

CR 2005/55 - Income tax: share buy-back: Rio Tinto Limited

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Class Ruling

Income tax: share buy-back: Rio Tinto Limited

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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 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);
 - section 45A of the ITAA 1936;
 - section 45B of the ITAA 1936;
 - section 45C of the ITAA 1936;
 - paragraph 128B(3)(ga) of the ITAA 1936;
 - Division 16K of Part III of the ITAA 1936;
 - Division 1A of Part IIIA of the ITAA 1936;
 - section 177EA of the ITAA 1936;
 - section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 104-10 of the ITAA 1997;
 - section 116-20 of the ITAA 1997;
 - section 118-20 of the ITAA 1997;
 - section 118-25 of the ITAA 1997;
 - section 136-10 of the ITAA 1997;

- section 136-25 of the ITAA 1997;
- section 202-5 of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 202-45 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997; and
- section 207-145 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is the shareholders of Rio Tinto Limited ('Rio Tinto'), a publicly listed company, who disposed of ordinary shares under Rio Tinto's off-market share buy-back ('the Buy-Back') which was announced by Rio Tinto on 11 March 2005 and described in the Arrangement part of this Ruling.

4. The class of persons to which this Ruling applies does not include Rio Tinto and Tinto Holdings Australia Pty Ltd (THA). The Ruling does not deal with how the taxation law applies to Rio Tinto or THA in relation to the Buy-Back.

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 28.

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 Ruling applies to the income year (as defined in the ITAA 1997) for a participating shareholder in which that shareholder disposed of shares under the 2005 Rio Tinto off-market buy-back of ordinary shares described in the Arrangement part of the Ruling. The arrangement will be completed within that income year. For participating shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2005. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of 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 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

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 23 December 2004;
- Correspondence dated 21 January 2005, 26 January 2005, 1 February 2005, 2 February 2005, 3 March 2005, 31 March 2005, 19 May 2005 and 31 May 2005; and
- The Off-market Buy-Back Booklet (April 2005) issued by Rio Tinto to shareholders.

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

12. On 11 March 2005 Rio Tinto announced its intention to make an off-market share buy-back of its own shares. Rio Tinto announced its intention to spend approximately \$400 million to \$500 million to purchase its ordinary shares. However, under the terms of the Buy-Back Rio Tinto could choose to buy-back a higher or lower amount, or none at all. Rio Tinto also announced that after the conclusion of this Buy-Back, Rio Tinto would buy-back a further number of its ordinary shares from Tinto Holdings Australia Pty Ltd, a wholly owned subsidiary of Rio Tinto plc on the same basis (capital component and fully franked dividend) as the Buy-Back.

13. As at 31 December 2004, the share capital of Rio Tinto comprised approximately 499 million fully paid ordinary shares. The financial statements of Rio Tinto at 31 December 2004 showed total share capital of \$1,717 million and retained profits and reserves of \$4,971 million.

14. The shareholders in Rio Tinto are a mix of individuals, companies, superannuation funds and other institutional investors, some of whom are non-residents.

15. The Buy-Back forms part of Rio Tinto's continuing capital management strategy that aims to return capital that is surplus to its needs. Rio Tinto anticipates that the Buy-Back will have positive effects over the longer term on earnings per share and returns on equity.

16. The Buy-Back was conducted through a tender process during a specified tender period and was open to all eligible ordinary shareholders who were registered on the Record Date for the Buy-Back (24 March 2005). Shares acquired on an ex-entitlement basis on or after the ex-entitlement date (18 March 2005) carried no entitlement to participate. Participation in the Buy-Back was voluntary. Hence, shareholders not wishing to participate were not required to do anything. Implementation of the Buy-Back program was subject to obtaining shareholder approval, which Rio Tinto plc sought and obtained at the annual general meeting held on 14 April 2005 and Rio Tinto sought and obtained at the annual general meeting held on 29 April 2005.

17. The tender period opened on 18 April 2005 and closed on 6 May 2005. Under the tender process, eligible shareholders were able to make an offer to sell some or all of their ordinary shares to Rio Tinto at specified discount percentages to the volume weighted average price of Rio Tinto's ordinary shares sold on the Australian Stock Exchange (ASX) over the last five trading days up to and including the closing day of the tender period. The discounts were within the range of 8% to 14% inclusive, in 1% intervals (the maximum discount would be 14%).

18. Alternatively, shareholders had the option of offering to sell their shares as a Final Price Tender, meaning that they were willing to have the shares they tendered bought back for the price which was ultimately determined by Rio Tinto to be the Buy-Back Price. Shareholders could withdraw or amend their tenders prior to the closing time of the tender period.

19. Shareholders could also provide a Minimum Price Condition from a range of 5 specified minimum prices. Tenders with a Minimum Price Condition which was greater than the Buy-Back Price would not be accepted.

20. Eligible shareholders who held 200 ordinary shares or less, and who wished to participate in the Buy-Back, would be required to tender all of their shares at either one specified discount within the range, or as a Final Price Tender.

21. The Buy-Back Price would be calculated by applying the relevant discount determined by Rio Tinto to the volume weighted average price of Rio Tinto's ordinary shares sold on the ASX over the last five trading days up to and including the closing day of the tender period.

22. Offers made by shareholders who tendered a discount percentage less than the final discount percentage determined by Rio Tinto would not be accepted.

23. All shares tendered at or above the accepted discount or as Final Price Tenders would be accepted and, therefore bought back and cancelled by Rio Tinto (subject to any Minimum Price Condition). The exception to this was if the total number of shares successfully tendered exceeded the number of shares Rio Tinto wished to buy back. In these circumstances, provision was made for a scale back of acceptance of tenders.

24. All shares bought back would receive the same Buy-Back Price per share, even if they were tendered at a greater discount percentage than finally accepted. None of the shares tendered below the accepted discount would be bought back. In the event that the number of shares tendered that satisfied the Buy-Back criteria exceeded the number of shares Rio Tinto had determined to buy back, accepted tenders could be scaled back.

25. Notwithstanding a scale back, certain small shareholdings could be excluded from any scale back and priority could be given to tenders below the Buy-Back Price and to a small number of shares tendered by each successful shareholder.

26. All shares bought back under the Buy-Back were cancelled.

27. Under the Buy-Back \$4.00 per share was debited to Rio Tinto's untainted share capital account and the balance of the Buy-Back Price was debited to Rio Tinto's retained profits. Rio Tinto's share capital account is not 'tainted' within the meaning of section 160ARDM of the ITAA 1936.

28. On 9 May 2005 the Buy-Back was completed and Rio Tinto announced that:

- it had successfully completed the off-market share Buy-Back of approximately 27.3 million Rio Tinto shares;
- the total amount of capital repurchased under the Buy-Back was approximately \$1 billion, representing approximately 8.7% of the publicly held issued capital of Rio Tinto;
- the final price paid by Rio Tinto for shares bought back under the Buy-Back was set at \$36.70 per share (being the Buy-Back Price), representing a discount of 14% to the volume weighted average price of Rio Tinto shares over the 5 days up to and including the closing date of the Buy-Back;
- shares tendered at a 14% discount or as a Final Price Tender, without the Minimum Price Condition of \$37.50 or \$40, were accepted. No scale back was applied to any of the accepted shares;
- shares tendered at a discount below 14% per share were not accepted; and
- under a separate buy-back, Tinto Holdings Australia Pty Ltd, a wholly owned subsidiary of Rio Tinto plc, accepted the same buy-back price of \$36.70 so that its proportional shareholding in Rio Tinto did not increase as a result of this Buy-Back.

Ruling

The Dividend Component

29. Participating shareholders are taken to have been paid a dividend out of the profits of Rio Tinto of \$32.70 ('the Dividend Component') for each share bought back under section 159GZZP of the ITAA 1936.

30. 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.

Assessability of the Dividend Component and tax offset

31. The Dividend Component and an amount equal to the franking credit on the Dividend Component ('gross-up') is included in the assessable income of resident individual, superannuation fund and company shareholders who participate in the Buy-Back. Those shareholders will be 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, subject to being a 'qualified person' (see paragraph 38).

32. The difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes.

Non-resident shareholders

33. 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.

The Capital Component and Sale Consideration

34. Participating shareholders are taken to have received \$6.44 as consideration in respect of the sale of each of their shares on 9 May 2005 pursuant to section 159GZZZQ of the ITAA 1936 (unless the participating shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and (9) apply).

35. Taxation Determination TD 2004/22 outlines how to determine what would have been 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. If the Buy-Back Price for each share bought back under the Buy-Back was less than what would have been the market value of the share if the Buy-Back did not occur and was never proposed to occur, in accordance with TD 2004/22, then the market value rule in subsection 159GZZZQ(2) of the ITAA 1936 applies to the Buy-Back. The effect of this rule is that the difference between the Buy-Back Price and the market value determined in accordance with TD 2004/22 will be included in the consideration received for the disposal of the share for ordinary income or capital gains tax purposes in addition to the Capital Component of \$4.00 per share.

36. The treatment of the Sale 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. In general, the relevant treatment should be as follows:

(a) Shares held on capital account

- The Sale Consideration represents the capital proceeds for the CGT event A1 that happens when a share is bought back: see Note 3 to subsection 116-20(1) of the ITAA 1997. The amount by which the Sale Consideration of \$6.44 exceeds the cost base of each share will be a capital gain to the shareholder and, unless any capital losses are available to the shareholder, will be included in the shareholder's assessable income. If the share's reduced cost base exceeds \$6.44 the difference will be a capital loss: subsection 104-10(4) of the ITAA 1997.

(b) Shares held on revenue account

- Where the shares are held as trading stock, the Sale Consideration of \$6.44 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 Sale Consideration of \$6.44 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$6.44 the difference will be an allowable deduction.

Non-resident shareholders

37. A non-resident shareholder that participates in the Buy-Back will only make a capital gain or capital loss if their shares have the necessary connection with Australia under the tests in section 136-25 of the ITAA 1997. A Rio Tinto share will have the necessary connection with Australia if, at any time during the 5 years before 9 May 2005, the shareholder together with their associates owned 10% or more by value of the issued shares in Rio Tinto.

Qualified persons

38. For the purposes of Division 1A of Part IIIAA of the ITAA 1936 participating shareholders will be 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 17 March 2005; 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.

The anti-avoidance provisions

39. 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 treat the whole, or any part, of the Capital Component of the Buy-Back Price received by participating shareholders as an unfranked dividend.

40. 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.

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.

Explanation

The Dividend and Capital Components

42. The purchase price (or Buy-Back 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

43. 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 which is debited against the share capital account, is taken to be a dividend paid by the company to the seller on the day the buy-back occurs.

44. In this case the purchase price was \$36.70 per share and \$4.00 of this was debited to the untainted share capital account. Thus the Dividend Component is \$32.70 per share.

45. The Dividend Component of \$32.70 per share is a frankable distribution but only to the extent that the Buy-Back Price does not exceed 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 (paragraph 202-45(c) of the ITAA 1997). Taxation Determination TD 2004/22 outlines how to determine what would have been the market value of a share at the time of a buy-back if the buy-back did not occur and was never proposed to occur.

46. In this case, the Buy-Back Price did not exceed the market value of Rio Tinto shares determined in accordance with TD 2004/22. The Dividend Component is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997. Rio Tinto fully franked the distribution and the amount of the attached franking credit was \$14.01 per share.

47. For Australian resident individual and corporate tax entity shareholders, and also for Australian superannuation funds, the amount of the dividend is included in their assessable income under subsection 44(1) of the ITAA 1936. Generally, an amount equal to the amount of the franking credit is included in their assessable income under subsection 207-20(1) of the ITAA 1997 ('gross-up') and they are also entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 reflecting the franking credit attached to the dividend.

48. However, it should be noted that provisions exist which may deny a gross up 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 in relation to the distribution for the purposes of Division 1A of Part IIIAA of the ITAA 1936' to be entitled to a tax offset. Broadly speaking, to be a 'qualified person' in relation to the dividend paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule (or certain alternative rules) and the related payments rule. See paragraphs 62 to 70 of this Ruling.

49. Subsection 159GZZP(2) provides that the difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes.

Non-resident shareholders

50. As the Dividend Component received under the Buy-Back is fully franked, a non-resident shareholder is not liable to Australian withholding tax on the Dividend Component in accordance with paragraph 128B(3)(ga) of the ITAA 1936.

The Capital Component and Sale Consideration

51. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 9 May 2005. The disposal may have different taxation implications for shareholders depending on how the shares were held, for instance:

- an investor who held their shares on capital account will be subject to the 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 of Part 2-25 of the ITAA 1997.

52. 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.

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

54. 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 \$36.70 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 for each share bought back under the Buy-Back.

55. 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.

56. For the purposes of determining market value under subsection 159GZZZQ(2) the following methodology has been proposed by Rio Tinto and accepted by the Commissioner in accordance with TD 2004/22; the market value of each Rio Tinto share is the volume weighted average price of the company's share on the ASX over the last five trading days before the first announcement of the Buy-Back (3 February 2005), adjusted for the ex-dividend component and for the movement in the Rio Tinto plc share price from the close of trading on the London Stock Exchange on 2 February 2005 to the opening of trading in London on 6 May 2005.

57. Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$39.14. Thus under subsection 159GZZZQ(2), the shareholders are taken to have received \$39.14 for the sale of each share rather than \$36.70.

58. Pursuant to subsection 159GZZZQ(3) of the ITAA 1936, the deemed consideration of \$39.14 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 Buy-Back, the reduction amount is equivalent to the Dividend Component, that is, \$32.70.

59. Thus, the Sale Consideration determined under section 159GZZZQ of the ITAA 1936 is \$6.44 calculated as follows:

Deemed consideration (market value)	\$39.14
less the reduction amount (Dividend Component)	<u>\$32.70</u>
Sale Consideration	<u>\$6.44</u>

60. However, it should be noted that where the participating shareholder is a corporate tax entity, which is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the Dividend Component, an adjustment may be made to the Sale Consideration. Under subsection 159GZZZQ(8), if that shareholder would otherwise incur either a capital loss or a deductible loss (or any increase in such a loss) in respect of the sale of a share bought back under the Buy-Back, the Sale Consideration is increased by an offsettable amount determined under subsection 159GZZZQ(9). The reduction amount is reduced by so much of the offsettable amount that does not exceed the capital loss or the deductible loss.

Non-resident shareholders

61. Pursuant to section 136-10 of the ITAA 1997, a non-resident will make a capital gain or a capital loss from the sale of shares under the Buy-Back only if the shares have the necessary connection with Australia under the tests in section 136-25. Under category 5 of the table set out in section 136-25 of the ITAA 1997, a Rio Tinto share will have the necessary connection with Australia if, at any time during the 5 years before 9 May 2005, the shareholder together with their associates owned 10% or more by value of the issued shares in Rio Tinto.

Qualified person

62. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked distribution made to 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 Dividend Component paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule.

63. In general terms, a shareholder will not satisfy the related payments rule if the shareholder, or associate of the shareholder, is under an obligation to make, or makes, a payment in respect of the dividend which effectively passes the benefit of the dividend to another person.

64. 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.

65. 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.

66. In this case the Commissioner does not regard the announcement of the Buy-Back as affecting whether the shares or an interest in shares were held at risk or not.

67. There are 45 clear days between 24 March 2005 and 9 May 2005 that is, the date the tender offer was accepted. However, shares in Rio Tinto traded on the ASX on an ex-entitlement basis on and after 18 March 2005. Therefore, a shareholder who acquired shares on or before 17 March 2005 and disposed of those shares into the Buy-Back satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days.

68. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first: subsection 160APHI(4) of the ITAA 1936. This rule operates on a last-in-first-out basis, so that shareholders will be deemed to have disposed of their most recently acquired shares first for the purposes of applying the 45 day rule.

69. Rio Tinto shares acquired by participating shareholders which do not confer an entitlement to participate in the Buy-Back do not constitute 'related securities' for the purposes of subsection 160APHI(4) of the ITAA 1936 to any Rio Tinto shares held by the shareholder which do confer an entitlement to participate in the Buy-Back.

70. Accordingly, subsection 160APHI(4) of the ITAA 1936 will not apply in relation to shares disposed of into the Buy-Back where a participating shareholder acquired, on or after 18 March 2005, any additional Rio Tinto shares that did not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

Sections 45A and 45B of the ITAA 1936

71. It was noted at paragraph 27 of this Ruling that Rio Tinto debited \$4.00 of the Buy-Back Price to its untainted share capital account. This amount is a distribution of capital to participating shareholders.

72. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C of the ITAA 1936 applies. The effect of such a determination is that all or part of the distribution of capital to a 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.

73. Section 45A is an anti-avoidance provision that applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of share capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

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

75. Section 45B applies where certain capital benefits are provided to shareholders in substitution for dividends. In broad terms, section 45B 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)).

76. In the case of the Buy-Back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, the requisite degree of purpose of enabling the shareholder to obtain a tax benefit – by way of distribution of share capital – was not present.

77. Having regard to the 'relevant circumstances' of the scheme (the Buy-Back), as set out in subsection 45B(8), there was not a 'more than incidental' purpose, by way of capital distribution, of enabling the shareholders to obtain a tax benefit. Further, the Capital Component of the Buy-Back Price cannot be said to be attributable to profits, nor does the pattern of distributions that have been made by Rio Tinto in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA of the ITAA 1936

78. Section 177EA 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.

79. Specifically, subsection 177EA(3) 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, the 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.

80. 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 Rio Tinto, 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.

81. 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.

82. The Commissioner has come to the view 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, as outlined in subsection 177EA(17). Among the circumstances of the Buy-Back reflected in those paragraphs are:

- 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;
- the greater attraction of the Buy-Back to some resident shareholders with a low marginal tax rate than other resident shareholders (e.g. whereas complying superannuation funds are taxed at 15% and corporations at 30%, individuals can be taxed at a marginal tax rate up to 47%); and
- that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

83. Where section 177EA applies the Commissioner has a discretion, pursuant to subsection 177EA(5) to make a determination to debit the company's franking account pursuant to paragraph 177EA(5)(a), or deny the imputation benefit to each shareholder pursuant to paragraph 177EA(5)(b). 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

84. Section 204-30 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)); and
- (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)).

85. Relevantly, 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)).

86. 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.

87. A significant proportion of the Rio Tinto shareholding was held by non-residents who do not fully benefit from franking, a feature of the Buy-Back, to the same extent as resident shareholders. Thus, the conditions in subsection 204-30(1) for the provision to apply are met. However, the Commissioner will not make a determination under section 204-30.

Detailed contents list

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Commissioner of Taxation

29 June 2005

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