


CR 2008/85 - Income tax: off-market share buy-back: MMC Contrarian Limited

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Class Ruling

Income tax: off-market share buy-back: MMC Contrarian Limited

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ⓘ This publication provides you with the following level of protection:

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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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.

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:

- subsection 6(1) 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 159GZZZJ of the ITAA 1936;
- section 159GZZZK of the ITAA 1936;
- section 159GZZZM of the ITAA 1936;
- section 159GZZZP of the ITAA 1936;
- section 159GZZZQ 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;
- Division 725 of the ITAA 1997;
- Division 727 of the ITAA 1997;
- section 855-10 of the ITAA 1997;
- section 855-15 of the ITAA 1997;
- section 855-25 of the ITAA 1997;
- section 855-30 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of MMC Contrarian Limited (MMC) who disposed of shares to MMC under the MMC off-market share buy-back (buy-back) announced on 26 August 2008 and described in the scheme part of this Ruling. In this Ruling, the shareholders of MMC are collectively referred to as 'shareholders' or 'participating shareholders'.

Qualifications

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. 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 9 to 26 of this Ruling.

6. 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

8. This Ruling applies from 1 July 2008 to 30 June 2009. The Ruling continues to apply after 30 June 2009 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will 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 this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant.

10. The relevant documents or part of documents include the application for class ruling dated 11 September 2008 and further information received on 22 September 2008 and 14 October 2008.

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

Background

11. MMC is an investment company listed on the Australian Securities Exchange (ASX). MMC primarily invests in ASX listed securities and its investment portfolio mainly comprises shares, cash, hybrid securities and debentures.

12. As at 29 August 2008, MMC had approximately 5,672 shareholders and 1.96% of MMC's issued capital was held by non resident shareholders. It had 248,407,825 ordinary shares on issue.

13. As at 30 June 2008 MMC had share capital of \$220,233,169 and retained losses of \$39,682,000.

14. MMC is the head company of a tax consolidated group and it does not directly or indirectly (through its investments) hold an interest in Australian real property.

15. Guinness Peat Group (Australia) Pty Limited and its associates (GPG) held approximately 15.17% of MMC's shares. HGL Limited (HGL) held approximately 13.84% of MMC's shares.

Proposal

16. On 26 August 2008, the MMC Board announced:

- a proposed capital return of up to \$75 million (being up to approximately 43% of the shares on issue) by way of an equal access buy-back scheme (buy-back). Shareholders could tender up to 100% of their shares at a price equivalent to MMC's pre-tax net tangible asset backing (NTA) at 30 September 2008; and
- the acquisition by GPG of HGL's remaining shareholdings in MMC after its participation in the buy-back (sale of shares).

17. Each of the two above transactions was subject to shareholder approval and the buy-back would only proceed if shareholders approved the sale of shares. These approvals were given at MMC's annual general meeting of shareholders on 23 October 2008. The transactions were also subject to HGL not withdrawing from the proposed sale of shares.

18. The buy-back and the sale of shares resolutions were interdependent because GPG would be required to acquire less shares in MMC as a result of the buy-back and GPG's obligations under the share sale agreement were conditional upon HGL participating in the buy-back.

Buy-back

19. An invitation was made to all shareholders to tender shares in the buy-back. The tender process opened on 7 October 2008 and closed on 27 October 2008. However, employees were unable to make an offer of shares to MMC under the buy-back due to restrictions placed on their shareholdings.

20. Further, MMC did not make buy-back invitations to shareholders who resided in, or had a registered address in, foreign countries other than in those countries where the company was aware that the laws of that country would allow the buy-back invitations or acceptances of the offers.

21. Where a shareholder held less than 250 shares and made a buy-back offer, the shareholder was required to offer to sell all of the shareholder's shares. A scale back mechanism operated in the event that MMC received buy-back offers for more than \$75 million worth of shares.

22. The record date for participation in the buy-back was 3 October 2008, and the results of the buy-back were announced and shares bought back were cancelled on 29 October 2008.

23. The buy-back price per share was equivalent to MMC's pre-tax NTA at 30 September 2008. This was 70.9 cents. MMC bought back 105.8 million shares.

24. MMC debited the entire amount of the buy-back price against its untainted share capital account.

GPG's participation in buy-back

25. GPG would not make buy-back offers to MMC unless shareholders (other than itself and HGL) had made buy-back offers to MMC for 30% or more of the shares.

Sale of shares from HGL to GPG

26. On 25 August 2008, GPG and HGL entered into a sale agreement whereby GPG agreed to acquire HGL's remaining shareholdings in MMC after its participation in the buy-back. This sale agreement has now been concluded.

Ruling

Purchase price in respect of each share bought back

27. As the entire purchase price in respect of the shares acquired through the buy-back is debited against MMC's untainted share capital account, it does not constitute a dividend as defined in subsection 6(1) of the ITAA 1936 and participating shareholders will not be taken to have been paid a dividend under section 159GZZZP of the ITAA 1936.

Consideration in respect of the sale of each share bought back

28. Pursuant to section 159GZZZQ of the ITAA 1936, participating shareholders are taken to have received a purchase price equivalent to MMC's NTA at 30 September 2008 – 70.9 cents – as consideration in respect of the sale of each of their shares under the buy-back.

29. The treatment of the 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

30. The sale consideration under the buy-back represents the capital proceeds for capital gains tax purposes pursuant to section 116-20 of the ITAA 1997. A participating shareholder will make a capital gain on a share if the sale consideration per share exceeds the cost base of that share. Similarly, a participating shareholder will make a capital loss if the sale consideration is less than the reduced cost base of a share.

31. The shares are taken to have been disposed of for capital gains tax purposes on 29 October 2008 (subsection 104-10(3) of the ITAA 1997).

Shares held on revenue account

32. Where the shares are held as trading stock, the sale consideration of 70.9 cents per share under the buy-back 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 under the buy-back exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds the sale consideration under the buy-back, the difference is an allowable deduction.

Value shifting rules

33. There will be no consequences for an entity under Divisions 725 and 727 of the ITAA 1997 as a result of participating in the share buy-back arrangement.

Foreign resident shareholders

34. A foreign resident shareholder who participates 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' (section 855-10 of the ITAA 1997).

35. The term 'taxable Australian property' includes an 'indirect Australian real property interest' (item 2 in the table in section 855-15 and section 855-25 of the ITAA 1997). A MMC share is not an indirect Australian real property interest as it does not pass the principal asset test in section 855-30 of the ITAA 1997 (section 855-25 of the ITAA 1997).

36. It follows that a MMC share will only be 'taxable Australian property' if:

- it has been used by the foreign resident in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- it is a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident – item 5 of the table in section 855-15).

The anti-avoidance provisions

37. The Commissioner will not make a determination under sections 45A or 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the buy-back price received by participating shareholders.

Commissioner of Taxation

3 December 2008

Appendix 1 – Explanation

❶ *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.*

Income tax treatment of the buy-back

38. The purchase by MMC of its shares under the buy-back will be an off-market purchase for the purposes of Division 16K of Part III of the ITAA 1936. This characterisation follows from the definitions contained in sections 159GZZZJ and 159GZZZK of the ITAA 1936.

39. The buy-back consideration of 70.9 cents per share which is equivalent to MMC's NTA at 30 September 2008 does not constitute a dividend as defined under subsection 6(1) of the ITAA 1936 as the entire amount will be debited against MMC's untainted share capital account.

Purchase price in respect of each share bought back

40. Under section 159GZZZM of the ITAA 1936, the purchase price in respect of shares acquired through the buy-back is the amount of money the participating shareholder received as a result of or in respect of the buy-back.

41. Under section 159GZZZP of the ITAA 1936, the purchase price contains a dividend component only if the buy-back price exceeds the amount debited against the company's share capital account. As the buy-back price will be debited entirely against MMC's untainted share capital account, no part of the purchase price will be taken to be a dividend for income tax purposes.

Consideration in respect of the sale of each share bought back

42. 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; and
- a share trader who held their shares on revenue account will be subject to the ordinary income provisions.

43. It should be noted that shareholders who have both an income tax and 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.

44. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the shareholder is taken to have received an amount equal to the purchase price of 70.9 cents per share (in this case, the purchase price equals to the MMC's NTA at 30 September 2008) as consideration in respect of the sale of the share bought back.

45. For the purposes of computing the amount of the gain or loss (either on capital or revenue account) in these cases, the consideration in respect of the disposal of a share under the buy-back that participating shareholders will be taken to have received is 70.9 cents per share which is equivalent to MMC's NTA at 30 September 2008 as determined by MMC in accordance with the scheme.

Value shifting rules

46. There is a direct value shift under a scheme involving equity or loan interests in an entity where there is a decrease in the market value of some equity or loan interest and an increase or issue at a discount of other equity or loan interests: section 725-145 of the ITAA 1997. There is an indirect value shift where there is an unequal exchange of economic benefits between two entities (the losing entity and gaining entity: subsection 727-150(3) of the ITAA 1997.

47. A direct value shift or indirect value shift can occur where there is a buy-back of shares at other than market value. There can only be consequences for a direct value shift if there is any entity that controls the target entity for value shifting purposes at some time during the scheme period defined in section 725-55: paragraph 725-50(b) of the ITAA 1997. Section 727-355 of the ITAA 1997 sets out the relevant tests for whether an entity controls a company for value shifting purposes.

48. There can only be consequences for an indirect value shift (IVS) if the entities between which the value is shifted (the losing entity and the gaining entity) satisfy an ultimate controller test and or a common ownership nexus test at some time during the IVS period defined in subsection 727-150(7) of the ITAA 1997: paragraph 727-100(c) and sections 727-105 and 727-110 of the ITAA 1997.

49. On the basis of information provided, there is no entity that controls MMC for value shifting purposes or that meets, together with MMC, the ultimate controller test and or the common ownership nexus test as described above. As a result, there are no consequences under Divisions 725 and 727 of the ITAA 1997 for any direct value shift or indirect value shift that occurs under the share buy-back arrangement.

Foreign resident shareholders

50. A foreign resident disregards a capital gain or capital loss from a CGT event that happens in relation to a CGT asset that is not 'taxable Australian property' (section 855-10 of the ITAA 1997). The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997.

51. A CGT asset that is a share in a company is a taxable Australian property if:

- it is an indirect Australian real property interest (see item 2 of the table in section 855-15 of the ITAA 1997);
- it has been used at any time by a foreign resident in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997); or
- it is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident).

52. A MMC share that is disposed of under the buy-back is not an indirect Australian real property interest as it does not pass the principal asset test in section 855-30 of the ITAA 1997. This is because MMC does not directly or indirectly (through its investments) hold an interest in Australian real property.

53. It follows that a foreign resident participating shareholder who:

- has not used a MMC share in carrying on a business through a permanent establishment in Australia; and
- or made an election under section 104-165(3) of the ITAA 1997 on ceasing to be an Australian resident in relation to the share,

disregards a capital gain or capital loss arising from the disposal under the buy-back (section 855-10 of the ITAA 1997).

The anti-avoidance provisions

Sections 45A and 45B

54. Sections 45A and 45B of the ITAA 1936 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 received by the shareholder under the buy-back is treated as an unfranked dividend. Accordingly, the application of these two provisions to the buy-back must be considered.

55. Section 45A of the ITAA 1936 is an anti-avoidance provision that applies in circumstances where capital benefits are streamed to certain shareholders (the advantaged shareholders) who derive a greater benefit from the receipt of share capital and it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

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

57. Section 45B of the ITAA 1936 applies where certain capital payments are paid to shareholders in substitution for dividends. In broad terms, 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)).

58. In the case of the buy-back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) of the ITAA 1936 have been met, the requisite purpose of enabling the shareholder to obtain a tax benefit – by way of capital distribution – was not present.

59. Having regard to the 'relevant circumstances' of the scheme, as set out in subsection 45B(8) of the ITAA 1936, it is apparent that there was no requisite purpose, by way of capital distribution, of enabling the shareholders to obtain a tax benefit. Further, the buy-back consideration cannot be said to be attributable to the profits of the company. MMC will continue to pay dividends in line with its stated dividend policy. Accordingly, section 45B of the ITAA 1936 does not apply to the buy-back.

60. As neither of sections 45A nor 45B of the ITAA 1936 apply to the buy-back, the Commissioner will not make a determination under either of those sections that section 45C of the ITAA 1936 will apply to deem any part of the buy-back consideration to be an unfranked dividend.

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- arrangements
- general value shifting regime
- share capital
- share buy-backs

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 45A
- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
- ITAA 1936 45B(2)(a)
- ITAA 1936 45B(2)(b)
- ITAA 1936 45B(2)(c)
- ITAA 1936 45B(8)
- ITAA 1936 45C
- ITAA 1936 Pt III Div 16K
- ITAA 1936 159GZZZJ
- ITAA 1936 159GZZZK
- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1997 6-5

- ITAA 1997 104-10
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- ITAA 1997 727-100(c)
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- ITAA 1997 727-150(7)
- ITAA 1997 727-355
- ITAA 1997 855-10
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- ITAA 1997 855-30
- TAA 1953
- Copyright Act 1968

Other references:

- PS LA 2007/9

ATO references

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