


CR 2009/32 - Income tax: off-market share buy-back: Progen Pharmaceuticals Limited

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Class Ruling

Income tax: off-market share buy-back: Progen Pharmaceuticals 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 provisions 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 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 204-30 of the ITAA 1997;
- Division 725 of the ITAA 1997;
- Division 727 of the ITAA 1997; and
- section 855-10 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Progen Pharmaceuticals Limited (Progen) who:

- held ordinary shares; and
- disposed of those ordinary shares under the Progen fixed price capital only off-market share buy-back (Buy-Back) as described in paragraphs 10 to 23 of this Ruling.

4. In this Ruling, the persons belonging to this class of entities are referred to as 'participating shareholders'.

Qualifications

5. The Commissioner makes this Ruling on the precise scheme 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 10 to 23 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 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

10. The following description of the scheme is based on information provided by the applicant. The following relevant documents, or relevant parts of them, form part of and are to be read with the description of the scheme:

- the class ruling application dated 24 March 2009;
- a copy of the announcement to the Australian Securities Exchange (ASX) dated 9 March 2009;
- a copy of the waiver document from the ASX dated 10 March 2009;
- a notice of general meeting for Progen shareholders on 22 April 2009;
- a copy of the Buy-Back Offer Booklet released on the ASX on 23 March 2009;
- a copy of an independent expert report by WHK Horwath Securities on Progen's voluntary Share Buy-Back arrangement dated 12 March 2009; and
- financial reports for Progen for half-year ended 31 December 2008.

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

Background

11. Progen was incorporated in September 1989. It is an Australian resident public company which was listed on the ASX in December 1995.

12. Progen is a biotechnology company and is principally involved in the development of new cancer treatments. Progen has operations in Australia and the United States of America.

13. The financial statements of Progen as at 31 December 2008 show total share capital of \$191.472 million, reserves of \$3.361 million, accumulated losses of \$120.986 million and \$72.912 million in cash and cash equivalents. As at 11 March 2009 Progen had 60,545,131 ordinary shares on issue.

14. The shareholders in Progen are a mixture of individuals, companies and institutions. Some of these shareholders are foreign residents.

The Buy-Back Arrangement

15. On 9 March 2009 Progen announced its intention to undertake a capital-only off-market buy back of up to \$40 million of its ordinary shares at a fixed price of \$1.10 per share. Progen would buy back 36,363,636 Progen shares representing approximately 60% of its issued shares.

16. A commercial objective of the Buy-Back was to reduce the high level of cash in Progen (approximately \$72.9 million) which was considered unnecessary to fund the current level of operations, while remaining a going concern.

17. The Buy-Back was conducted through a fixed price tender process and was open to all shareholders who were registered as such on the Record Date (19 March 2009) and still holding Progen shares at the time they lodge their Acceptance Notice.

18. The tender process opened on 23 March 2009 and closed on 24 April 2009.

19. The Buy-Back was approved at a meeting of Progen's shareholders held on 22 April 2009.

20. Eligible shareholders were entitled to nominate a maximum number of shares they wished to offer for sale to Progen. Participation in the Buy-Back was voluntary. The exact number of shares bought back depended on the level of shareholder participation. However, to the extent that shareholder participation in the Buy-Back would otherwise exceed the Buy-Back limit, a scale back would apply on a pro-rata basis such that the maximum value of all shares bought back did not exceed \$40 million.

21. Under the Buy-Back, \$1.10 per share was debited to Progen's untainted share capital account. Progen has confirmed that no transactions have taken place which would have caused its share capital account to be tainted within the meaning of Division 197 of the ITAA 1997.

22. Progen accepted the offers made by participating shareholders on 30 April 2009. Progen further announced that:

- it had successfully completed the Buy-Back of 35,836,034 Progen shares, representing approximately 60% of the issued capital;
- the total amount of capital repurchased under the Buy-Back was approximately \$39.4 million; and
- no scale back mechanism was applied.

23. All shares bought back by Progen under the Buy-Back were cancelled.

Ruling

Purchase price in respect of each share bought back

24. As the entire purchase price in respect of the shares acquired through the Buy-Back was debited against Progen's share capital account, 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

25. Participating shareholders will be taken to have received \$1.10 as consideration in respect of the sale of each of their shares bought back under the Buy-Back (Sale Consideration) under section 159GZZZQ of the ITAA 1936.

26. 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

27. The Sale Consideration of \$1.10 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 a share if the Sale Consideration per share exceeds the cost base of that share. The capital gain is the amount of the excess (subsection 104-10(4) of the ITAA 1997). A participating shareholder will make a capital loss if the Sale Consideration per share is less than the reduced cost base of the share. The capital loss is the amount of the difference (subsection 104-10(4) of the ITAA 1997).

28. The shares are taken to have been disposed of for CGT purposes on 30 April 2009 under subsection 104-10(3) of the ITAA 1997.

Shares held on revenue account

29. Where the shares are held as trading stock, the Sale Consideration of \$1.10 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 \$1.10 per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost of each share exceeds the Sale Consideration of \$1.10 per share the difference is an allowable deduction.

Foreign resident shareholders

30. 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'.

Value shifting rules

31. There will be no consequences for an entity under Divisions 725 and 727 of the ITAA 1997 as a result of participating in the Buy-Back.

Anti-avoidance provisions

32. 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.

33. 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.

34. 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.*

Purchase price in respect of each share bought back

35. 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.

36. Under section 159GZZZP of the ITAA 1936, the purchase price of each share bought back 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 of \$1.10 has been debited entirely against Progen'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

37. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 30 April 2009. The disposal 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.

38. It should be noted that participating shareholders who have both an income tax and CGT liability will 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 were held as trading stock, the capital gain or capital loss is disregarded under section 118-25 of the ITAA 1997.

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

40. Subsection 159GZZZQ(1) of the ITAA 1936 provides that the shareholder is taken to have received an amount equal to the purchase price (in this case the \$1.10 received for each share bought back) as consideration in respect of the sale of the share bought back.

Foreign resident shareholders

41. A foreign resident shareholder that participated 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.

42. Progen has advised that it does not own, either directly or indirectly, any Australian real property. Accordingly, Progen shares cannot be an indirect Australian real property interest for any foreign resident shareholders under section 855-10 of the ITAA 1997.

43. It follows that a Progen share that was disposed under the Buy-Back can 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 gain or loss on ceasing to be an Australian resident – item 5 of the table in section 855-15 of the ITAA 1997).

Value shifting rules

44. 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 interests 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 the two entities (the losing entity and gaining entity (subsection 727-150(3) of the ITAA 1997)).

45. 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 of the ITAA 1997 (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.

46. There can only be consequences for an indirect value shift 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 indirect value shift 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).

47. On the basis of information provided, there is no entity that controls Progen for value shifting purposes or that meets, together with Progen, 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 or indirect value shift that occurs under the share Buy-Back arrangement.

Anti-avoidance provisions

48. Sections 45A and 45B of the ITAA 1936 are anti-avoidance provisions which seek to deal with potential streaming of capital benefits and the payment of capital benefits to shareholders instead of dividends. If the Commissioner makes a determination pursuant to subsections 45A(2) or 45B(3) of the ITAA 1936 the amount of the capital benefit or a part of the capital benefit received by the shareholder under the Buy-Back is treated as an unfranked and non-rebatable 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 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.

50. 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 was no streaming of capital benefits to some shareholders in lieu of the payment of dividends to other shareholders. Accordingly, section 45A of the ITAA 1936 has no application to the Buy-Back.

Section 45B

51. 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).

52. 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 a capital distribution is not present.

53. Having regard to the relevant circumstances of the scheme (the Buy-Back) as set out in subsection 45B(8) of the ITAA 1936, it cannot 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. Further, the Buy-Back consideration cannot be said to be attributable to the profits of the company.

54. 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

55. 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.

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

Section 177EA

57. 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.

58. 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.

59. The Progen 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.

60. 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 Progen constitutes a dividend.

61. The Commissioner will not make a determination under section 177EA of the ITAA 1936.

Section 204-30

62. Section 204-30 of the ITAA 1997 applies where a tax entity streams distributions to members (advantaged member) who will derive a greater benefit from imputation benefits than members (disadvantaged member) who will receive a lesser benefit from imputation: subsection 204-30(8) of the ITAA 1997.

63. Where section 204-30 of the ITAA 1997 applies, the Commissioner may exercise his discretion pursuant to subsection 204-30(3) and make a determination in writing to cause a franking debit to arise in the accounts of the tax entity in relation to a distribution to a disadvantaged member, or cancel the imputation benefit of an advantaged member.

64. Under the Buy-Back scheme, all members are entitled to participate. However because no part of the consideration for the Buy-Back will constitute a dividend, no imputation benefit arises in relation to the participating or non-participating members.

65. Accordingly, 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(2)
- 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(3)
- ITAA 1936 45B(8)
- ITAA 1936 45C
- ITAA 1936 159GZZZM
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
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- ITAA 1997 6-5
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- ITAA 1997 855-10
- ITAA 1997 855-15
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- Law Administration Practice Statement PS LA 2007/9

ATO references

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