

CR 2016/3 - Income tax: Eildon Capital Limited - off-market share buy-back



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Class Ruling

Income tax: Eildon Capital Limited – off-market share buy-back

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① 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:
- subsection 44(1) of the *Income Tax Assessment Act 1936* (ITAA 1936)
 - subsection 45A(2) of the ITAA 1936
 - subsection 45B(3) 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
 - Division 16K of the ITAA 1936
 - Division 1A of former Part IIIA of the ITAA 1936
 - section 177EA of the ITAA 1936

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 8-1 of the ITAA 1997
- Division 67 of the ITAA 1997
- section 104-10 of the ITAA 1997
- subsection 110-55(9) of the ITAA 1997
- subsection 116-20(1) 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
- paragraph 202-45(c) of the ITAA 1997
- paragraph 204-30(3)(c) of the ITAA 1997
- Subdivision 207-B of the ITAA 1997
- section 207-145 of the ITAA 1997
- section 855-10 of the ITAA 1997
- section 977-50 of the ITAA 1997, and
- subsection 995-1(1) of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1936, unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is ordinary shareholders of Eildon Capital Limited (ECL) (formerly known as CVC Private Equity Limited) who:

- (a) disposed of their ordinary shares in ECL under the off-market share buy-back (the 'Buy-Back') announced by ECL on 23 October 2015 and described in paragraphs 8 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 ECL 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 shareholders belonging to this class of entities are referred to as '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 8 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

7. This Ruling applies from 1 July 2015 to 30 June 2016. The Ruling continues to apply after 30 June 2016 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

8. 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.

9. ECL is an unlisted public company established in 1993 and is a resident of Australia as that term is defined in subsection 6(1).

10. ECL shares are not traded on any official stock exchange.

11. ECL is a venture capital and private equity firm which specialises in management buyouts, management buy-ins and transactions where the owner retains an equity and management role. ECL intends to change into a mezzanine property investment business.

12. ECL's shareholders are a mix of individuals, companies, trusts, partnerships and superannuation funds.

13. ECL has paid dividends to its shareholders over the last 9 years.

14. On 23 October 2015, ECL announced that it proposed to undertake the Buy-Back of up to \$8.5 million of its shares, which would represent approximately 35% of its issued capital.
15. The Buy-Back enables an orderly exit for those shareholders who did not wish to participate in the new business direction.
16. As at 23 October 2015, ECL had 20,724,249 shares on issue, \$19,425,969 in its share capital account and \$7,339,329 in net profits available for distribution.
17. At the Annual General Meeting dated 23 November 2015, ECL shareholders approved the Buy-Back. ECL shareholders also approved the change in the company's name from CVC Private Equity Limited.
18. This offer was open to all shareholders who held ECL shares prior to 18 December 2015. Participation in the Buy-Back was voluntary and shareholders who did not wish to participate were not required to do anything.
19. ECL offered to purchase the shares under the Buy-Back from Participating Shareholders for \$1.17 per share. The period of offer commenced on 24 November 2015 and ended at 5pm 18 December 2015.
20. The buy-back price of \$1.17 per share comprised two components. The Capital Component was \$0.92 per share. The Capital Component was debited to ECL's share capital account. The dividend component of \$0.25 per share was fully franked.
21. Where more shares were tendered than the number of shares ECL was to purchase under the Buy-Back, ECL was entitled to scale back tendered shares equally. Where the scale back would result in an Eligible Participant holding less than 2,000 shares, ECL would purchase all the shares in the Buy-Back.
22. On 18 December 2015, ECL announced:
- it had successfully completed the buy-back of 3,880,077 ECL shares, representing approximately 19% of the issued shares of ECL
 - the total amount of the Buy-Back Price for shares repurchased under the Buy-Back was \$4,539,690.09, and
 - a scale back mechanism was not applied.
23. All Shares acquired by ECL under the Buy-Back were cancelled.
24. The share capital account (as defined in section 975-300 of the ITAA 1997) of ECL is not tainted (within the meaning of Division 197 of the ITAA 1997).

Ruling

Off-market purchase

25. For the purposes of Division 16K, the Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend Component

26. Participating Shareholders are taken to have received a dividend of \$0.25 (the Dividend Component) on 18 December 2015 for each share bought back under section 159GZZZP.

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

28. The difference between the Buy-Back Price and the Dividend Component is not a dividend for income tax purposes (subsection 159GZZZP(2)).

Assessability of the Dividend Component and tax offset

Direct distributions

29. The Dividend Component of \$0.25 per share and, subject to the shareholder being a 'qualified person', the amount of the franking credit on the Dividend Component, is included in the assessable income of Australian resident individual and corporate shareholders, and trustees of resident complying superannuation funds who participated in the Buy-Back in the income year in which the Buy-Back occurred (subsection 44(1), and subsection 207-20(1) of the ITAA 1997).

30. Participating Shareholders are entitled to a tax offset under subsection 207-20(2) of the ITAA 1997 equal to the amount of the franking credit attached to the Dividend Component, subject to being a 'qualified person'.

Indirect distributions

Partnerships

31. The Dividend Component of \$0.25 per share and, subject to being a qualified person, the amount of the franking credit attached to the Dividend Component is included in the assessable income of a Participating Shareholder that is a partnership for the purposes of computing the net income of the partnership pursuant to section 90.

Trusts

32. The Dividend Component of \$0.25 per share and, subject to being a qualified person, the amount of the franking credit attached to the Dividend Component is included in the assessable income of a Participating Shareholder that is a trustee of a trust for the purposes of computing the net income of the trust pursuant to subsection 95(1).

Partners and Beneficiaries

33. Subsections 207-35(3) to (6) of the ITAA 1997 set out the circumstances in which a partner or beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution. Where the franked distribution flows indirectly (within the meaning of Subdivision 207-B of the ITAA 1997) through a trust or partnership to a resident that is an individual, a corporate tax entity (at the time the distribution flows indirectly to it) or a trustee mentioned in paragraphs 207-45(c), (ca) or (d) of the ITAA 1997, the entity will, subject to the qualified person rule, be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45 of the ITAA 1997).

Refundable tax offset

34. 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 in accordance with subsections 67-25(1A) to (1DA) of the ITAA 1997.

Non-resident Participating Shareholders

35. As the Dividend Component is fully franked, non-resident Participating Shareholders are not liable to Australian withholding tax in respect of the Dividend Component (paragraph 128B(3)(ga)).

Sale Consideration

36. Participating Shareholders are taken to have received \$0.92 per share as consideration in respect of each share bought back under the Buy-Back (Sale Consideration) on 18 December 2015 in accordance with section 159GZZZQ, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and (9) apply.

37. If the Buy-Back Price for each share purchased by ECL 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 the market value rule in subsection 159GZZZQ(2) applies to the Buy-Back. The effect of this rule is that the difference between the Buy-Back Price and the market value will be included in the consideration received for the disposal of the share for ordinary income or capital gains tax (CGT) purposes. The Sale Consideration was equal to the market value of the shares in this Buy-Back.

Capital gains tax

38. The shares are taken to have been disposed of for CGT purposes on 18 December 2015 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

39. The Sale Consideration of \$0.92 per share represents the capital proceeds for CGT purposes; see Note 3 following subsection 116-20(1) of the ITAA 1997, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and (9) apply.

40. A Participating Shareholder (other than a partnership) will make a capital gain on the 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 Participating Shareholder (other than a partnership) will make a capital loss on a share 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).

Shares held as trading stock

41. Where shares were held as trading stock (as defined in subsection 995-1(1) of the ITAA 1997), the Sale Consideration of \$0.92 per share is included in assessable income pursuant to section 6-5 of the ITAA 1997, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and (9) apply.

42. Any capital gain or capital loss made will be disregarded if at the time of the CGT event the shares were held as trading stock (section 118-25 of the ITAA 1997).

Shares held as revenue assets

43. Where shares were held as revenue assets (as defined in section 977-50 of the ITAA 1997), but were not trading stock, the amount by which the Sale Consideration of \$0.92 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income pursuant to section 6-5 of the ITAA 1997. Similarly, the amount by which the cost of each share exceeds the Sale Consideration of \$0.92 per share is an allowable deduction pursuant to section 8-1 of the ITAA 1997.

44. Any capital gain made by a Participating Shareholder that held shares on revenue account but not as trading stock will be reduced by the amount otherwise included in assessable income as discussed in paragraph 42 of this Ruling (section 118-20 of the ITAA 1997). The reduced cost base for the corresponding CGT outcome is reduced by the amount of the allowable deduction as discussed in paragraph 42 of this Ruling (subsection 110-55(9) of the ITAA 1997).

Foreign resident Participating Shareholders: CGT consequences

45. Any capital gain or loss made by Participating Shareholders that are foreign residents is disregarded if the shares purchased under the Buy-Back were not taxable Australian property (section 855-10 of the ITAA 1997).

Qualified persons

46. For the purposes of paragraph 207-145(1)(a) of the ITAA 1997 which refers to Division 1A of former Part IIIAA, Participating Shareholders will be considered to satisfy the holding period rule under former section 160APHO, and 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 2 November 2015, and
- during the period when the shares were held the Participating Shareholders had sufficient risks of loss or opportunities for gain in respect of 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 ECL shares nor the making of an offer by a shareholder to ECL in respect of an ECL share will affect whether the shares purchased by ECL under the Buy-Back were held 'at risk' within the meaning of Division 1A of former Part IIIAA.

47. If a Participating Shareholder acquired any additional ECL shares after 2 November 2015, the Participating Shareholder may be subject to the 'last-in-first-out' rule in former subsection 160APHI(4) to the extent of shares acquired.

The anti-avoidance provisions

48. 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 Capital Component of the Buy-Back Price received by Participating Shareholders.

49. 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.

50. 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.

Commissioner of Taxation13 January 2016

Appendix 1 – Explanation

① *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.*

Off-market purchase

51. For the purposes of Division 16K, where a company buys a share in itself from a shareholder the purchase is a 'buy-back' (paragraph 159GZZZK(a)).

52. Division 16K categorises a buy-back as either an 'on-market purchase' or an 'off-market purchase'.

53. A buy-back is an on-market purchase if the share bought back is listed for quotation in the official list of a stock exchange in Australia or elsewhere, and the buy-back is made in the ordinary course of trading on that stock exchange (paragraph 159GZZZK(c)). A buy-back that is not an on-market purchase is an off-market purchase (paragraph 159GZZZK(d)).

54. ECL is an unlisted public company. Therefore, the Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend and Capital Components

55. The Buy-Back Price received by Participating Shareholders comprises two components:

- a Dividend Component, and
- a Capital Component.

56. The amount of each of these components is determined in accordance with sections 159GZZZP and 159GZZZQ, and has regard to how ECL accounted for the Buy-Back.

The Dividend Component

57. Section 159GZZZP 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 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 on 18 December 2015 being the day the buy-back occurred.

58. The Buy-Back Price was \$1.17 per share, of which \$0.92 (the Capital Component) was debited against amounts standing to the credit of ECL's share capital account. As a result, the Dividend Component is taken to be \$0.25 per share.

59. The Dividend Component is frankable to the extent that the Buy-Back Price does not exceed the market value of an ECL share at the time of the Buy-Back if it did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997). The Commissioner accepts that the Buy-Back Price does not exceed the relevant market value. Therefore, the Dividend Component of \$0.25 per share is frankable.

Assessability of the Dividend Component and tax offset

Direct distributions

60. For Participating Shareholders who are Australian residents (other than a partnership or a trust):

- the Dividend Component is included in the assessable income of each Participating Shareholder under subsection 44(1), and
- subject to the 'qualified person' rule, the amount of the franking credit on the Dividend Component is included in the assessable income of each Participating Shareholder under subsection 207-20(1) of the ITAA 1997.

61. Subject to the 'qualified person' rule, Participating 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

Partnerships

62. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of a partnership for the purposes of working out the net income of the partnership under section 90.

63. Subject to the 'qualified person' rule, pursuant to subsection 207-35(1) of the ITAA 1997, the amount of the franking credit on the Dividend Component is included in the assessable income of a partnership for the purposes of working out the net income of the partnership under section 90.

Trusts

64. Pursuant to subsection 44(1), the Dividend Component is included in the assessable income of a trustee for the purposes of working out the net income of the trust under subsection 95(1).

65. Subject to the 'qualified person' rule, pursuant to subsection 207-35(1) of the ITAA 1997, the amount of the franking credit on the Dividend Component is included in the assessable income of a trustee for the purposes of working out the net income of the trust under subsection 95(1).

Partners and Beneficiaries

66. Subsections 207-35(3) to (6) of the ITAA 1997 set out the circumstances in which a partner or beneficiary to whom a franked distribution flows indirectly is required to gross up their assessable income for their share of the franking credit on the franked distribution. Where the franked distribution flows indirectly (within the meaning of Subdivision 207-B of the ITAA 1997) through a trust or partnership to a resident that is an individual, a corporate tax entity (at the time the distribution flows indirectly to it) or a trustee mentioned in paragraphs 207-45(c), (ca) or (d) of the ITAA 1997, the resident entity will, subject to the qualified person rule, be entitled to a tax offset equal to the entity's share of the franking credit on the franked distribution (section 207-45 of the ITAA 1997).

Refundable tax offset

67. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997, provided the offsets are not excluded from those rules pursuant to subsections 67-25(1A) to (1DA).

Non-resident Participating Shareholders

68. As the Dividend Component of the Buy-Back Price is fully franked, and no determination will be made in respect of the Dividend Component under either paragraph 204-30(3)(c) of the ITAA 1997 or paragraph 177EA(5)(b), a Participating Shareholder that is a non-resident is not liable to Australian withholding tax on the Dividend Component (paragraph 128B(3)(ga)).

Sale Consideration

69. For the purposes of determining the amount of a gain or loss (for ECL shares held on capital or revenue account), the consideration received by a Participating Shareholder in respect of the disposal of a share (the Sale Consideration) under the Buy-Back is determined in accordance with section 159GZZZQ. The effect of section 159GZZZQ is to adjust the Capital Component in order to determine the Sale Consideration for CGT or revenue account treatment.

70. Subsection 159GZZZQ(1) provides that a shareholder is taken to have received an amount equal to the purchase price (in this case the Buy-Back Price of \$1.17 received for each ECL share bought back) as consideration in respect of the sale of the share bought back.

71. The Commissioner accepts that the market value of each ECL share was \$1.17 per share, which accorded with the Buy-Back Price.

72. Pursuant to subsection 159GZZZQ(3), the consideration of \$1.17 is reduced by a 'Reduction Amount'. The Reduction Amount is worked out pursuant to subsection 159GZZZQ(4). In the circumstances of the Buy-Back, the Reduction Amount is equal to the Dividend Component of \$0.25, unless a Participating Shareholder is a corporate tax entity to whom subsections 159GZZZQ(8) and (9) apply (see paragraph 73 below). As a result, the Sale Consideration for each ECL share disposed of under the Buy-Back is \$0.92 (being \$1.17 less \$0.25).

73. However, 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 159GZZZQ(8), if such a Participating Shareholder would also make either a capital loss or a deductible loss (or any increase in such a loss) in respect of the sale of a share purchased by ECL under the Buy-Back, the Reduction Amount (being the Dividend Component) is itself reduced by so much of the offsettable amount, which is determined under subsection 159GZZZQ(9), that does not exceed the capital loss or the deductible loss. The effect for a Participating Shareholder that is a corporate tax entity is a capital loss or a deductible loss is reduced to the extent of the Dividend Component.

Capital gains tax

74. Participating Shareholders are taken to have disposed of their shares purchased by ECL under the Buy-Back on 18 December 2015 (CGT event A1).

75. The Sale Consideration of \$0.92 per share represents the capital proceeds for CGT purposes; see Note 3 following subsection 116-20(1) of the ITAA 1997. The Sale Consideration may be adjusted where the Participating Shareholder is a corporate tax entity (see paragraph 73 of this Explanation).

76. A Participating Shareholder (other than a partnership) will make a capital gain in respect of the disposal of a share if the Sale Consideration per share exceeds the cost base of the share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder (other than a partnership) will make a capital loss in respect of the disposal of 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).

77. While all Participating Shareholders are subject to CGT, any capital gain or capital loss made will be adjusted if they held their shares as trading stock, or as revenue assets that are not trading stock, as discussed in paragraphs 78 to 80 of this Explanation.

Shares held as trading stock

78. Where shares were held as trading stock (as defined in subsection 995-1(1) of the ITAA 1997), Participating Shareholders include the Sale Consideration of \$0.92 in assessable income (section 6-5 of the ITAA 1997). The Sale Consideration may be adjusted where the Participating Shareholder is a corporate tax entity (see paragraph 73 of this Explanation). Any capital gain or capital loss made will be disregarded at the time of the CGT event where the shares were held as trading stock (section 118-25 of the ITAA 1997). This CGT exemption extends to partners in a partnerships (paragraph 118-25(1)(b)) and beneficiaries of a trust (paragraph 118-25(1)(c)).

Shares held as revenue assets

79. Where shares were held as revenue assets (as defined in section 977-50 of the ITAA 1997) but were not trading stock, the amount by which the Sale Consideration of \$0.92 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income pursuant to section 6-5 of the ITAA 1997. Similarly, the amount by which the cost of each share exceeds the Sale Consideration of \$0.92 per share is an allowable deduction pursuant to section 8-1 of the ITAA 1997. The Sale Consideration may be adjusted where the Participating Shareholder is a corporate tax entity (see paragraph 73 of this Explanation).

80. Any capital gain made because of the CGT event will be reduced by the amount otherwise included in assessable income as discussed in paragraph 79 of this Explanation (section 118-20 of the ITAA 1997). The reduced cost base for the corresponding CGT outcome is reduced by the amount of the allowable deduction as discussed in paragraph 79 of this Explanation (subsection 110-55(9) of the ITAA 1997). There are similar CGT adjustments for partners in partnerships (paragraph 118-20(1)(b), paragraph 118-20(2)(b) and subsection 118-20(3)).

Foreign resident Participating Shareholders: CGT consequences

81. 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. An ECL share that is disposed of in the Buy-Back will constitute taxable Australian property if the share:

- is an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997)
- was 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), or

- 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).

Qualified persons

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

83. Broadly, a Participating Shareholder will not satisfy the related payments rule if the Participating Shareholder, or an associate of the Participating 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.

84. The holding period rule requires a shareholder to hold 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 are acquired and ends on the 45th day after the day on which the shares became ex-dividend. In determining whether a shareholder has satisfied the holding period rule, any days when there were materially diminished risks of loss or opportunities 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.

85. Under former subsection 160APHM(2), a shareholder is taken to have materially diminished risks of loss and opportunities for gain with respect to 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.

86. The Commissioner does not regard the announcement of the Buy-Back as affecting whether ECL shares were held at risk or not.

87. A Participating Shareholder who acquired shares on or before 2 November 2015 that were purchased by ECL under the Buy-Back satisfied the holding period rule as long as those shares were held at risk for at least 45 continuous days.

88. A Participating Shareholder who acquired shares after 2 November 2015 that were subsequently purchased by ECL under the Buy-Back will not satisfy the holding period rule in relation to the dividend paid under the Buy-Back for the purposes of former Division 1A of Part IIIAA, but may be a 'qualified person' in certain circumstances.

89. Generally, under the holding period rule a shareholder is deemed to have disposed of their most recently acquired shares first (former subsection 160APHI(4)) commonly referred to as the 'last-in first-out' rule. Accordingly, a Participating Shareholder who acquired any additional ECL shares after 2 November 2015 may not qualify for the franking credits attached to the dividends received on some or all of the shares sold into the Buy-Back.

The anti-avoidance provisions

Sections 45A and 45B

90. 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 a shareholder that participates in a buy-back is treated as an unfranked dividend.

91. 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.

92. The Commissioner accepts that in the circumstances of the Buy-Back there is no streaming of capital benefits to advantaged shareholders and dividends to disadvantaged shareholders for the purposes of section 45A. This is because all Participating Shareholders received both a distribution of share capital as well as a Dividend Component in equal proportion based on the number of shares sold into the Buy-Back.

93. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends.

94. In broad terms, there needs to be a scheme in which, having regard to the relevant circumstances of the scheme, it would be concluded that the person, or one of the persons, who entered into the scheme or carried out the scheme or any part of the scheme did so for a purpose, other than an incidental purpose, of enabling the relevant taxpayer to obtain a tax benefit.

95. As the distribution of share capital as part of the Buy-Back Price will generally result in a lesser amount of tax payable to Participating Shareholders than what would be payable if it had instead been an assessable dividend, those shareholders will obtain a tax benefit within the meaning of subsection 45B(9).

96. Having regard to the 'relevant circumstances' (as set out in subsection 45B(8)) of the Buy-Back, it is apparent that:

- the distribution of share capital of \$0.92 per share accords with average capital per share and could not be said to be attributable to the profits of ECL

- the pattern of distributions of ECL does not indicate that the distribution of share capital of \$0.92 per share reflects amounts in substitution for a dividend
- the Buy-Back is not expected to alter ECL's dividend policy, and
- as a consequence of the Buy-Back, the distribution of share capital resulted in the cancellation of ordinary shares in ECL held by Participating Shareholders and a corresponding loss of dividend, voting and other rights.

97. Accordingly, the Commissioner will not make a determination under subsection 45A(2) or subsection 45B(3) that section 45C applies to treat all or part of the distribution of share capital of \$0.92 per share as an unfranked dividend paid by ECL.

Section 177EA

98. Section 177EA is a general anti-avoidance provision that operates to prevent franking credit trading.

99. In broad terms, section 177EA requires that, in considering the relevant circumstances of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out 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 respect of the Buy-Back, the relevant taxpayer is the Participating Shareholder and the scheme comprises the circumstances surrounding the Buy-Back. Accordingly, the issue is whether, having regard to the relevant circumstances of the Buy-Back, it would be concluded that ECL, one or more shareholders or any other parties, there is a more than incidental purpose of conferring an imputation benefit under the scheme.

101. Having regard to all of the relevant circumstances of the Buy-Back for the purposes of subsection 177EA(17), the Commissioner has come to the view that section 177EA applies to the Buy-Back to the extent that any non-resident shareholders do not participate. Among the circumstances of the Buy-Back reflected in those paragraphs is the greater attraction of the Buy-Back to resident shareholders of the franking credits than for non-resident shareholders.

102. Where section 177EA applies the Commissioner has a discretion pursuant to subsection 177EA(5) to make a determination to debit ECL's franking account pursuant to paragraph 177EA(5)(a), or to deny the imputation benefit to each Participating Shareholder pursuant to paragraph 177EA(5)(b). The Commissioner will exercise his discretion in such a way that he will not make a determination to deny the imputation benefit to each Participating Shareholders under paragraph 177EA(5)(b).

Section 204-30 of the ITAA 1997

103. 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 certain shareholders, referred to as favoured members obtain imputation benefits and other shareholders, referred to as disadvantaged members, obtain lesser or no imputation benefits. The favoured members are those that would derive a greater benefit from imputation benefits than disadvantaged members.

104. For section 204-30 of the ITAA 1997 to apply, Participating Shareholders who constitute advantaged members must derive a greater benefit from franking credits than other shareholders who do not participate in the Buy-Back who constitute disadvantaged members. Some of the cases in which a member of an entity 'derives a greater benefit from franking credits' are listed in subsection 204-30(8) by reference to the ability of a member to fully utilise franking credits.

105. The conditions for the application of section 204-30 of the ITAA 1997 set out in subsection 204-30(1) may be present in the Buy-Back to the extent any non-resident shareholders do not participate. However, the Commissioner will not make a determination under subsection 204-30(3).

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Income tax ~~ Capital gains tax ~~ Exemptions ~~ Other
Income tax ~~ Capital management ~~ Qualified person
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Income tax ~~ Capital management ~~ Share buy back
International issues ~~ Non-resident withholding tax
obligations

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