1997

41. 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.

Section 177EA of the ITAA 1997

42. 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.

Explanation

The Taxation Treatment of Buy-backs

43. The tax effect of a share Buy-back is determined under the specific provisions of Division 16K of the ITAA 1936.

44. With respect to off-market share Buy-backs Division 16K provides that participating shareholders are taken to have been paid a dividend (in this Class Ruling described as 'the Dividend Component'), and are also taken to have received consideration in respect of each share bought back (in this Class Ruling described as 'the Sale Consideration'). Under subsection 159GZZZP(1) of the ITAA 1936 the dividend amount is deemed to have been paid and is therefore included in the assessable income of participating shareholders on the day the Buy-back occurred, which in this case was during the year of income ended 30 June 2004.

45. 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

46. Section 159GZZZP of the ITAA 1936 provides that where the Buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price 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 \$14.50 per share and \$4.00 of this was debited to the share capital account. Thus the dividend amount is \$10.50 per share.

47. The dividend amount of \$10.50 per share is frankable.

Assessability of the Dividend Component and tax offset

Direct distributions

48. In the case of Australian resident shareholders (other than a partnership or trust) who participate in the Buy-back and who directly receive the Dividend Component:

- the Dividend Component of \$10.50 is included in the assessable income of each shareholder under subsection 44(1) of the ITAA 1936; and
- an amount equal to the amount of the franking credit on the Dividend Component is included in the assessable income of each shareholder under subsection 207-20(1) of the ITAA 1997 (gross-up).

49. These 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

50. The franked distribution may flow indirectly to a partner in a partnership or a beneficiary of certain trusts.

51. In general terms, pursuant to subsection 207-50(2) of the ITAA 1997, a franked distribution will flow indirectly to a partner in a partnership where the partner:

- has an individual interest in the partnership's net income that is covered by paragraph 92(1)(a) or (b) of the ITAA 1936, or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or (b) of the ITAA 1936; and
- has a share of the franked distribution under section 207-55 of the ITAA 1997 that is a positive amount.

52. In general terms, pursuant to subsection 207-50(3) of the ITAA 1997, a franked distribution will flow indirectly to a beneficiary of a trust where the beneficiary:

- has a share of the trust's net income that is covered by paragraph 97(1)(a) of the ITAA 1936 or has an individual interest in the trust's net income that is covered by paragraph 98A(1)(a) or (b) or paragraph 100(1)(a) or (b) of the ITAA 1936; and
- has a share of the franked distribution under section 207-55 of the ITAA 1997 that is a positive amount.

53. In the case of partnerships and certain trusts that participate in the Buy-back the following income tax consequences arise.

Partnerships

54. Pursuant to subsection 44(1) of the ITAA 1936, the Dividend Component of \$10.50 is included in the assessable income of the partnership for the purposes of computing the net income of the partnership under section 90 of the ITAA 1936.

55. Pursuant to subsection 207-35(1) of the ITAA 1997, an amount equal to the amount of the franking credit on the Dividend Component is included in the assessable income of the partnership for the purposes of computing the net income of the partnership under section 90 of the ITAA 1936 (gross-up).

56. In the case where an individual partner, corporate partner, or a trustee partner specified by paragraph 207-45(c) or (d) of the ITAA 1997 (that is, trustees liable to be assessed under section 98, 99 or 99A of the ITAA 1936, or certain superannuation funds, approved deposit funds and pooled superannuation trusts) has an individual interest in the partnership's net income that is covered by paragraph 92(1)(a) or (b) of the ITAA 1936 or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or (b) of the ITAA 1936, and the partner has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the partner is entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Trusts

57. Pursuant to subsection 44(1) of the ITAA 1936, the Dividend Component of \$10.50 is included in the assessable income of a trustee for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936.

58. Pursuant to subsection 207-35(2) of the ITAA 1997, an amount equal to the amount of the franking credit on the Dividend Component is included in the assessable income of the trustee for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936 (gross-up).

59. In the case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified by paragraph 207-45(c) or (d) of the ITAA 1997 (that is, trustees liable to be assessed under section 98, 99 or 99A of the ITAA 1936, or certain superannuation funds, approved deposit funds and pooled superannuation trusts) has a share of the trust's net income that is covered by paragraph 97(1)(a) of the ITAA 1936 or has an individual interest in the trust's net income that is covered by paragraph 98A(1)(a) or (b) or paragraph 100(1)(a) or (b) of the ITAA 1936, and the beneficiary has a share of the Dividend Component under section 207-55 of the ITAA 1997 that is a positive amount, the beneficiary is entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component under section 207-57 of the ITAA 1997.

Refundable tax offset

60. The franking credit on the Dividend Component will be subject to the refundable tax offset rules in Division 67, provided the shareholders participating in the Buy-back are not excluded by subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident shareholders

61. As the Dividend Component is fully franked, a non-resident shareholder is not liable to Australian withholding tax on the Dividend Component pursuant to paragraph 128B(3)(ga) of the ITAA 1936.

Gross-up and tax offset denied in certain circumstances

62. Pursuant to Subdivision 207-F the gross-up and tax offset are denied in respect of direct and indirect distributions in the circumstances stated by section 207-145 of the ITAA 1997 and section 207-150 of the ITAA 1997. These circumstances include the following:

- the entity receiving the distribution (either directly or indirectly) is not a qualified person for the purposes of Division 1A of Part IIIAA of the ITAA 1936;
- the Commissioner has made a determination under paragraph 204-30(3)(c) of the ITAA 1997 that no imputation benefit is to arise for the entity in respect of the distribution; and
- the Commissioner has made a determination under paragraph 177EA(5)(b) of the ITAA 1936 that no imputation benefit is to arise in respect of the distribution.

63. 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 at paragraphs 76 to 81 below.

64. 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 in paragraphs 89 to 100.

Disposal of Shares under the Buy-back

65. Participating shareholders are taken to have sold those shares accepted under the Buy-back. The sale may have different taxation implications for shareholders depending on how the shares were held. For instance:

- an investor who held their shares on capital account will be subject to the capital gains tax provisions contained in Part 3-1 and 3-3 of the ITAA 1997; and
- a shareholder who held their shares on revenue account will be subject to the ordinary income provisions and, if the shares are held as trading stock, the specific trading stock provisions in Part 2-25 of the ITAA 1997.

66. It should be noted that shareholders who have both an income tax and a capital gains tax liability in respect of the Sale Consideration will generally have the amount of the capital gain reduced under the anti-overlap provisions contained in paragraph 118-20(1)(a) of the ITAA 1997. If the shares are held as trading stock the capital gain or loss is disregarded under paragraph 118-25(1)(a) of the ITAA 1997.

67. For the purposes of computing the amount of the gain or loss (on capital or revenue account), 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.

68. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the shareholder is taken to have received an amount equal to the purchase price (in this case the \$14.50 received for each share bought back) as consideration in respect of the sale of the share bought back. However, this amount is subject to certain adjustments in order to arrive at the Sale Consideration.

69. Subsection 159GZZZQ(2) of the ITAA 1936 is one of the adjusting provisions. It provides that if the purchase price is less than the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur the shareholder is taken to have received an amount equal to the market value as consideration in respect of the sale of the share bought back.

70. For the purposes of determining the application of subsection 159GZZZQ(2) the market value of each Westpac share is the volume weighted average price of the shares over the five trading days before announcement of the Buy-back, adjusted for the movement in the S&P/ASX 200 Index from the commencement of trading on the announcement date to the close of trading on the day the Buy-back closed, and further adjusted on an ex-dividend basis (Taxation Determination TD 2004/22). Under this methodology, the market value of a share bought back under the Buy-back was calculated to be \$17.71. Thus, the shareholders are taken to have received \$17.71 for the sale of each share rather than \$14.50.

71. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of \$17.71 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated under subsection 159GZZZQ(4) of the ITAA 1936. In the circumstances of the Westpac Buy-back, the Reduction Amount is equivalent to the Dividend Amount, that is, \$10.50. Therefore, the Sale Consideration for each share disposed of under the Buy-back is \$7.21 (\$17.71 less \$10.50).

Employee share plan participants

72. Westpac employees who hold shares under certain Westpac Employee Share Plans ('the Plans') may have chosen to use the deferral concession under section 139E of Division 13A of Part III of the ITAA 1936. If an employee used the deferral concession, the discount received on the shares is included in the employee's assessable income in the year in which the cessation time occurs (subsections 139B(1) and (3)). The manner in which the discount is calculated depends on whether the shares are disposed of at arm's length by the employee within 30 days of cessation time or not (section 139CC).

73. If the shares are disposed of by the employee within 30 days of the cessation time the discount is the amount or value of any consideration received for the disposal of the shares less any consideration paid or given by the employee for their acquisition (subsection 139CC(3)). Any capital gain or loss from an arm's length CGT event A1, E1, E2 or E5 that happens within 30 days of cessation time is disregarded (subsection 130-83(2) of the ITAA 1997).

74. Subsection 159GZZZQ(1) of the ITAA 1936 provides that in determining whether an amount is included in assessable income in respect of a buy-back (both for CGT purposes and for shares held on revenue account), the seller is taken to have received as consideration in respect of the sale of the shares an amount equal to the purchase price. This amount is then reduced in accordance with subsection 159GZZZQ(4) as previously explained.

75. Thus, section 159GZZZQ of the ITAA 1936 applies to determine the amount of consideration received by employee shareholders on disposal of shares obtained under the Plans for the purposes of subsection 139CC(3) where those employees disposed of their shares under the Buy-back within 30 days of the cessation time. Accordingly, the amount of consideration for disposal of the shares for the purposes of subsection 139CC(3) is taken to be \$7.21.

Qualified Person

76. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked distribution, an entity that is not a 'qualified person' in relation to the distribution for the purposes of Division 1A of Part IIIAA of the ITAA 1936 is denied a gross-up and tax offset. A person is a 'qualified person' as defined in subsection 995-1(1) of the ITAA 1997 in relation to a distribution, if the person would have been a qualified person in relation to the distribution under Division 1A of Part IIIAA of the ITAA 1936, as in force on 30 June 2002. To be a qualified person in relation to the Westpac dividend received under the Buy-back the participating shareholder must satisfy both the holding period rule and the related payments rule.¹ This Class Ruling only addresses the holding period rule under section 160APHO of the ITAA 1936.

77. The holding period rule requires a taxpayer 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 held the shares or interest 'at risk', any days during which there are materially diminished risks of loss or opportunities for gain in relation to the relevant shares or interest are not counted. Paragraph 160APHO(2)(a) of the ITAA 1936 provides that the day of acquisition and the day of disposal of the relevant shares are also not counted.

78. Pursuant to subsection 160APHM(2) of the ITAA 1936, a taxpayer is taken to have materially diminished the risks of loss and opportunities for gain on a particular day with respect to shares or interests in shares if the taxpayer's 'net position' on that day has less than 30% of the risks and opportunities relating to the shares or interest in shares.

79. The Commissioner does not regard the announcement of the Westpac Buy-back offer as affecting whether or not the shares or an interest in the shares were held 'at risk'. A tendering shareholder does not take a position with respect to their tendered shares until they are no longer able to withdraw the tender, being 18 June 2004 (section 160APHJ of the ITAA 1936). Furthermore, the net position in relation to the tendered shares at this time is such that the shareholder cannot be taken to have materially diminished the risks of loss or opportunities for gain from the shares to the extent required by subsection 160APHM(2) of the ITAA 1936. The scale back and acceptances and Buy-back Price were determined on 21 June 2004, and accordingly 21 June 2004 was the last day when the shares that were bought back were held 'at risk'.

¹ This is subject to certain exceptions provided in the ITAA 1936 and ITAA 1997.

80. There are 45 clear days between 6 May 2004 and 21 June 2004 (not counting those dates). Therefore, a shareholder will be a qualified person in relation to the Dividend Component provided:

- the shares are acquired on or before 6 May 2004;
- the shareholder has no other positions in relation to the shares sold into the Buy-back; and
- the shareholder has not made, is not under an obligation to make, nor is likely to make, any related payments.

81. A shareholder who acquired shares on or after 7 May 2004 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 section 160APHO of the ITAA 1936 but may nonetheless be a qualified person if the shareholder satisfies the small shareholder exemption under section 160APHT of the ITAA 1936.

The Anti-Avoidance Provisions

Sections 45A and 45B of the ITAA 1936

82. That part of the price received by a shareholder in a share buy-back that is not identified as a dividend by the operation of Division 16K of the ITAA 1936 is a distribution of capital. In other words, the \$4.00 debited against its share capital account is a distribution of share capital to participating shareholders.

83. 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.

84. Section 45A of the ITAA 1936 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.

85. 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.

86. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, section 45B of the ITAA 1936 applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- 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
- 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)).

87. In this case, 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.

88. 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 element of the Buy-back Price cannot be said to be attributable to the profits of the company, nor does the pattern of distributions that have been made by Westpac in the past indicate that it was being paid in substitution for a dividend.

Section 204-30 of the ITAA 1997

89. Section 204-30 of the ITAA 1997 applies where a company streams the payment of franked distributions to its shareholders in such a way that the imputation benefits attaching to the distribution are received by those shareholders who derive a greater benefit from them and other shareholders receive lesser imputation benefits, or no imputation benefits.

90. If section 204-30 applies the Commissioner is vested with a discretion, pursuant to subsection 204-30(3), whether or not to make a determination to debit the company's franking account pursuant to paragraph 204-30(3)(a), or that no imputation benefit is to arise in respect of the dividend to those shareholders who derive a greater benefit pursuant to paragraph 204-30(3)(b).

91. 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.

92. A significant portion (approximately 26%) of Westpac's ordinary shares is held by non-residents. Under the Australian tax system non-resident shareholders do not benefit from franking to the same extent as resident shareholders. The Commissioner holds the view that the structure of an off-market share buy-back is a means whereby franking credits may be streamed to resident shareholders, who will receive a greater benefit from franking credits than non-resident shareholders.

93. Although section 204-30 applies to the Westpac Buy-back, the Commissioner will not make a determination pursuant to subsection 204-30(3). This is because the Commissioner will exercise his discretion under section 177EA of the ITAA 1936. One of the relevant circumstances in the application of section 177EA is the fact that resident shareholders receive a greater benefit from franking credits than non-resident shareholders.

Section 177EA of the ITAA 1936

94. 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.

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

- there is a scheme for a disposition of shares, or an interest in shares, in a company;
- 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;
- the dividend or distribution was, or is expected to be, franked;
- 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

- 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.

96. 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 Westpac, 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.

97. 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.

98. 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).

99. In this regard, the Commissioner has come to the view that the requisite purpose exists and thus that section 177EA applies to the Buy-back. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the arrangement, in particular the structure of the Buy-back, including the tender process and scale back mechanisms which direct franking credits to those shareholders that are able to take the greatest advantage of franking credits, whether the franking credits were being delivered 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 Westpac's capital management strategy and business plan, as manifested in past activities and transactions and intended future transactions.

100. In regard to the discretion pursuant to subsection 177EA(5), however, it would be inappropriate, given the large and diverse shareholding of Westpac, 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).

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