


CR 2008/88 - Income tax: off-market share buy-back: Lion Selection Limited

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Class Ruling

Income tax: off-market share buy-back: Lion Selection 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:

- section 45A of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 45B of the ITAA 1936;
- section 45C of the ITAA 1936;
- section 159GZZZP of the ITAA 1936;
- section 159GZZZQ of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 104-10 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-165 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 204-30 of the ITAA 1997;
- section 855-10 of the ITAA 1997; and
- section 855-15 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies are ordinary shareholders (participating shareholders) of Lion Selection Limited (LST) who disposed of LST ordinary shares under the LST off-market share buy-back (Buy-Back) details of which were announced on 25 September 2008 and is described in the Scheme part of this Ruling.

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 27 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. The following documents or relevant parts of them form part of and are to be read with the description.

10. The relevant documents or parts of documents are:

- LST's application for class ruling dated 3 October 2008;
- LST's draft shareholder buy-back booklet;
- LST's ASX releases dated 25 and 26 September 2008, 19 March 2008 and 23 June 2008;
- LST's target statement dated 23 May 2008;
- LST's notice of general meeting and explanatory statement dated 19 May 2008;
- LST's notice of general meeting and explanatory statement dated 26 September 2008; and
- LST's annual Financial Report for the year ended 31 July 2008.

Note: LST has provided certain information on a commercial-in-confidence basis that will not be disclosed under the Freedom of Information Legislation.

11. LST was listed on the Australian Securities Exchange on 17 April 2007.

12. LST's balance sheet as at 31 July 2008 provides the following relevant financial information:

Assets	322,163,000
Liabilities	3,389,000
Net Assets	318,774,000
Contributed equity	316,820,000
Reserves	–
Retained profits	1,954,000
Total minority interest	–
Total Shareholder Funds	318,774,000

13. On 7 July 2008, prior to the sale of part of its interest in Indophil, LST announced an on-market buy-back program (the existing on-market buy-back) under which it could purchase up to 10% of the company's shares on-market. The Board announced a 'Tranche 1' limit of \$10 million for the existing on-market buy-back which represented approximately 3% of the company's shares. As at 25 September 2008, 4.7 million shares (2.5% of issued capital) had been bought back under that program.

14. On 25 September 2008 LST announced a plan to buy-back up to 50% of its issued shares, which is approximately \$150 million. LST announced that this would be done via an off-market share buy-back, the consideration for which would be capital only.

15. Under the tender process, shareholders were entitled to tender up to 100% of their eligible shares.

16. The notice of general meeting and explanatory statement was sent to LST shareholders on 26 September 2008. An Independent Expert's Report was provided to shareholders on 17 October 2008.

17. LST sought approval for the Buy-Back from shareholders at a general meeting on 31 October 2008. The Buy-Back was approved by shareholders.

18. The Buy-Back was conducted through a tender process and participation from shareholders was voluntary.

19. Shareholders who held shares at 7.00pm Melbourne time on the record date 7 November 2008 were eligible to participate in the Buy-Back. Certain foreign shareholders were not entitled to participate.

20. The tender period opened on 12 November 2008 and closed on 2 December 2008.

21. LST bought back shares at a Buy-Back price representing 95% of LST's post-tax net tangible asset (NTA) backing calculated by reference to the average closing post-tax NTA over the final 5 trading days of the tender period 26 November 2008 – 2 December 2008.

22. LST has undertaken that it would not buy back shares at more than a 14% discount to the volume weighted average price (VWAP) of its shares on the ASX for the five (5) days up to and including the closing date of the buy-back tender price.

23. This Buy-Back is part of a wider Buy-Back program under which LST is seeking to buy back up to 143 million shares, which is approximately 75% of LST's issued shares at the time the existing on-market buy-back commenced. This 75% buy-back limit includes shares which have already been bought back under the existing on-market buy-back. This Buy-Back has been funded from asset sales.

24. All of the Buy-Back consideration was debited against LST's share capital account.

25. LST has confirmed that this is not a tainted share capital account for the purposes of Division 197 of the ITAA 1997.

26. On 5 December 2008 LST accepted the offers made by participating shareholders. LST announced on that date that:

- it had successfully completed the Buy-Back of approximately 102 million LST ordinary shares, representing 55.4% of the issued capital;
- the total amount of capital repurchased under the Buy-Back was approximately \$150 million;
- the final price for the Buy-Back was \$1.469 per share; and
- a scale-back mechanism was applied (66.6%).

27. All shares bought back by LST under the Buy-Back were cancelled.

Ruling

Purchase price of share acquired – section 159GZZZP

28. Participating shareholders will not be taken to have been paid a dividend under section 159GZZZP of the ITAA 1936.

Consideration in respect of share acquired – section 159GZZZQ

29. Participating shareholders will be taken to have received the price that LST announced as the price per share as consideration in respect of the sale of each of their shares under section 159GZZZQ of the ITAA 1936. The consideration paid as determined by the tender process was \$1.469.

30. 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

31. The consideration of \$1.469 represents the capital proceeds for capital gains tax (CGT) purposes under section 116-20 of the ITAA 1997. A participating shareholder will make a capital gain on the sale of a share if the sale consideration per share exceeds the cost base of that share. The capital gain is equal to the amount of the excess (subsection 104-10(4) of the ITAA 1997). A participating shareholder will make a capital loss on the sale of a share if the capital proceeds from the sale are less than the reduced cost base of the share. The capital loss is equal to the amount of the difference (subsection 104-10(4) of the ITAA 1997).

32. The shares are taken to have been disposed of for CGT purposes on 5 December 2008 under subsection 104-10(3) of the ITAA 1997.

Shares held on revenue account

33. Where the shares are held as trading stock, the consideration of \$1.469 is included in assessable income under section 6-5 of the ITAA 1997. Where the shares are held as revenue assets, the amount by which the consideration of \$1.469 per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds the consideration of \$1.469 per share the difference is an allowable deduction.

Foreign resident shareholders

34. Under section 855-10 of the ITAA 1997, foreign resident shareholders that participate in the Buy-Back will only have CGT consequences if their shares bought back under the Buy-Back are 'taxable Australian property'.

Anti-avoidance provisions

35. 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 distribution of share capital received under the Buy-Back by participating shareholders.

36. The Commissioner will not make a determination under section 177EA of the ITAA 1936 in relation to the distribution of share capital to participating shareholders under the Buy-Back.

37. The Commissioner will not make a determination under section 204-30 of the ITAA 1997 in relation to the distribution of share capital to participating shareholders under the Buy-Back.

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.*

38. The purchase by LST of its shares under the Buy-Back is an off-market purchase for the purposes of Division 16K of the ITAA 1936. This characterisation follows from the definitions contained in section 159GZZZJ and section 159GZZZK of the ITAA 1936.

Purchase price for shares that are bought back

39. Section 159GZZZP of the ITAA 1936 provides that where the buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price in respect of the buy-back of the share which is debited against amounts standing to the credit of the company's share capital account, is taken to be a dividend paid by the company to the seller as a shareholder in the company.

40. Subsection 975-300(3) of the ITAA 1997 provides that an account is not a share capital account if it is tainted for the purposes of the ITAA 1997. LST confirmed that LST's share capital account is not a tainted capital account.

41. LST has advised that the Buy-Back purchase price of \$1.469 has been debited entirely against LST's share capital account. No part of the purchase price will be taken to be a dividend for income tax purposes.

Consideration for shares that are bought back

42. The consideration in respect of the disposal of a share under an off-market buy-back is determined in accordance with section 159GZZZQ of the ITAA 1936.

43. Subsection 159ZZZQ(1) of the ITAA 1936 provides that for the purposes of computing the amount of the gain or loss (either on capital or revenue account) a seller will be taken to have received an amount equal to the purchase price in respect of the Buy-Back as consideration in respect of the sale of a share.

44. In this case participating shareholders will be taken to have received the purchase price announced by LST under the tender process of \$1.469. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 5 December 2008.

45. The disposal of shares under the Buy-Back may have different income tax implications for participating shareholders depending on how the shares were held. For instance:

- an investor holding their shares on capital account will be subject to the CGT provisions; and
- a share trader holding their shares on revenue account will also be subject to the ordinary income provisions.

46. It should be noted that under the anti-overlap provisions contained in section 118-20 of the ITAA 1997 shareholders who have both an income tax and CGT liability will generally have the amount of the capital gain reduced by the amount included in assessable income under the ordinary income tax provisions (but not below zero). If the shares were held as trading stock at the time of the cancellation, the capital gain or loss is disregarded under section 118-25 of the ITAA 1997.

Foreign resident shareholders

47. A foreign resident shareholder that participates in the Buy-Back disregards 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. A LST share that is disposed of under the Buy-Back will only be taxable Australian property if:

- it is an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997);
- 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 gain or loss on ceasing to be an Australian resident – item 5 of the table in section 855-15 of the ITAA 1997).

Anti-avoidance provisions

48. 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 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.

Section 45A

49. Section 45A of the ITAA 1936 applies in respect of a company that whether in the same year of income or in different years of income, directs the payment of capital benefits and the payment of dividends to its shareholders in such a manner, that:

- (a) capital benefits are, or apart from the operation of the provision would be received by certain shareholders (the advantaged shareholders) who would in the year of income in which the capital benefits are provided, derive a greater benefit from the receipt of capital benefits than other shareholders; and
- (b) it is reasonable to assume that the other shareholders (the disadvantaged shareholders) have received or will receive dividends.

50. For the purposes of the provision, subsection 45A(3) of the ITAA 1936 defines a capital benefit to include:

- the provision to the shareholder of shares in the company; and
- the distribution to the shareholder of share capital or share premium.

51. All eligible shareholders of LST were entitled to participate in the proposed Buy-Back. Under the terms of the Buy-Back, it is expected that given the lack of retained profits, the entire Buy-Back price paid by LST for its shares would be debited against its share capital account and will constitute a capital benefit as defined in subsection 45A(3) of the ITAA 1936. No part of the Buy-Back price will constitute a dividend.

52. Given that all eligible shareholders of LST were entitled to participate in the proposed Buy-Back and will receive a Buy-Back price comprised wholly of a capital component, it clearly could not be concluded that as a consequence of the proposed Buy-Back, shareholders who would derive a greater benefit from the receipt of capital will receive capital benefits while other shareholders receive dividends.

53. Consequently, the Commissioner will not make a determination under section 45A of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital component of the buy-back price received by shareholders.

Section 45B

54. Section 45B of the ITAA 1936 applies where certain capital payments are made to shareholders in substitution for dividends. Broadly this provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a) of the ITAA 1936);
- 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) of the ITAA 1936); and
- having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, entered into the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c) of the ITAA 1936).

55. 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, having regard to the relevant circumstances of the scheme as set out in subsection 45B(8) of the ITAA 1936, it could not 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, other than a merely incidental purpose of enabling a taxpayer to obtain a tax benefit.

56. Consequently, the Commissioner will not make a determination under section 45B of the ITAA 1936 that section 45C of the ITAA 1936 applies to the whole, or any part, of the capital component of the buy-back price received by shareholders.

Section 45C

57. As neither section 45A nor 45B of the ITAA 1936 apply to the Buy-Back, the Commissioner will not make a determination under either of those provisions that section 45C of the ITAA 1936 will apply to the Buy-Back.

58. No part of the Buy-Back consideration will be taken to be an unfranked dividend in the hands of participating shareholders.

Section 177EA

59. Section 177EA of the ITAA 1936 is a general anti-avoidance provision that applies to a wide range of schemes designed to obtain 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.

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

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

61. The LST Buy-Back represents an arrangement that extinguishes the rights, powers or liabilities attaching to or otherwise relating to, the membership interests represented by the shares concerned. Consequently, the Buy-Back will constitute a scheme for the disposition of a membership interest.

62. For the purposes of section 177EA of the ITAA 1936, subsection 960-120(1) of the ITAA 1997 defines a distribution to include a dividend paid by the company. No part of the Buy-Back price paid by LST constitutes a dividend.

63. The Commissioner will not make a Determination under section 177EA of the ITAA 1936.

Section 204-30

64. Section 204-30 of the ITAA 1997 applies where a corporate tax entity streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its members in such a way that:

- (a) 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) of the ITAA 1997);

- (b) the member would derive a greater benefit from franking credits than another member of the entity (paragraph 204-30(1)(b) of the ITAA 1997); 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) of the ITAA 1997).

65. Relevantly, if section 204-30 of the ITAA 1997 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) of the ITAA 1997); 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) of the ITAA 1997).

66. 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) of the ITAA 1997 by reference to the ability of the members to fully utilise imputation benefits.

67. All eligible shareholders of LST were entitled to participate in the Buy-Back and will receive similar consideration in respect of the shares disposed of.

68. No part of the Buy-Back price paid by LST constitutes a dividend.

69. The Commissioner will not make a Determination under section 204-30 of the ITAA 1997.

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:

- return of capital on shares
- share buy-backs
- share capital

Legislative references:

- ITAA 1936 45A
- ITAA 1936 45A(3)
- 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 Div 16K
- ITAA 1936 159GZZZJ
- ITAA 1936 159GZZZK
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1936 177EA
- ITAA 1936 177EA(3)
- ITAA 1997 6-5

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- ITAA 1997 104-165
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- ITAA 1997 116-20
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- ITAA 1997 204-30
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- ITAA 1997 975-300(3)
- TAA 1953
- Copyright Act 1968

Other references:

- Law Administration Practice Statement PS LA 2007/9

ATO references

NO: 2008/18530

ISSN: 1445-2014

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