CR 2012/57 - Income tax: off-market share buy-back: European Gas Limited

Class Ruling

Income tax: off-market share buy-back: European Gas Limited

Contents Para

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 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 104-10 of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- section 118-20 of the ITAA 1997;

- section 118-25 of the ITAA 1997; and
- section 855-10 of the ITAA 1997.

All legislative references 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 European Gas Limited (EGL), a publicly listed company, who:

(a) disposed of their ordinary shares in EGL under the EGL off-market share buy-back which was announced by EGL on 4 June 2012 and which is described in paragraphs 10 to 24 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 EGL shares.

(Note – Division 230 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 EGL 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 24 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.

Date of effect

8. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 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:

- the application for a Class Ruling dated 10 May 2012;
- a copy of the announcement to the Australian Securities Exchange (ASX) dated 4 June 2012;
- a copy of the Independent Expert's Report prepared by Ernst & Young dated 1 June 2012; and
- a copy of the share buy-back offer booklet released on the ASX on 4 June 2012.

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

10. EGL is a public company listed on the ASX.

11. The financial statements of EGL as at 30 June 2011 were denominated in Euro. The statements show share capital equivalent to A$71,677,245, reserves equivalent to A$4,428,089 and accumulated losses equivalent to A$27,247,806. EGL has never paid a dividend to its shareholders.

12. As at 10 May 2012, the share capital of EGL comprised 297,272,505 fully paid ordinary shares and issued share capital equivalent to A$68,494,555.

13. The shareholders in EGL are a mix of individuals, companies, trusts, partnerships and superannuation funds, some of whom are non-residents. All shares were acquired after 19 September 1985.

The Buy-back Arrangement

14. On 4 June 2012, EGL announced its intention to undertake an off-market share buy-back (the Buy-back) under which it intended to buy-back all of its shares as part of a major capital management initiative.

15. Participation in the Buy-back was voluntary and therefore eligible shareholders who did not wish to participate were not required to do anything.

16. EGL shareholders who did not participate in the Buy-back or were ineligible to participate in the Buy-back continue to hold their EGL shares.

17. The Buy-back offer was open to all eligible shareholders who were registered on the Record Date for the Buy-back being 14 June 2012. Eligible EGL shareholders who held EGL shares with a value of less than A$2,000 on the Record Date could only accept the Buy-back Offer in respect of all of their EGL shares.

18. Eligible EGL shareholders were also required to accept the Buy-back in respect of all their EGL shares if, as a result of accepting the Buy-back Offer in respect of only some of their EGL shares, they held EGL shares with a value of less than A$500 following the Buy-back.

19. The Buy-back was approved by EGL shareholders at an Extraordinary General Meeting held on 17 July 2012.

20. The Buy-back offer period opened on 19 June 2012 and closed on 24 July 2012.

21. As consideration for the Buy-back, EGL transferred shares it held in a foreign owned subsidiary, European Gas Limited UK (EGL UK), to participating EGL shareholders at the exchange rate of one EGL UK share for each fully paid up EGL share.

22. All shares bought back under the Buy-back were cancelled.

23. Under the Buy-back, A$0.192 per share was debited to EGL's untainted share capital account.

24. On 26 July 2012 EGL announced that it had successfully completed the Buy-back of 221,615,657 EGL shares.

Ruling

The distribution is not a dividend

25. As the entire purchase price in respect of the shares acquired through the Buy-back is debited against EGL's share capital account, participating shareholders will not be taken to have been paid a dividend under section 159GZZZP.

Consideration in respect of the sale of each share bought back

26. Participating shareholders are taken to have received A$0.192 per share as consideration (Sale Consideration) in respect of the sale of each of their shares bought back under the Buy-back pursuant to section 159GZZZQ.

27. 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

28. The shares are taken to have been disposed of for capital gains tax (CGT) purposes on 26 July 2012 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

29. The Sale Consideration of A$0.192 per share 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. The capital gain is the amount of the excess. 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 that share (subsection 104-10(4) of the ITAA 1997).

Shares held on revenue account

30. Where the shares are held as trading stock, the Sale Consideration of A$0.192 per share 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 per paragraph 29 of this Ruling. 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 were held as trading stock.

31. Where the shares are held as revenue assets, but are not trading stock, the amount by which the Sale Consideration of A$0.192 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 A$0.192 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

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

The anti-avoidance provisions

33. The Commissioner will not make a determination under subsections 45A(2) or 45B(3) that section 45C applies to the whole, or any part, of the consideration received by participating shareholders.

Commissioner of Taxation
15 August 2012

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.

Purchase price in respect of each share bought back

34. The income tax consequences of an off-market share buy-back are worked out under Subdivision C of Division 16K of Part III. Those consequences are based on the 'purchase price' of the share worked out under section 159GZZZM.

35. Paragraph 159GZZZM(b) provides that if the seller of the share has received or is entitled to receive property other than money as a result of or in respect of, the Buy-back, the purchase price is the market value of that property in respect of the Buy-back. In this case one EGL UK share for each share EGL bought back.

36. The Commissioner accepts that the market value of each EGL share was A$0.192 per share, which accorded with the consideration received by participating shareholders.

37. Under section 159GZZZP, 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 company's share capital account is taken to be a dividend paid by the company to the seller on the day the Buy-back occurs. In this case, as the Buy-back price of A$0.192 per share has been debited entirely against EGL'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

38. For the purposes of determining the amount of a capital gain or capital 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.

39. Subsection 159GZZZQ(1) provides that a shareholder is taken to have received an amount equal to the purchase price (in this case the A$0.192) received for each share bought back as consideration in respect of the sale of the share bought back.

40. Participating shareholders are therefore taken to have disposed of those shares accepted under the Buy-back for Sale Consideration of A$0.192 per share on 26 July 2012 (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

41. The Sale Consideration of A$0.192 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. The capital gain is the amount of the excess. 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 that share (subsection 104-10(4) of the ITAA 1997).

Shares held on revenue account

42. Where the shares are held as trading stock, the Sale Consideration of A$0.192 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 loss is disregarded under section 118-25 of the ITAA 1997.

43. Where the shares are held as revenue assets, but are not trading stock, the amount by which the Sale Consideration of A$0.192 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 A$0.192 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

44. Under subsection 855-10(1) of the ITAA 1997, an entity disregards a capital gain or capital loss from a CGT event if they are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens and the CGT event happens in relation to a CGT asset that is not 'taxable Australian property'.

45. The term 'taxable Australian property' is defined in the table in section 855-15 of the ITAA 1997. The table sets out these five categories of CGT assets:

Item 1	taxable Australian real property;
Item 2	an indirect Australian real property interest not covered by item 5;
Item 3	a CGT asset used at any time in carrying on a business through a permanent establishment in Australia and which is not covered by item 1, 2, or 5;
Item 4	an option or right to acquire a CGT asset covered by item 1, 2 or 3; and
Item 5	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).

46. A foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happened under the Buy-back, cannot disregard under subsection 855-10(1) of the ITAA 1997 a capital gain or capital loss from CGT event A1 if:

- their share in EGL is an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997);
- their share in EGL has been used at any time by the foreign resident in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15); or
- their share in EGL is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15).

The anti-avoidance provisions

47. Sections 45A and 45B are two anti-avoidance provisions which, if either applies, 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 that is paid by the company. Accordingly, the application of these two provisions to the Buy-back must be considered.

Section 45A

48. 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.

49. 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.

Section 45B

50. Section 45B applies where certain amounts of a capital nature are provided to shareholders in substitution for dividends. Specifically, the provision applies where:

- there is a scheme under which a person is provided with a capital benefit by a company (paragraph 45B(2)(a));
- 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
- 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 or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

51. In the case of the Buy-back, whilst the conditions of paragraphs 45B(2)(a) and 45B(2)(b) have been met, having regard to the relevant circumstances of the scheme as set out in subsection 45B(8), 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.

52. Consequently, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to the distribution received by participating shareholders.

Section 45C

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

Appendix 2 – Detailed contents list

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

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- schemes
- share buy-backs
- share capital

Legislative references:

- ITAA 1936
- 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 159GZZZM(b)
- ITAA 1936 159GZZZP
- ITAA 1936 159GZZZQ
- ITAA 1936 159GZZZQ(1)
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 104-165(3)
- ITAA 1997 116-20
- ITAA 1997 118-20
- ITAA 1997 118-25
- ITAA 1997 855-10
- ITAA 1997 855-15
- TAA 1953
- Copyright Act 1968

Other references:

- Law Administration Practice Statement PS LA 2007/9 Share Buy-Backs

ATO references
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