

CR 2005/14 - Income tax: off-market share buy-back: Tower Limited

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Class Ruling

Income tax: off-market share buy-back: Tower Limited

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Preamble

The number, subject heading, **What this Class Ruling is about** (including **Tax law, 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 laws' 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:
- section 44 of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - sections 45A, 45B and 45C of the ITAA 1936;
 - sections 159GZZZM, 159GZZZP and 159GZZZQ of the ITAA 1936;
 - section 177EA of the ITAA 1936;
 - section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 112-30 of the ITAA 1997;
 - Subdivision 115-A of the ITAA 1997;
 - sections 118-20 and 118-25 of the ITAA 1997;
 - Division 136 of the ITAA 1997; and
 - sections 204-30 and 995-1 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the Australian resident shareholders of Tower Limited (Tower) who disposed of their Tower shares under the Tower off-market share buy-back which was first announced by Tower on 15 November 2004 and described in the arrangement part of this Ruling. In this Ruling they are referred to as Tower shareholders.

4. This Class Ruling does not apply to shareholders of Tower who are not resident of Australia (as defined by section 6 of the ITAA 1936) and does not deal with how the taxation law applies to these shareholders in relation to the buy-back.

5. This Class Ruling does not apply to Tower and does not deal with how the taxation laws apply to Tower in relation to the buy-back. Furthermore, it should be noted that certain information which relates to the affairs of Tower, 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

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

7. 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 12 to 21.

8. 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

10. This Class Ruling applies to the year ended 30 June 2005. 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

11. This Ruling is withdrawn and ceases to have effect after 30 June 2005. 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

12. 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 the Class Ruling dated 22 October 2004 and subsequent correspondence;
- table showing the number of resident and non-resident shareholders with the number of shares held as at 30 September 2004;
- draft financial statements for the year ended 30 September 2004 as at 5 November 2004;
- 30 September 2003 Annual Report;
- half yearly report for the six months ended 31 March 2004;
- issued share capital and summary of rights;
- table of shareholders spread at 30 September 2004 and table of top 20 shareholders at 30 September 2004;

- table of recent dividend history;
- timetable of relevant Australian Stock Exchange (ASX) announcements (including Notice of Meeting and Explanatory Statement); and
- Tower buy-back booklet.

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

13. Tower is a company incorporated in New Zealand and is listed on the New Zealand and Australian stock exchanges. On 13 September 2004 Tower announced the spin off of its Australian wealth management business to its shareholders.

14. On 15 November 2004 Tower announced an off-market buy-back (the Buy-Back) under which it intended to buy-back 0.135 Tower shares for every Tower share held by all shareholders. It notified the ASX and the New Zealand Stock Exchange (NZSX) on 15 November 2004 that it was writing to shareholders regarding the proposed Buy-Back. In December, it wrote to shareholders and included with the notification the Notice of Meeting, Explanatory Statement and Proxy Form. As at the record date 11 February 2005 for determination of entitlements to the Buy-Back offer Tower had approximately 412 million ordinary fully paid shares on issue.

15. In Tower's Annual Report for the year ended 30 September 2003, the balance sheet disclosed total shareholders' equity of \$NZ836 million, consisting of \$NZ1,035 million contributed share capital and \$NZ199 million accumulated losses. Tower's Annual Report also disclosed that there was a nil balance in the Franking Account.

16. As consideration for the Buy-Back, Tower transferred shares in a wholly owned Australian subsidiary, Australian Wealth Management Pty Ltd (AWM) to its shareholders at the exchange rate of 2.155 AWM shares for each Tower share bought. Tower did not undertake specific borrowings to finance the Buy-Back.

17. The Buy-Back required both Tower shareholder and New Zealand Court approval.

18. Tower shareholders consist of a mix of resident and non-resident individuals, companies, superannuation funds and trusts.

19. The arrangement is the result of Tower strategically reviewing its businesses and deciding to transfer the wealth management business (that is, shares in AWM) to its shareholders by way of the Buy-Back (Tower had not previously undertaken an off-market share buy-back).

20. All Tower shareholders, as registered on 11 February 2005, were required to participate in the Buy-Back.

21. The market value of an AWM share at the time of the Buy-Back was equal to \$1.00 per share.

Ruling

The distribution is not a dividend

22. The return of share capital does not constitute a dividend for the purposes of both the ITAA 1936 and the ITAA 1997.

Tower shares – sale consideration

23. Tower shareholders are taken to have received \$2.33 as consideration in respect of the sale of each of their Tower shares for the purposes of section 159GZZZQ of the ITAA 1936. The tax consequences arising from the receipt of the sale consideration will depend on whether the sale was on capital account or on revenue account. Depending on whether the shares were held on capital or revenue account, the relevant tax consequences are as follows:

- (a) shares held on capital account:
- CGT event A1 in section 104-10 of the ITAA 1997 happened to each share that was bought back by Tower. The time of the CGT event was 14 February 2005.
 - To the extent that each share's cost base was less than \$2.33, the difference is a capital gain. To the extent that each share's reduced cost base was greater than \$2.33, the difference is a capital loss: subsection 104-10(4) of the ITAA 1997.
 - A capital gain made on a share that was bought back is a discount capital gain if the share was acquired at least twelve months before 14 February 2005 and the other conditions in Subdivision 115-A of the ITAA 1997 are satisfied.
- (b) shares held on revenue account:
- To the extent that the cost of each share was less than \$2.33, the difference is assessable income.
 - To the extent that the cost of each share was greater than \$2.33, the difference is an allowable deduction.
 - If a Tower shareholder held their Tower shares as trading stock, any capital gain or capital loss made on the Buy-Back is disregarded under section 118-25 of the ITAA 1997.

- Tower shareholders who have both an amount of income and a capital gain in respect of the Buy-Back of a Tower share can reduce the amount of the capital gain by the amount included in assessable income in accordance with section 118-20 of the ITAA 1997.

The anti-avoidance provisions

24. The Commissioner will not make a determination under either section 45A or section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to treat the whole, or any part, of the capital component of the Buy-Back price received by Tower shareholders as an unfranked dividend.

25. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the ITAA 1936.

26. The Commissioner will not make a determination under paragraph 204-30(3)(c) of the ITAA 1997.

Explanation

The purchase price in respect of the Buy-Back

27. The income tax consequences of an off-market share buy-back are worked out under Subdivision C of Division 16K of Part III of the ITAA 1936. Those consequences are based on the 'purchase price' of the share worked out under section 159GZZZM of the ITAA 1936.

28. Paragraph 159GZZZM(b) of the ITAA 1936 provides that if the seller of the share has received or is entitled to receive property other than money as a result of, or in respect of, the buy-back, the purchase price is the market value of that property in respect of the buy-back. In this respect, the Tower shareholders received property other than money, being approximately 2.155 AWM shares for each Tower share bought back. The market value of each AWM share worked out at the time of the Buy-Back was equal to \$1.00.

29. The purchase price may comprise two components:

- a dividend component; and
- a capital component.

The amount of each component is determined in accordance with sections 159GZZZP and 159GZZZQ of the ITAA 1936, having regard to how the company accounts for the buy-back.

The dividend component

30. 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.

31. In this case, the entire purchase price of \$2.155 per share was debited to the share capital account. Consequently, as there is no difference between the purchase price and the amount debited against the company's share capital account no dividend amount is to be included in a shareholder's assessable income under section 44 of the ITAA 1936.

The capital component (or sale consideration)

32. For the purposes of computing the amount of a 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.

33. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the seller is taken to have received an amount equal to the purchase price in respect of the buy-back. However, this amount may be:

- increased under subsection 159GZZZQ(2) of the ITAA 1936 if the purchase price is less than the market value of the share at the time of the buy-back worked out as if the buy-back did not occur and was never proposed to occur; and/or
- reduced under subsection 159GZZZQ(3) of the ITAA 1936 to the extent that all or part of it is a dividend and included in the seller's assessable income of any income year.

34. As the purchase price (\$2.155) for the Buy-Back is less than the market value of the Tower shares, subsection 159GZZZQ(2) of the ITAA 1936 will apply. Also, as there is no dividend component no other provision in section 159GZZZQ modifies the consideration in respect of the Buy-Back.

35. The methodology for arriving at a market value pursuant to subsection 159GZZZQ(2) is set out in Taxation Determination TD 2004/22. Tower has adopted the methodology as set out in that determination to arrive at a market value of \$2.33 per share.

36. Therefore, the consideration determined under section 159GZZZQ of the ITAA 1936 is \$2.33 per share.

37. The disposal may have different taxation implications for Tower shareholders depending on how the shares were held, for instance:

- shares held on capital account are subject to the capital gains tax provisions; and
- shares held on revenue account are subject to other income tax provisions.

38. If the shares were held as trading stock, any capital gain or capital loss made on the Buy-Back is disregarded under section 118-25 of the ITAA 1997.

39. Tower shareholders who have both an income tax and a capital gains tax liability in respect of the Buy-Back will generally have the amount of the capital gain reduced under section 118-20 of the ITAA 1997.

Capital gains tax consequences

Disposal of Tower shares

40. CGT event A1 in section 104-10 of the ITAA 1997 happened to each share that is transferred to Tower under the Buy-Back. The time of the CGT event was 14 February 2005, when Tower acquired the shares from the shareholders and provided the AWM shares as consideration: subsection 104-10(3).

41. To the extent that each Tower share's cost base is less than \$2.33, the difference is a capital gain. To the extent that each share's reduced cost base is greater than \$2.33, the difference is a capital loss. Tower shareholders who held their shares on capital account will include a capital gain or capital loss in working out their net capital gain or net capital loss for the year of income in which the CGT event happened.

42. A capital gain that is made by an individual, a complying superannuation entity, a trust or a life insurance company is a discount capital gain if the conditions in sections 115-15 to 115-25 of the ITAA 1997 are satisfied. These conditions are that the capital gain must result from a CGT event happening after 11.45 am on 21 September 1999, the capital gain must not have been worked out using an indexed cost base and the asset must have been acquired at least 12 months before 14 February 2005.

43. The effect of a capital gain being a discount capital gain is that, in some circumstances, it may be reduced by the discount percentage under section 115-100 of the ITAA 1997.

Anti-avoidance provisions**Sections 45A and 45B of the ITAA 1936**

44. Sections 45A and 45B of the ITAA 1936 are anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies to treat all or part of the capital component received by the shareholder under the buy-back as an unfranked dividend.

45. 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.

46. Although a 'capital benefit' (as defined in paragraph 45A(3)(b) of the ITAA 1936) was provided to Tower shareholders under the Buy-Back, the circumstances of the Buy-Back indicate 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.

47. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. Broadly, 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 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)).

48. The term 'scheme' is broadly defined by section 177A of the ITAA 1936 as:

- (a) any agreement, arrangement, understanding, promise or undertaking, whether express or implied and whether or not enforceable, or intended to be enforceable by legal proceedings; and
- (b) any scheme, plan, proposal, action, course of action or course of conduct.

Tower will provide a capital benefit to its shareholders. The distribution of share capital, which is in the form of AWM shares, constitutes the provision of a capital benefit within the meaning conveyed by subsection 45B(5) of the ITAA 1936.

49. As some Tower shareholders derived either a capital gain or capital loss from the sale of their shares under the Buy-Back they will pay less income tax than if the Buy-Back consideration had been a dividend. Some Tower shareholders will therefore obtain a tax benefit within the meaning conveyed by subsection 45B(9) of the ITAA 1936.

50. In this Buy-Back, while the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of enabling a shareholder to obtain a tax benefit is not present having regard to the 'relevant circumstances' of the scheme as set out in subsection 45B(8) of the ITAA 1936.

51. Furthermore, the capital component of the Buy-Back cannot be said to be attributable to Tower's profits, nor does the pattern of distributions that have been made by Tower in the past indicate that the capital component was being paid in substitution for a dividend. Accordingly section 45B has no application to the Buy-Back.

52. As sections 45A and 45B will not apply to the Buy-Back, the Commissioner will not make a determination that section 45C will apply to any part of the capital component received under the Buy-Back by participating shareholders.

Section 177EA of the ITAA 1936

53. 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.

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

- (a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and
- (b) either:
 - (i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or
 - (ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and
- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and

- (d) except for this section, a person ('the relevant taxpayer') would receive, or could reasonably be expected to receive, imputation benefits as a result of the 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 an imputation benefit.

55. Section 177EA does not apply because the Buy-Back price does not include a franked distribution.

Section 204-30 of the ITAA 1997

56. 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) the 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)).

57. Section 204-30 does not apply because the Buy-Back price has no dividend component.

Detailed contents list

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Commissioner of Taxation

30 March 2005

<i>Previous draft:</i>	- ITAA 1936 45B
Not previously issued as a draft	- ITAA 1936 45B(2)(a)
	- ITAA 1936 45B(2)(b)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 45B(2)(c)
CR 2001/1; TR 92/1; TR 92/20;	- ITAA 1936 45B(5)
TR 97/16; TD 2004/22	- ITAA 1936 45B(8)
	- ITAA 1936 45B(9)
<i>Subject references:</i>	- ITAA 1936 45C
- capital gains tax	- ITAA 1936 159GZZZM
- capital streaming	- ITAA 1936 159GZZZM(b)
- dividend streaming	- ITAA 1936 Pt III Div 16K Subdiv C
arrangements	- ITAA 1936 159GZZZP
- dividends	- ITAA 1936 159GZZZQ
- return of capital on shares	- ITAA 1936 159GZZZQ(1)
- share buy-backs	- ITAA 1936 159GZZZQ(2)
	- ITAA 1936 159GZZZQ(3)
<i>Legislative references:</i>	- ITAA 1936 177EA
- Copyright Act 1968	- ITAA 1936 177EA(3)
- TAA 1953 Pt IVA	- ITAA 1936 177EA(5)(b)
- ITAA 1936 6	- ITAA 1997 104-10
- ITAA 1936 44	- ITAA 1997 104-10(3)
- ITAA 1936 45A	- ITAA 1997 104-10(4)
- ITAA 1936 45A(3)(b)	- ITAA 1997 112-30
	- ITAA 1997 Subdiv 115-A

- ITAA 1997 115-15
 - ITAA 1997 115-20
 - ITAA 1997 115-25
 - ITAA 1997 115-100
 - ITAA 1997 118-20
 - ITAA 1997 118-25
 - ITAA 1997 Div 136
 - ITAA 1997 204-30
 - ITAA 1997 204-30(1)(a)
 - ITAA 1997 204-30(1)(b)
 - ITAA 1997 204-30(1)(c)
 - ITAA 1997 204-30(3)(c)
 - ITAA 1997 995-1
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ATO references

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