

CR 2011/43 - Income tax: off-market share buy-back: BHP Billiton Limited

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Class Ruling

Income tax: off-market share buy-back: BHP Billiton 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 provisions

2. The relevant provisions dealt with in this Ruling are:

- subsection 44(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 90 of the ITAA 1936;
- subsection 95(1) of the ITAA 1936;
- paragraph 128B(3)(ga) of the ITAA 1936;
- section 159GZZP of the ITAA 1936;
- section 159GZZQ of the ITAA 1936;

- former Division 1A of Part IIIAA of the ITAA 1936;
- section 177EA of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 67 of the ITAA 1997;
- section 104-10 of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- section 118-20 of the ITAA 1997;
- section 118-25 of the ITAA 1997;
- section 202-5 of the ITAA 1997;
- section 202-40 of the ITAA 1997;
- section 204-30 of the ITAA 1997;
- section 207-20 of the ITAA 1997;
- section 207-45 of the ITAA 1997
- section 207-145 of the ITAA 1997; and
- section 855-10 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 the ordinary shareholders of BHP Billiton Limited (BHP Billiton), a publicly listed company, who:

- (a) disposed of their ordinary shares in BHP Billiton under the BHP Billiton off-market share buy-back which was announced by BHP Billiton on 22 February 2011 and which is described in paragraphs 10 to 28 of this Ruling; and
- (b) are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their BHP Billiton shares.

(Note – Division 230 of the ITAA 1997 will generally not apply to individuals, unless they have made an election for it to apply to them.)

In this Ruling, the ordinary shareholders of BHP Billiton 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 10 to 28 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 to the income year (as defined in the ITAA 1997) in which a participating shareholder disposed of shares under the Buy-Back of ordinary shares described in the Scheme part of the Ruling. For participating shareholders that do not have a substituted accounting period, this will be the income year ending 30 June 2011.
9. 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. 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.

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

11. BHP Billiton is a public company listed on the Australian Securities Exchange (ASX).

12. As at 31 December 2010, the Share Capital comprised of 3,358.4 million fully paid ordinary shares and a small number of partly paid shares. The financial statements of BHP Billiton at 30 June 2010 show total US dollar share capital equivalent to AUD\$938 million, reserves equivalent to AUD\$435 million and retained profits equivalent to AUD\$19,334 million.

13. The shareholders in BHP Billiton are a mix of individuals, companies and superannuation funds, some of whom are non-residents.

14. On 22 February 2011, BHP Billiton announced (first announcement date) its intention to undertake an off-market buy-back of its own shares (the Buy-Back). BHP Billiton announced it would spend approximately AUD\$5,000 million in purchasing its ordinary shares, representing approximately 4% of its issued capital. BHP Billiton retained the discretion to vary the size of the Buy-Back. BHP Billiton also retained the discretion to repurchase a lesser amount of shares, or no shares at all.

15. The Buy-Back forms part of BHP Billiton's continuing capital management strategy that aims to return capital that is surplus to its needs. BHP Billiton anticipates that the Buy-Back will have a positive effect over the long term on earnings per share (EPS) and returns on equity.

16. The Buy-Back was conducted through a tender process during a specified tender period and was open to all shareholders, who were registered as such on 3 March 2011 (Record Date) for the Buy-Back, except for:

- BHP Billiton employees who had an interest in 'Restricted Employee Shares';
- shareholders whose ordinary shares were acquired on an ex-entitlement basis on or after the Ex-entitlement Date (25 February 2011);
- Certain non-residents described as 'Excluded Foreign Persons' including US and Canadian resident shareholders that were not able to participate in the Buy-Back; and
- Holders of American Depository Receipts representing BHP Billiton shares.

17. Participation in the Buy-Back was voluntary and therefore eligible shareholders who did not wish to participate were not required to do anything. Non-participating shareholders did not receive any property, dividends or distributions by way of compensation.

18. The Buy-Back tender period opened on 21 March 2011 (Opening Date) and closed on 8 April 2011 (Closing Date).

19. 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 BHP Billiton over the five trading days up to and including the Closing Date. The Tender Discount ranged from 10% to 14%, in 1% intervals. Shareholders could also submit tenders to sell different parcels of shares at different Tender Discounts, or at the Final Price Tender which was the price as finally determined under the tender process.

20. Shareholders were also provided with a choice to nominate a Minimum Buy-Back Price (Minimum Price) in addition to the required selection of a Tender Discount percentage or percentages. The tender process allowed shareholders to specify one of three Minimum Prices. Shareholders who failed to nominate a Tender Discount and who only specified a Minimum Price did not have their tenders accepted.

21. Shareholders who held 125 shares or less were only permitted to tender all of their holding at a single Tender Discount or as a Final Price Tender.

22. Tenders at a Tender Discount percentage less than the discount percentage determined by BHP Billiton (Buy-Back Discount), and those tenders where the Minimum Price specified was greater than the Buy-Back Price, were not accepted. Tenders at a Tender Discount equal to or greater than the Buy-Back Discount or at the Final Price Tender were accepted (subject to any scale back) and shareholders received the Buy-Back Price for each share bought back.

23. Where the number of shares tendered that satisfied the Buy-Back criteria exceeded the number of shares BHP Billiton determined to buy back, shareholders with tenders equal to the accepted discount percentage (including Final Price Tenders) were scaled back on a pro-rata basis. A Priority Parcel of 125 shares was bought back from each successful tendering shareholder before the scale back was applied.

24. Notwithstanding the scale back, any shareholder who tendered all of their shares at or below the Buy-Back Price, or as a Final Price Tender, and would have, unless otherwise determined, 50 or fewer shares as a result of the scale back, had all of the shares they tendered bought back in full.

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

- (a) BHP Billiton would not Buy-Back shares at a discount greater than 14% to the VWAP of BHP Billiton shares over the five trading days up to and including the closing day of the tender period (8 April 2011); and
- (b) the Buy-Back Price would not exceed the market value of BHP Billiton shares determined in accordance with Taxation Determination TD 2004/22.

26. On 11 April 2011 BHP Billiton announced that:

- it had successfully completed the Buy-Back of 146,899,809 BHP Billiton shares;
- the total amount of capital repurchased under the Buy-Back was \$6,000,857,198 representing 4.4 per cent of the issued capital of BHP Billiton;
- the final price for the Buy-Back was set at \$40.85 per share, representing a discount of 14% to the VWAP of \$47.4985 of BHP Billiton shares over the five days up to and including 8 April 2011 (the closing date) of the Buy-Back;
- shares tendered at a discount of 14% or as a Final Price Tender were accepted, subject to any minimum price condition and scale back;
- shares tendered at discounts from 10% to 13% were not accepted; and
- a scale-back mechanism was applied of 78.27%, subject to paragraphs 23 and 24 of this Ruling.

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

28. Under the Buy-Back, \$0.28 per share was debited to BHP Billiton's untainted share capital account and the balance of the Buy-Back Price was debited to BHP Billiton's retained profits.

Ruling

The Dividend Component

29. Participating shareholders are taken to have been paid a dividend of \$40.57 (the Dividend Component) for each share bought back under section 159GZZZP.

30. The Dividend Component is a frankable distribution pursuant to section 202-40 of the ITAA 1997, and is therefore capable of being franked in accordance with section 202-5 of the ITAA 1997.

31. 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***

32. The Dividend Component of \$40.57 and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of resident individuals, company shareholders, partnerships and trustees that are corporate tax entities and the trustees of trusts that are complying superannuation funds who participate in the Buy-Back under subsection 44(1) of the ITAA 1936 and subsection 207-20(1) of the ITAA 1997 respectively in the income year in which the Buy-Back occurred. These shareholders will be entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit on the Dividend Component, subject to being a 'qualified person'.

Indirect distributions***Partnerships***

33. The Dividend Component of \$40.57 and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of a partnership that participates in the Buy-Back for the purposes of computing the net income of the partnership under section 90.

34. In a case where an individual partner, corporate tax entity, or a trustee partner specified by paragraphs 207-45(c) or 207-45(d) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) is assessable in respect of a share of the net income of the partnership, or allowed a deduction in respect of a share of the partnership loss, the partner will be entitled to a tax offset equal to the partner's share of the franking credit on the Dividend Component. This is provided that the whole or part of that share of the net income or partnership loss of the partnership is attributable to an amount included in the assessable income of the partnership because the Dividend Component is made to the partnership.

Trusts

35. The Dividend Component of \$40.57 and an amount equal to the franking credit on the Dividend Component (gross-up) is included in the assessable income of a trustee for the purposes of computing the net income of the trust under subsection 95(1).

36. In a case where an individual beneficiary, corporate tax entity, or a trustee beneficiary specified by paragraphs 207-45(c) or 207-45(d) of the ITAA 1997 (certain trustees, and certain superannuation funds, approved deposit funds and pooled superannuation trusts) is assessable in respect of a share of the net income of the trust, the beneficiary both includes an amount in its assessable income (the gross-up), and is entitled to a tax offset equal to the beneficiary's share of the franking credit on the Dividend Component, provided that the Dividend Component was taken into account in working out the whole or part of that share of the net income of the trust.

Refundable tax offset

37. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997. Certain trustees and corporate tax entities are not entitled to the refundable tax offset rules because of subsections 67-25(1A) to 67-25(1D) of the ITAA 1997.

Non-resident shareholders

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

Sale Consideration

39. Participating shareholders are taken to have received \$9.31 as consideration in respect of each share bought back under the Buy-Back (Sale Consideration) on 8 April 2011 in accordance with section 159GZZQ, unless the participating shareholder is a corporate tax entity to which subsections 159GZZQ(8) and 159GZZQ(9) apply.

40. 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 then, in accordance with TD 2004/22, the market value rule in subsection 159GZZQ(2) applies to the Buy-Back.

41. The effect of the 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 (CGT) purposes, in addition to the capital amount of \$0.28 per share debited to the share capital account (Capital Component). Accordingly, the Sale Consideration is \$9.31.

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 shares are taken to have been disposed of for CGT purposes on 11 April 2011 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

44. The Sale Consideration of \$9.31 represents the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997. A shareholder will make a capital gain when CGT event A1 happens if the Sale Consideration per share exceeds the cost base of that share. Similarly, a shareholder will make a capital loss if the Sale Consideration per share is less than the reduced cost base of the share (subsection 104-10(4) of the ITAA 1997).

Shares held on revenue account

45. Where the shares are held as trading stock, the Sale Consideration of \$9.31 is included in assessable income under section 6-5 of the ITAA 1997. These shareholders will also make a capital gain or capital loss calculated as discussed at paragraph 44 of this Ruling for those who held their shares on capital account. However, under section 118-25 of the ITAA 1997 any capital gain or capital loss a participating shareholder makes will be disregarded if at the time of the CGT event the shares are held by them as trading stock.

46. Where the shares are held as revenue assets, but are not trading stock, the amount by which the Sale Consideration of \$9.31 per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$9.31 per share the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of that share these shareholders will also make a capital gain. However, under section 118-20 of the ITAA 1997 any capital gain a participating shareholder makes will be reduced if, because of the event, the capital proceeds have otherwise been included in assessable income. The capital gain is reduced by the amount of the Sale Consideration otherwise included in assessable income or to zero, whichever is the greater. (A corresponding rule applies to a partner of a partnership.)

Foreign resident shareholders: CGT consequences

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

Qualified persons

48. For the purposes of section 207-145 of the ITAA 1997 which refers to former Division 1A of Part IIIAA, participating shareholders will be considered to satisfy the holding period rule under former section 160APH0 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 24 February 2011; and
- during the period when the shares or interest in the shares were held the shareholders had sufficient risks of loss or opportunities for gain in respect of the shares or interest in the shares (as defined in former 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 BHP Billiton shares nor the making of an offer by a shareholder to BHP Billiton in respect of a BHP Billiton share will affect whether the shares bought back under the Buy-Back are held 'at risk' for the purposes of former Division 1A of Part IIIAA.

49. The 'last-in first-out' rule in former subsection 160APH(4) has no effect for the purposes of the Buy-Back to BHP Billiton shares acquired on or after 25 February 2011 (the Ex-entitlement Date) which do not confer an entitlement to participate in the Buy-Back.

The anti-avoidance provisions

50. The Commissioner will not make a determination under subsection 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.

51. 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 of the Buy-Back Price by participating shareholders.

52. 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 of the Buy-Back Price by participating shareholders.

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 Components

53. The purchase price received by participating shareholders comprises two components:

- a Dividend Component; and
- a Capital Component.

The amount of each of these components is determined in accordance with sections 159GZZP and 159GZZQ, having regard to how the company accounts for the off-market share buy-back.

The Dividend Component

54. Section 159GZZP provides that where the buy-back of a share is an off-market purchase, the difference between the purchase price and the part (if any) of the purchase price which is debited against the share capital account, is taken to be a dividend paid by the company to the seller on the day the buy-back occurs. In this case the purchase price was \$40.85 per share and \$0.28 of the amount was debited to the share capital account (Capital Component). Therefore the Dividend Component is \$40.57 per share.

55. The Dividend Component of \$40.57 per share is frankable but only to the extent that the Buy-Back Price does not exceed the market value of the share at the time of the Buy-Back if the Buy-Back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997).

56. 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. In this case, the Buy-Back Price did not exceed the market value determined in accordance with TD 2004/22.

Assessability of the Dividend Component and tax offset

Direct distributions

57. 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); 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).

58. 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

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

60. 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 paragraph 92(1)(b), or has an individual interest in a partnership loss of the partnership that is covered by paragraph 92(2)(a) or paragraph 92(2)(b); and
- has a share of the franked distribution under section 207-55 of the ITAA 1997 that is a positive amount.

61. 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) or has an individual interest in the trust's net income that is covered by section 98A or section 100; and
- has a share of the franked distribution under section 207-55 of the ITAA 1997 that is a positive amount.

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

Partnerships

63. 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.

64. 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 (gross up).

65. In the context of an entity that is an individual, a corporate tax entity when the distribution flows indirectly to it, or a trustee specified in paragraph 207-45(c) or 207-45(d) of the ITAA 1997 the entity will, subject to the 'qualified person' rule, be entitled to a tax offset equal to its share of the franking credit on the Dividend Component as determined under section 207-57 of the ITAA 1997.

Trusts

66. 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).

67. 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 trustee for the purposes of computing the net income of the trust under subsection 95(1) of the ITAA 1936 (gross-up).

68. In the context of an entity that is an individual, a corporate tax entity when the distribution flows indirectly to it, or a trustee specified in paragraph 207-45(c) or paragraph 207-45(d) of the ITAA 1997 the entity will, subject to the 'qualified person' rule, be entitled to a tax offset equal to its share of the franking credit on the Dividend Component as determined under section 207-57 of the ITAA 1997.

Refundable tax offset

69. 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 67-25(1D) of the ITAA 1997.

Non-resident shareholders

70. 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***Calculation of Sale Consideration***

71. For the purposes of determining the amount of a gain or loss (where the shares are held on capital or revenue account) the consideration in respect of the disposal of a share, the Sale Consideration, under a buy-back is determined in accordance with section 159GZZZQ.

72. Subsection 159GZZZQ(1) provides that a shareholder is taken to have received an amount equal to the purchase price (in this case the \$40.85 received for each share bought back) as consideration in respect of the sale of the share bought back. However, this amount is subject to certain adjustments in order to arrive at the Sale Consideration.

73. Subsection 159GZZZQ(2) is one of the adjusting provisions. It provides that if the purchase price is less than the market value of the share at the time of the buy-back (calculated as 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.

74. For the purposes of determining the application of subsection 159GZZZQ(2) the following methodology has been proposed by BHP Billiton and accepted by the Commissioner in accordance with TD 2004/22: The market value of each share is the volume weighted average price of BHP Billiton Ltd shares over the last five trading days before the announcement of the Buy-Back, adjusted for the percentage change in the London Stock Exchange quoted price of BHP Billiton Plc shares from the close of trading on 21 February 2011 to the opening of trading on 8 April 2011.

75. Under this methodology, the market value of a share bought back under the Buy-Back is \$49.88. Therefore, the shareholders are taken to have received \$49.88 for the sale of each share rather than \$40.85.

76. Pursuant to subsection 159GZZZQ(3), the deemed consideration of \$49.88 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 Component, that is, \$40.57 unless the seller is a corporate tax entity to whom subsection 159GZZZQ(8) applies. Therefore, the Sale Consideration for each share disposed of under the Buy-Back is \$9.31 (\$49.88 less \$40.57).

77. However, it should be noted that where a 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 159GZZQ(8), if that shareholder would otherwise make 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 off-settable amount determined under subsection 159GZZQ(9). The Reduction Amount is reduced by so much of the off-settable amount that does not exceed the capital loss or the deductible loss.

78. Participating shareholders are taken to have disposed of those shares accepted under the Buy-Back on 11 April 2011 (CGT event A1). 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 CGT provisions; and
- a share trader who held their shares on revenue account will be subject to the ordinary income provisions and the CGT provisions.

Shares held on capital account

79. The Sale Consideration of \$9.31 represents the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997. A shareholder will make a capital gain on a share if the Sale Consideration per share exceeds the cost base of that share. Similarly, a shareholder will make a capital loss on a share if the Sale Consideration per share is less than the reduced cost base of the share (subsection 104-10(4) of the ITAA 1997).

Shares held on revenue account

80. Where the shares are held as trading stock, the Sale Consideration of \$9.31 is included in assessable income under section 6-5 of the ITAA 1997. These shareholders will also make a capital gain or capital loss. However, as the shares are held as trading stock, the capital gain or capital loss is disregarded under section 118-25 of the ITAA 1997.

81. Where the shares are held as revenue assets, but are not trading stock, the amount by which the Sale Consideration of \$9.31 per share exceeds the cost of each share is included in the shareholder's assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$9.31 per share the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of the share these shareholders will also make a capital gain. However, shareholders who hold their shares as revenue assets will have the amount of the capital gain reduced under the anti-overlap provisions contained in section 118-20 of the ITAA 1997.

Foreign resident shareholders: CGT consequences

82. A foreign resident shareholder who 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 855-10 of the ITAA 1997. A BHP Billiton share that is disposed into 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).

Qualified persons

83. Paragraph 207-145(1)(a) of the ITAA 1997 provides that in relation to a franked dividend made by an entity only a qualified person in relation to the distribution for the purposes of former Division 1A of Part IIIAA is entitled to a franking credit or tax offset. Broadly speaking, to be a 'qualified person' in relation to the Dividend Component paid under the Buy-Back, the participating shareholder must satisfy both the holding period rule and the related payments rule.

84. Broadly, 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 effectively passes on the economic benefit of the dividend to another person.

85. The holding period rule requires a shareholder 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 during the relevant qualification period. In the absence of a related payment, the relevant qualification period is the primary qualification period, which commences on the day after the shares or the interest in the shares are acquired and ends on the 45th day after the day on which they became ex-dividend. In determining whether a shareholder has satisfied the holding period rule, any days during which there is a materially diminished risk of loss or opportunity for gain in respect of the relevant shares are not counted. The day of acquisition and the day of disposal of the relevant shares are also not counted.

86. Under former subsection 160APHM(2), a shareholder is taken to have materially diminished the risks of loss and opportunities for gain with respect to shares or interests in shares if the 'net position' in respect of the risks of loss and opportunity for gain of the shareholder results in the shareholder having less than 30% of the risks and opportunities relating to the shares or interest in shares.

87. 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.

88. There are 45 clear days between 24 February 2011 and 11 April 2011, that is, the date the tender offer was accepted. Therefore, a shareholder who acquired shares on or before 24 February 2011 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 24 February 2011 that were subsequently bought back under the Buy-Back may not be a qualified person in relation to the dividend paid under the Buy-Back for the purposes of former Division 1A of Part IIIAA except in certain circumstances.

89. Generally, under the holding period rule a shareholder will be deemed to have disposed of his or her most recently acquired shares first (former subsection 160APH(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. Accordingly, shareholders who, after 24 February 2011, acquired any additional BHP Billiton 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.

90. However, BHP Billiton shares acquired by participating shareholders which did not confer an entitlement to participate in the Buy-Back (ex-entitlement shares) which were purchased after BHP Billiton shares that did 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 former subsection 160APH(4). Ex-entitlement shares do not constitute 'related securities' for the purposes of former subsection 160APH(2) to any cum-entitlement shares. Accordingly, for any additional BHP Billiton shares that a participating shareholder acquired on or after 24 February 2011 that did not confer an entitlement to participate in the Buy-Back, the 'last-in first out' rule in former subsection 160APH(4) will not apply in relation to those shares.

The anti-avoidance provisions

Sections 45A and 45B

91. Sections 45A and 45B 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.

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

93. 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.

94. Section 45B 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 (the 'relevant 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 the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

95. In the context of the Buy-Back, the requirements of paragraphs 45B(2)(a) and 45B(2)(b) have been met.

96. A consideration of the relevant circumstances of the Buy-Back confirms that:

- the Capital Component of the Buy-Back price was determined in accordance with the average capital per share method preferred by PS LA 2007/9; and
- the Buy-Back is not expected to alter the company's distribution history; and
- as a consequence of the Buy-Back, the distribution of share capital will result in a reduction in the participants' ownership interests in the company.

97. Consequently, the Commissioner will not make a determination that section 45C applies to treat all or part of the Capital Component of the Buy-Back price as an unfranked dividend paid by the company.

Section 177EA

98. Section 177EA 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.

99. Specifically, subsection 177EA(3) provides that section 177EA applies if:

(a) there is a scheme for a disposition of membership interests, or an interest in membership interests, in a corporate tax entity; and

(b) either:

(i) a frankable distribution has been paid, or is payable or expected to be payable, to a person in respect of the membership interests; or

(ii) a frankable distribution has flowed indirectly, or flows indirectly or is expected to flow indirectly, to a person in respect of the interest in membership interests, as the case may be; and

- (c) the distribution was, or is expected to be, a franked distribution or a distribution franked with an exempting credit; and
- (d) except for this section, the person (the **relevant taxpayer**) would receive, or could reasonably be expected to receive, imputation benefits as a result of the distribution; and
- (e) having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into or carried out the scheme or any part of the scheme did so for a purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain an imputation benefit.

100. In the present case the conditions of paragraphs 177EA(3)(a) to 177EA(3)(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 BHP Billiton, 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.

101. In arriving at a conclusion the Commissioner must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(17). The relevant circumstances listed there encompass a range of circumstances which, taken individually or collectively, could indicate the requisite purpose. Due to the diverse nature of these circumstances some may not be present at any one time in any one scheme.

102. The Commissioner has come to the view that section 177EA applies to the Buy-Back. In coming to this conclusion the Commissioner had regard to all the relevant circumstances of the arrangement, as outlined in subsection 177EA(17). Among the circumstances of the Buy-Back reflected in those paragraphs are:

- the delivery of franking credits in excess of what would have otherwise been distributed in the ordinary course of dividend declaration;
- the greater attraction of the Buy-Back to resident shareholders who could fully utilise the franking credits than to non-resident shareholders who could not;
- the greater attraction of the Buy-Back to some resident shareholders with a low marginal tax rate than other resident shareholders (for example, whereas superannuation funds are taxed at 15% and corporations at 30% individuals can be taxed at a marginal tax rate 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.

103. Where section 177EA applies the Commissioner has a discretion pursuant to subsection 177EA(5) to make a determination to debit the company's franking account pursuant to paragraph 177EA(5)(a), or deny the imputation benefit to each shareholder pursuant to paragraph 177EA(5)(b). The Commissioner will exercise his discretion in such a way that he does not make a determination that the imputation benefit obtained by the participating shareholders be denied under paragraph 177EA(5)(b).

Section 204-30

104. 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).

105. Relevantly, if section 204-30 of the ITAA 1997 applies, the Commissioner is vested with a discretion under subsection 204-30(3) of the ITAA 1997 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 distribution made to a favoured member and specified in the determination (paragraph 204-30(3)(c) of the ITAA 1997).

106. Streaming is the act of selectively directing the flow of franking credits to those members that derive a greater benefit from imputation benefits (favoured members) at the expense of those that do not (disadvantaged members). For section 204-30 of the ITAA 1997 to apply, the Buy-Back must be capable of being viewed as an arrangement that facilitates such an outcome. The circumstances in which a member will be taken to have received a greater benefit than another member are detailed in subsection 204-30(8) of the ITAA 1997 by reference to the ability of the members to fully utilise imputation benefits.

107. A significant portion of BHP Billiton shareholding is 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 of the ITAA 1997.

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Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22; TR 2006/10

Subject references:

- dividend income
- dividend streaming arrangements
- frankable dividends
- qualified person
- share buy backs

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