

CR 2019/30 - Pinewood Community Financial Services Limited - off-market share buy-back



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Class Ruling

Pinewood Community Financial Services Limited – off-market share buy-back

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❶ Relying on this Ruling

This publication (excluding the appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in the ruling. That is, you will not pay any more tax or pay any penalties or interest in respect of the matters covered by this ruling.

Further, if we think that the ruling disadvantages you, we may apply the law in a way that is more favourable to you.

Summary – 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
- Division 16K of the ITAA 1936
- section 159GZZZK of the ITAA 1936
- section 159GZZZP of the ITAA 1936
- section 139GZZZQ of the ITAA 1936
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)
- section 104-10 of the ITAA 1997

- subsection 106-5(1) of the ITAA 1997
- subsection 106-5(2) 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 202-45 of the ITAA 1997
- Division 230 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1936 or the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies is the ordinary shareholders of Pinewood Community Financial Services Limited who:

- disposed of the ordinary shares in Pinewood under the off-market share buy-back which was announced by Pinewood on 20 December 2018 and is described in paragraphs 9 to 33 of this Ruling
- are Australian residents, and
- are not subject the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Pinewood 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, these ordinary shareholders of Pinewood 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 9 to 33 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 2018 to 30 June 2019. The Ruling continues to apply after 30 June 2019 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 *Public Rulings*).

Scheme

8. The following description of the scheme is based on information provided by the applicant as well as the:

- Notice of General Meeting dated 20 December 2018, and
- Buy-Back Booklet provided to all Pinewood shareholders.

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

Corporate Structure and shareholding

9. Pinewood Community Financial Services Limited (Pinewood) is a public company which was incorporated on 30 January 2002.

10. Pinewood operates a Bendigo Bank Community® Bank under a Community Banking Franchise Agreement (Franchise Agreement) with the Bendigo and Adelaide Bank Ltd (Bendigo Bank).

11. As at 19 September 2018, Pinewood had:

- 532,300 fully paid ordinary shares on issue. There are no partly paid shares or any other class of shares on issue.
- Share capital of \$532,300.
- Retained earnings of \$180,738.

12. There have been no corporate actions involving the shares since incorporation.

13. Pinewood has a total of 222 shareholders consisting of individuals, companies, trusts and superannuation funds, none of which are non-residents.

The Franchise Agreement

14. Relevant, key terms of Pinewood's Franchise Agreement are:

- Pinewood may only distribute a maximum of 20% of the sum of its current year profits and retained earnings in each year ended 30 June. Alternatively, Pinewood may distribute an amount using a rate of return formula.
- Pinewood may provide some or all of the additional funds that it cannot distribute to shareholders to community groups and other organisations to assist with implementing projects that have a benefit to the local community of each branch such as seed funding for major projects like establishing a child care centre.
- Each shareholder is only entitled to one vote at meetings of the company, regardless of the number of shares held.
- No shareholder including any related parties may hold more than 10% of the total issued capital in the company.
- Shareholders are required to have a close connection with the community, whether living in the geographic location of the branch, or some connection with the local community.

Trading history

15. Ordinary shares in Pinewood trade in a low volume market administered in accordance with the Corporations (Low Volume Financial Markets) Instrument 2016/888.

16. Since 10 June 2014, a total of 44,500 Pinewood shares (that is, less than 2% of Pinewood shares per year) have traded at a weighted average price of \$0.95 cents per share.

Distribution history

17. Pinewood has paid fully franked dividends in the last three financial years at or close to the maximum allowed under the Franchise Agreement.

Share buy-back arrangement

18. Pinewood has continued to accumulate surplus capital. This is partially due to the limits on the dividends Pinewood may distribute to shareholders under the Franchise Agreement.

19. As Pinewood will not fully distribute or use its surplus capital in the short to medium term, Pinewood believes it is preferable to return capital which is excess to its needs to shareholders through a buy-back of its shares.

20. The initial capital raising was undertaken over 16 years ago. Since then, there has been a low turnover of Pinewood shares at a low price which makes it difficult for shareholders to dispose of their shares otherwise.

21. On 20 December 2018, Pinewood announced that it proposed to undertake an equal access off-market buy-back of a maximum of 20% – 106,460 – of its shares on issue for a maximum amount of \$170,336. Pinewood shareholders approved the Buy-Back at the General Meeting held on 30 January 2019.

22. The Bendigo Bank provided formal approval to Pinewood to undertake an equal access, off-market buy-back on this basis. Shareholders approved the buy-back at the General Meeting held on 30 January 2019.

23. The buy-back offer was made available to all eligible shareholders to enable Pinewood to buy back the same percentage of their ordinary shares. Participation in the buy-back was voluntary and Pinewood retained the discretion to vary the size of the buy-back, to repurchase a lesser amount of shares or no shares at all.

24. For each share bought back, Pinewood would pay the buy-back price of \$1.60, comprising:

- \$1.00 as the Capital component which was debited to Pinewood's Share capital account, and
- \$0.60 as the Dividend component which was debited to Pinewood's Retained earnings. The Dividend Component was unfranked.

25. A shareholder with 800 shares or less who wished to participate in the Buy-Back was required to offer to sell their entire shareholding.

26. If at the close of the Buy-Back offer, the total number of shares offered to be bought back by shareholders is less than or equal to 106,460, Pinewood would buy-back all the offered shares.

27. If the total number of shares which shareholders offered to participate in the Buy-Back exceeded 106,460, Pinewood would scale back the offer with preference to shareholders who held 800 shares or less respectively.

28. All shareholders who held shares in Pinewood at 5.00pm on 1 August 2018 and continued to be registered on Pinewood's Share Registry on that date were eligible to participate in the Buy-Back.
29. The buy-back commenced on Monday 11 February 2019 and closed at 5pm on Friday 29 March 2019. Shareholders were entitled to participate with shares held on 1 August 2018 (the Record Date).
30. On 15 April 2019, Pinewood announced that it purchased 106,460 of its shares under the Buy-Back.
31. Participating shareholders were paid on 15 April 2019.
32. Pinewood's share capital account (as defined in section 975-300) was not tainted for the purposes of section 197-50.
33. All shares bought back under the buy-back were cancelled.

Ruling

Off-market purchase

34. 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

35. Participating Shareholders are taken to have been paid a dividend of \$0.60 (Dividend Component) on 15 April 2019 for each share bought back (section 159GZZZP).
36. The Dividend Component is an unfrankable distribution pursuant to paragraph section 202-45(c) and is not capable of being franked in accordance with section 202-5.
37. 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

Direct distributions

38. The Dividend Component of \$0.60 per share 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 (subsections 44(1) and 207-20(1)).
39. As the Dividend Component is unfranked, Participating Shareholders are not entitled to a tax offset (subsection 207-20(2)).

Indirect distributions***Partnerships***

40. The Dividend Component of \$0.60 per share is included in the assessable income of a Participating Shareholder that is a partnership for the purposes of calculating the net income of the partnership pursuant to section 90.

Trusts

41. The Dividend Component of \$0.60 per share is included in the assessable income of a Participating Shareholder that is a trustee of a trust for the purposes of determining the net income of the trust pursuant to subsection 95(1).

Sale Consideration

42. A Participating Shareholder is taken to have received \$1.00 per share as consideration in respect of each share bought back under the Buy-Back on 15 April 2019 in accordance with section 159GZZZQ.

43. The treatment of the Sale Consideration will depend on whether the sale is on capital account or on revenue account.

Shares held on capital account

44. The shares are taken to have been disposed of for capital gains tax (CGT) purposes on 15 April 2019 pursuant to section 104-10 (CGT event A1).

45. The Sale Consideration of \$1.00 per share represents the capital proceeds for CGT purposes pursuant to section 116-20. A Participating Shareholder (other than a partnership) 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 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 (subsection 104-10(4)).

46. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Pinewood share sold into the Buy-Back by the partnership (subsection 106-5(2)). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of Pinewood shares into the Buy-Back.

Shares held on revenue account

47. Where shares were held as trading stock, the Sale Consideration of \$1.00 per share is included in assessable income pursuant to section 6-5. Participating Shareholders (other than partnerships) that held shares as trading stock also made a capital gain or capital loss. However, under section 118-25, any capital gain or capital loss the Participating Shareholders made will be disregarded if at the time of the CGT event, the shares were held as trading stock. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b)).

48. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$1.00 per share exceeds the cost of each share is included in the Participating Shareholder's assessable income. Correspondingly, if the cost of each share exceeds the Sale Consideration of \$1.00 per share, the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of that share, the Participating Shareholders (other than partnerships) will also make a capital gain. However, under section 118-20, any capital gain the Participating Shareholders made will be reduced if, because of the event, an amount is otherwise included in assessable income. The capital gain will be reduced to zero if the capital gain does not exceed the amount otherwise included in assessable income (subsection 118-20(2)). If the capital gain exceeds the amount otherwise included in assessable income, the capital gain will be reduced by the amount otherwise included in assessable income (subsection 118-20(3)). There is a similar reduction for partners in partnerships (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3)).

The anti-avoidance provisions

49. 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.

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

50. 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)).

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

52. 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)).

Although Pinewood's ordinary shares are traded in a low-volume market which may be reviewed on the company website, the shares are not listed for quotation in the official list of a stock exchange in Australia or elsewhere. As a result, for the purposes of Division 16K, the Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend and Capital Components

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

- a Dividend Component, and
- a Capital Component.

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

The Dividend Component

55. 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 the day the buy-back occurred.

56. The Buy-Back Price was \$1.60 per share, of which \$1.00 per share (the Capital Component) was debited against the amount standing to the credit of Pinewood's share capital account. As a result, the Dividend Component is taken to be \$0.60 per share, and is taken to be paid to Participating Shareholders on 15 April 2019.

57. Where the Buy-Back Price of a share bought back in an off-market buy-back is greater than its market value, the Dividend Component is unfrankable to the extent of the excess pursuant to paragraph 202-45(c).

58. The Commissioner agrees that the market value of a Pinewood share was \$1.00 per share. Accordingly, the buy-back price of \$1.60 per share was greater than the market value of a Pinewood share. As a result, the entire Dividend Component of \$0.60 per Pinewood share bought back was an unfrankable dividend (paragraph 202-45 (c)).

Assessability of the Dividend Component

Direct distributions

59. For Participating Shareholders who are Australian residents (other than a partnership or a trust) and who directly received the Dividend Component, the Dividend Component is included in their assessable income under subsection 44(1). As the Dividend Component is unfrankable there is no franking credit attached to the Dividend Component, the Dividend Component is not grossed up and there is no entitlement to a franking tax offset.

Indirect distributions

Partnerships

60. 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.

Trusts

61. Pursuant to subsection 44(1), 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).

The Capital Component

Calculation of Sale Consideration

62. For the purposes of determining the amount of a gain or loss (for Pinewood 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 purposes or revenue account treatment.

63. Subsection 159GZZZQ(1) provides that a Participating Shareholder is taken to have received an amount equal to the purchase price (the Buy-Back Price of \$1.60 received for each Pinewood 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.

64. 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 of the share as consideration in respect of the sale of the share bought back.

65. The Buy-Back Price of \$1.60 per Pinewood share was greater than its market value of not more than \$1.00, therefore subsection 159GZZZQ(2) does not operate to increase the Sale Consideration.

66. Pursuant to subsection 159GZZZQ(3), the consideration of \$1.60 is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated pursuant to subsection 159GZZZQ(4). In the circumstances of the Buy-Back, the Reduction Amount is equivalent to the Dividend Component of \$0.60. As a result, the Sale Consideration for each Pinewood share disposed of under the Buy-Back is \$1.00 (being \$1.60 less \$0.60).

67. As the Dividend Component was unfranked and therefore did not contain an 'offsetable amount', there is no further adjustment where the participating shareholder happens to be a company for the purposes of subsections 159GZZZQ(8) and (9).

68. Participating Shareholders are taken to have disposed of their shares accepted under the Buy-Back on 15 April 2019 (CGT event A1). The disposal may have different taxation implications for Participating 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

69. The Sale Consideration of \$1.00 per share represents the capital proceeds for CGT purposes pursuant to section 116-20. 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)).

Where the Participating Shareholder is a partnership, any capital gain or capital loss will be made by the partners individually (subsection 106-5(1)). Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Pinewood share sold into the Buy-Back by the partnership (subsection 106-5(2)). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of Pinewood shares into the Buy-Back.

Shares held on revenue account

70. Where shares were held as trading stock, the Sale Consideration of \$1.00 per share is included in assessable income under section 6-5. Participating Shareholders (other than partnerships) who disposed of shares held as trading stock will also make a capital gain or capital loss. However, as the shares were held as trading stock, the capital gain or capital loss is disregarded pursuant to section 118-25. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b)).

71. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$1.00 per share exceeds the cost of each share is included in assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$1.00 per share, the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of the share these Participating Shareholders (other than partnerships) also made a capital gain. However, Participating Shareholders who held their shares as revenue assets other than as trading stock will have the amount of the capital gain reduced under the CGT anti-overlap provisions contained in section 118-20. There is a similar reduction for partners in partnerships (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3)).

The anti-avoidance provisions

Sections 45A and 45B

72. 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 Participating 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.

73. Section 45A 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.

74. 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. Under the Buy-Back, 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 they sold into the Buy-Back. Accordingly, section 45A has no application to the Buy-Back.

75. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. In broad terms, section 45B applies where under a scheme:

- a person is provided with a capital benefit by a company (paragraph 45B(2)(a))
- 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, who entered into or carried out the scheme or any part of the scheme did so for a more-than-incidental purpose of enabling the relevant taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

76. While the conditions of paragraphs 45B(2)(a) and 45B(2)(b) were met in respect of the Buy-Back, the requisite purpose of enabling a person to obtain a tax benefit as a result of the capital distribution was not present.

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

- the distribution of share capital of \$1.00 per share accords with average capital per share and could not be said to be attributable to the profits of Pinewood
- the pattern of distributions of Pinewood does not indicate that the distribution of share capital of \$1.00 per share reflects an amount provided in substitution for a dividend
- the Buy-Back is not expected to alter Pinewood's dividend policy, and

- as a consequence of the Buy-Back, the distribution of share capital resulted in the cancellation of ordinary shares in Pinewood held by Participating Shareholders and a corresponding loss of dividend, voting and other rights.

78. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to treat all or any part of the distribution of share capital of \$1.00 per share as an unfranked dividend paid by Pinewood.

Franking credit provisions

Sections 177EA and 204-30

79. As the Dividend Component was both unfrankable and unfranked, it is not necessary to consider the operation of sections 177EA and 204-30. These provisions operate in certain circumstances when franked dividends are provided to shareholders.

Divisions 67 and 207

80. As the Dividend Component was both unfrankable and unfranked, it is not necessary to consider the operation of Division 207 (effect of receiving franked distributions) including paragraph 207-145(1)(a) (the qualified person rules), or Division 67 (refundable tax offset rules).

Appendix 2 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2004/22; TR 2006/10

Legislative references:

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- ITAA 1936 44(1)
- ITAA 1936 45A
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- ITAA 1936 45A(3)(b)
- ITAA 1936 45B
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- ITAA 1936 90
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- ITAA 1997 207-20(2)
- ITAA 1997 Div 230
- TAA 1953

Other references:

- Corporations (Low Volume Financial Markets) Instrument 2016/888
- PS LA 2007/9

ATO references

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Income tax ~~ Capital management ~~ Return of capital ~~ Share buy back

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