



CR 2007/37 - Income tax: off-market share buy-back: Corporate Express Australia Limited

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Class Ruling

Income tax: off-market share buy-back: Corporate Express Australia Limited

Contents	Para
LEGALLY BINDING SECTION:	
What this Ruling is about	1
Date of effect	9
Scheme	14
Ruling	30
NOT LEGALLY BINDING SECTION:	
Appendix 1:	
<i>Explanation</i>	51
Appendix 2:	
<i>Detailed contents list</i>	106

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this 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;
 - section 90 of the ITAA 1936;
 - subsection 95(1) of the ITAA 1936;
 - paragraph 128B(3)(ga) of the ITAA 1936;
 - Subdivision C of Division 16K of the ITAA 1936;

- Division 1A of Part IIIAA of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 116-20 of the ITAA 1997;
- section 118-20 of the ITAA 1997;
- section 118-25 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;
- section 207-55 of the ITAA 1997;
- section 207-57 of the ITAA 1997;
- section 207-145 of the ITAA 1997; and
- Division 855 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is shareholders who:

- acquired shares in Corporate Express Australia Limited (Corporate Express) other than under an eligible employee share ownership scheme; and
- disposed of those shares under the 2007 Corporate Express off market Buy-Back of ordinary shares described in the scheme part of the Ruling.

4. The class of persons to which this Ruling applies does not include Corporate Express. The Ruling does not deal with how the taxation law applies to Corporate Express 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 entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 29 of this Ruling.

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

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme 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 from 1 July 2006 to 30 June 2007. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

10. 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. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

14. This description is based on a number of documents provided to the Commissioner.

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

15. Corporate Express is an Australian incorporated company listed on the Australian Stock Exchange (ASX). On 8 February 2007 Corporate Express announced its intention to make an off-market buy-back of its own shares (the Buy-Back). In its announcement, Corporate Express stated that it would spend around \$50 million in purchasing its own ordinary shares. However Corporate Express could choose to buy-back a greater or lesser amount or none at all.

16. As at 8 February 2007 Corporate Express had approximately 184,410,008 fully paid ordinary shares on issue (and no other types of shares). Corporate Express' consolidated Balance Sheet, as at 31 December 2006, disclosed total shareholder's equity of \$229.414 million, consisting of \$55.281 million contributed share capital, \$172.157 million retained profits, and \$1.976 million in reserves. The shareholders in Corporate Express are a mix of individuals, companies, superannuation funds and other institutional investors, some of whom are non-residents.

17. The Buy-Back forms part of Corporate Express' continuing capital management strategy that aims to return capital that is surplus to its needs. Corporate Express anticipates that the Buy-Back will have positive effects on earnings per share and returns on equity.

18. The Buy-Back was conducted through a tender process during a specified tender period and was open to all eligible shareholders who were registered as such on the record date for the Buy-Back (19 February 2007) and were not Excluded Foreign Shareholders. Shares acquired on the ASX on an ex-entitlement basis on or after the ex-entitlement date (13 February 2007) carried no entitlement to participate. Participation in the Buy-Back was voluntary. Hence, eligible shareholders not wishing to participate were not required to do anything.

19. The tender period opened on Monday 26 February 2007 (Opening Date) and closed on 30 March 2007 (Closing Date). Under the tender process, shareholders were able to submit offers to sell their shares at specified discount percentages (Tender Discount) to the volume weighted average price (VWAP) of Corporate Express shares (Market Price) traded on the ASX over the last five trading days of the Buy-Back Tender Period. The maximum number of shares that a shareholder could tender into the Buy-Back was specified on the Tender Form. Shareholders were able to withdraw or amend their tenders prior to the closing date of the tender period (30 March 2007).

20. The Tender Discount percentages were within a specified range of 5% to 14% per share, in 1% intervals. In doing so, shareholders could also have submitted tenders to sell different parcels of shares (minimum 500 shares per parcel) at different tender discounts or, as a Final Price Tender, which was the price as finally determined under the tender process. However, if the shareholder held 500 shares or less, it was required to tender all of its shares (at one Tender Discount or as a Final Price Tender) in order to participate in the Buy-Back.

21. Shareholders who nominated a Tender Discount and/or a Final Price Tender were provided with a choice to nominate a 'minimum Buy-Back Price'. A Shareholder could make their tender conditional on the Buy-Back Price being no less than a Minimum Price. Shareholders who failed to nominate a Tender Discount or a Final Price Tender and who attempted to specify only a 'minimum Buy-Back Price' were not accepted.

22. The price at which the shares were bought back (Buy-Back Price) was the price that was derived by applying the Buy-Back Discount to the Market Price. The Buy-Back Discount was the largest Tender Discount which enabled Corporate Express to buy back the number of shares that it determined to buy back. Shareholders who tendered at a Tender Discount less than the Buy-Back Discount were not accepted. Shareholders who tendered at a Tender Discount equal to or larger than the Buy-Back Discount, or who lodged a Final Price Tender, had their shares accepted and received the Buy-Back Price for each share bought back, subject to any nominated Minimum Buy-Back Price. Where shareholders elected to nominate a 'minimum Buy-Back Price', and the Buy-Back Price was below that price, the tender was rejected.

23. A scale back mechanism would be applied if the total number of shares tendered as Final Price Tenders and at Tender Discounts equal to or greater than the Buy-Back Discount were more than the total number of shares Corporate Express determined to buy back. A Priority Parcel of 500 shares (or a lesser number as determined by Corporate Express) would be bought back from each successful tendering shareholder before the scale back was applied.

24. Further, notwithstanding the scale back, any shareholder who tendered all of their shares at one or more Tender Discounts equal to or greater than the Buy-Back Discount, and/or as a Final Price Tender, and would have, unless otherwise determined, 350 or fewer shares as a result of a scale back, had all of the shares they tendered bought back in full (Small Residual Holdings) under the Buy-Back.

25. The scale back would be applied as follows:

- (a) all shares tendered as a Final Price Tender or at a 14% Tender Discount was treated as a single Tender;
- (b) a Priority Parcel was bought back from each shareholder who tendered shares at a 14 per cent Tender Discount and/or as a Final Price Tender. Where the shareholder tendered a parcel of shares equal to or less than the Priority Parcel at a 14 per cent Tender Discount and/or as a Final Price Tender, all of those shares were bought back;
- (c) Small Residual Holdings were accepted in full;
- (d) the balance of the Tenders was scaled-back on a pro-rata basis; and
- (e) shares tendered at a Tender Discount smaller than 14 per cent were rejected.

26. The Buy-Back Price was subject to two overriding limits:

- (a) Corporate Express would not buy-back shares at a discount greater than 14% to the VWAP of Corporate Express shares over the five (5) trading days up to and including the closing day of the tender period (30 March 2007); and
- (b) the Buy-Back Price would not exceed the market value of Corporate Express shares determined in accordance with Taxation Determination TD 2004/22.

27. Under the Buy-Back, \$0.30 per share was debited to Corporate Express' untainted share capital account and the balance of the Buy-Back Price debited to Corporate Express' retained profits.

28. The Buy-Back was completed and all shares bought back were cancelled on 2 April 2007.

29. On 2 April 2007, Corporate Express announced that:

- it had successfully completed the off-market share Buy-Back of 16,984,761 Corporate Express shares, representing 9.2 % of the issued capital of Corporate Express;
- the total amount of capital repurchased under the Buy-Back was approximately \$90 million;

- the final price paid by Corporate Express for shares bought back under the Buy-Back was set at \$5.30 per share, representing a discount of 14% to the VWAP of Corporate Express shares over the 5 days up to and including the closing date of the Buy-Back;
- shares tendered at a tender discount of 14% or as a final price tender were accepted, subject to a scale back. The scale back mechanism set out at paragraphs 23 to 25 of this Ruling was applied which resulted in successful shareholders having 60.95% of their shares tendered in excess of the Priority Parcel bought back;
- shares tendered at tender discounts of less than 14% were not accepted; and
- no tenders were excluded on the basis of a minimum price condition.

Ruling

The Dividend Component

30. Participating Shareholders will be taken to have been paid a dividend of \$5.00 (the Dividend Component) for each share bought back under section 159GZZZP.

31. 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.

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

Assessability of the Dividend Component and Tax Offset

Direct distributions

33. 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 participated 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 (Tax Offset), subject to being a 'qualified person' (see paragraphs 46 and 47 of this Ruling).

Indirect distributions*Partnerships*

34. The Dividend Component and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of a partnership that participated in the Buy-Back for the purposes of computing the net income of the partnership under section 90.

35. 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 (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 will be 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, subject to the 'qualifying person rules' (see paragraphs 46 and 47 of this Ruling).

Trusts

36. The Dividend Component and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of the trustee that participated in the Buy-Back for the purposes of computing the net income of the trust under subsection 95(1).

37. In a case where an individual beneficiary, corporate beneficiary, or a trustee beneficiary specified in 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(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 will be 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, subject to the 'qualifying person rules' (see paragraphs 46 and 47 of this Ruling).

Refundable tax offsets

38. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided the participating shareholders are not excluded by the operation of sections 67-25 of the ITAA 1997.

Non-resident shareholders

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

The Capital Component (Sale Consideration)

40. Participating Shareholders are taken to have received \$0.70 as consideration in respect of the sale of each of their shares bought back under the Buy-Back (Sale Consideration) in accordance with section 159GZZZQ (unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and (9) apply).

41. 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) 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 amount of \$0.30 per share debited to the share capital account (Capital Component). Accordingly, the Sale Consideration is \$0.70.

42. 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.

Shares held on capital account

43. The Sale Consideration of \$0.70 represents the capital proceeds for capital gains 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 \$0.70 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 \$0.70 are less than the reduced cost base of the share. The shares are taken to be disposed of for capital gains purposes on 2 April 2007 pursuant to section 104-10 of the ITAA 1997.

Sales held on revenue account

44. Where the shares are held as trading stock, the Sale Consideration of \$0.70 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 \$0.70 exceeds the cost of each share will be included in the shareholder's assessable income. Correspondingly, if the cost exceeds \$0.70, the difference will be an allowable deduction.

Foreign resident shareholders

45. A foreign resident shareholder that participated in the Buy-Back can disregard any capital gain or capital loss made in respect of a share bought back under the Buy-Back if the share is not taxable Australian property under the tests in section 855-15 of the ITAA 1997. Generally, a Corporate Express share that is disposed into the Buy-Back will only be taxable Australian property if the foreign resident has used the Corporate Express share in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15).

Qualified persons

46. For the purposes of Division 1A of Part IIIAA, participating shareholders will be considered to satisfy the holding period rule under section 160APHO 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:

- the shares sold into the Buy-Back were acquired on or before 15 February 2007 (noting that Corporate Express shares traded on the ASX on an ex-entitlement basis in relation to the Buy-Back from 13 February 2007 (the Ex-entitlement Date)); and
- 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) for a continuous period of at least 45 days. Neither the announcement of the Buy-Back, the making of an invitation to shareholders to offer to sell their shares nor the making of an offer by a shareholder to Corporate Express in respect of a share will affect whether the shares bought back under the Buy-Back are held 'at risk' for the purposes of Division 1A of Part IIIAA.

47. Where a participating shareholder acquired, after 15 February 2007, any additional Corporate Express shares that did not confer an entitlement to participate in the Buy-Back, the 'last-in first-out' rule in subsection 160APHI(4) will not apply in relation to those shares. However, where a participating shareholder acquired shares after this date which do confer an entitlement to participate in the Buy-Back, the 'last-in first-out' rule will apply in relation to these shares.

The anti-avoidance provisions

48. The Commissioner will not make a determination under subsections 45A(2) or 45B(3) that section 45C applies to the whole, or any part, of the Capital Component of the Buy-Back Price received by participating shareholders.

49. The Commissioner will not make a determination under paragraph 177EA(5)(b) 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.

50. 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.

Commissioner of Taxation

9 May 2007

Appendix 1 – Explanation

ⓘ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

The Dividend and Capital Component

51. The purchase price received by a participating shareholder for each share bought back under the Buy-Back (the Buy-Back Price) comprises two components:

- a Dividend Component; and
- a Capital Component.

52. The amount of each of these components is determined in accordance with sections 159GZZZP and 159GZZZQ, having regard to how the company accounts for the Buy-Back.

The Dividend Component

53. Section 159GZZZP provides that where the buy-back of a share is an off-market purchase, the difference between the buy-back price and the part (if any) of the buy-back 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 the case of Corporate Express, the Buy-Back Price was \$5.30 per share and \$0.30 of this was debited to the share capital account (Capital Component). Thus the Dividend Component is \$5.00 per share.

54. The Dividend Component of \$5.00 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 share Buy-Back if the Buy-Back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997). 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.

55. In this case, the Buy-Back Price did not exceed the market value of Corporate Express shares determined in accordance with TD 2004/22.

Assessability of the Dividend Component and Tax Offset***Direct distributions***

56. 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 is included in the assessable income of each shareholder under subsection 44(1) of the ITAA 1936; and
- subject to the 'qualified person' rule, 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).

57. Subject to the 'qualified person' rule, 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

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

59. 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.

60. 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.

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

Partnerships

62. Pursuant to subsection 44(1), 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.

63. Subject to the 'qualified person' rule, 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).

64. 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, subject to the 'qualified person' rule, 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

65. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of a trustee for the purposes of computing the net income of the trust under subsection 95(1).

66. Subject to the 'qualified person' rule, 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).

67. 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, subject to the 'qualified person' rule, 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

68. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided the participating shareholders are not excluded by subsections 67-25(1A) to (1D) of the ITAA 1997.

Non-resident shareholders

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

The Capital Component (Sale Consideration)

70. Participating Shareholders are taken to have disposed of those shares accepted under the Buy-Back on 2 April 2007. 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 Parts 3-1 and Parts 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.

71. 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.

72. 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 the Buy-Back is determined in accordance with section 159GZZZQ.

73. Subsection 159GZZZQ(1) provides that the shareholder is taken to have received an amount equal to the Buy-Back Price 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.

74. Subsection 159GZZZQ(2) is one of the adjusting provisions. It provides that if the Buy-Back 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.

75. For the purposes of determining market value for the purposes of subsection 159GZZZQ(2), the following methodology has been proposed by Corporate Express and accepted by the Commissioner in accordance with TD 2004/22: the market value of each share is the VWAP of the company's share on the ASX over the last five trading days before the first announcement of the buy-back, adjusted for the percentage change in the S&P/ASX 200 Index from the commencement of trading on the first announcement date (the Opening S&P/ASX 200 Index) to the close of trading on the day the buy-back closes (the Closing S&P/ASX 200 Index), and further adjusted on an ex-dividend basis.

76. Under this methodology, the market value of a share bought back under the Buy-Back was calculated to be \$5.70. Thus, the shareholders are taken to have received \$5.70 for the sale of each share, rather than the Buy-Back Price of \$5.30 (Deemed Consideration).

77. Pursuant to subsection 159GZZZQ(3), the Deemed Consideration of \$5.70 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated under subsection 159GZZZQ(4). In the circumstances of the Buy-Back, the Reduction Amount is equivalent to the dividend amount, that is, \$5.00.

78. Therefore, the Sale Consideration determined under section 159GZZZQ is \$0.70, calculated as follows:

Deemed Consideration (Market value)	\$5.70
/less the Reduction Amount (Dividend Component)	\$5.00
Sale Consideration	\$0.70

79. 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) of the ITAA 1936, 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 offsetable amount determined under subsection 159GZZZQ(9). The Reduction Amount is reduced by so much of the offsetable amount that does not exceed the capital loss or the deductible loss.

Qualified person

80. Paragraph 207-145(1)(a) and paragraph 207-150(1)(a) of the ITAA 1997 provide that in relation to a franked distribution made or flows indirectly 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.

81. Broadly speaking, to be a 'qualified person' in relation to the Dividend Component paid under the Buy-Back, a participant must satisfy both the holding period rule and the related payments rule.

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

83. 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 of loss or opportunities for gain 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.

84. Under subsection 160APHM(2), a shareholder is taken to have materially diminished the risks of loss and opportunities for gain with respect to shares or interest 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.

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

86. There are 45 clear days between 15 February 2007 and 2 April 2007 (that is, the date the tender offer was accepted). Therefore a shareholder who acquired shares on or before 15 February 2007 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A shareholder who acquired shares after 15 February 2007 that were subsequently bought back under the Buy-Back is not a qualified person in relation to the dividend paid under the Buy-Back for the purposes of Division 1A of Part IIIAA except in certain circumstances. It is noted that Corporate Express shares traded on the ASX on an ex-entitlement basis in relation to the Buy-Back from 13 February 2007.

87. 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). The 45 day 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, including those in respect of any Dividend Component paid, the shareholder would not be a qualified person. Accordingly, shareholders who, after 15 February 2007, acquired any additional Corporate Express shares which conferred an entitlement to participate in the Buy-Back, may not qualify for the franking credits attached to the dividends paid on some or all of the shares sold into the Buy-Back.

88. However, Corporate Express shares acquired by participating shareholders which did not confer an entitlement to participate in the Buy-Back (ex-entitlement shares) which were purchased after Corporate Express shares that do confer an entitlement to participate in the Buy-Back (cum-entitlement shares) will not be considered to take the place of tendered cum-entitlement shares under an application of the 'last-in first-out' rule in subsection 160APHI(4). Ex-entitlement shares do not constitute 'related securities' for the purposes of subsection 160APHI(2) to any cum-entitlement shares. Accordingly, where a participating shareholder acquired, after 15 February 2007, any additional Corporate Express shares that did not confer an entitlement to participate in the Buy-Back, the 'last-in first-out' rule in subsection 160APHI(4) will not apply in relation to those shares.

The anti-avoidance provisions

Sections 45A and 45B

89. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination that section 45C applies in relation to the distribution of capital received under the Buy-Back, with the result that either the whole or a part of the distribution is taken to be an unfranked dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

90. Section 45A 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.

91. 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.

92. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Broadly, section 45B applies where:

- (a) there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- (b) under the scheme, a taxpayer, who may or may not be the person provided with the capital benefit, obtains a tax benefit (paragraph 45B(2)(b)); and
- (c) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme, did so for a purpose (whether or not the dominant purpose but not including an incidental purpose), of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

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

94. Having regard to the relevant circumstances of the scheme (the Buy-Back), as set out in subsection 45B(8), it is apparent that the inclusion of the Capital Component in the Buy-Back Price through a return of share capital was not inappropriate. Further, the Capital Component of the Buy-Back Price cannot be said to be attributable to the profits of the company, nor does the pattern of distributions made by Corporate Express in the past indicate that the Capital Component was being paid in substitution for a dividend.

Section 177EA

95. 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.

96. 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 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.

97. 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 Corporate Express, 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.

98. 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).

99. 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.

100. 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 relevant circumstances of the arrangement, as outlined in subsection 177EA(17). Among the circumstances 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 lower marginal tax rate than other resident shareholders (for example, whereas superannuation funds are taxed at 15% and corporations at 30%, individuals can be taxed at a marginal tax rate of up to 45%); and
- that participating shareholders were more likely than not to make an economic gain, but a loss for tax purposes, from their participation.

101. 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).

Paragraph 204-30(3)(c)

102. 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:

- 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));
- the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b)); and

- 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)).

103. If section 204-30 of the ITAA 1997 applies, the Commissioner is vested with 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)).

104. For section 204-30 of the ITAA 1997 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.

105. A significant portion of Corporate Express' 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) of the ITAA 1997 for the provision to apply are met. However the Commissioner will not make a determination under section 204-30.

Appendix 2 – Detailed contents list

106. The following is a detailed contents list for this Ruling:

	Paragraph
What this Ruling is about	1
Relevant provision(s)	2
Class of entities	3
Qualifications	5
Date of effect	9
Scheme	14
Ruling	30
The Dividend Component	30
Assessability of the Dividend Component and Tax Offset	33
<i>Direct distributions</i>	33
<i>Indirect distributions</i>	34
<i>Partnerships</i>	34
<i>Trusts</i>	36
<i>Refundable tax offsets</i>	38
<i>Non-resident shareholders</i>	39
The Capital Component (Sale Consideration)	40
Shares held on capital account	43
Sales held on revenue account	44
Foreign resident shareholders	45
Qualified persons	46
The anti-avoidance provisions	48
Appendix 1 – Explanation	51
The Dividend and Capital Component	51
The Dividend Component	53
Assessability of the Dividend Component and Tax Offset	56
<i>Direct distributions</i>	56
<i>Indirect distributions</i>	58
<i>Partnerships</i>	62
<i>Trusts</i>	65
<i>Refundable tax offset</i>	68
<i>Non-resident shareholders</i>	69

CR 2007/37

The Capital Component (Sale Consideration)	70
Qualified person	80
The anti-avoidance provisions	89
<i>Sections 45A and 45B</i>	89
<i>Section 177EA</i>	95
<i>Paragraph 204-30(3)(c)</i>	102
Appendix 2 – Detailed contents list	106

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Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22

Subject references:

- dividend streaming arrangements
- frankable dividends
- share buy-backs

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CR 2007/37

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