


CR 2015/14 - Income tax: off-market share buy-back: Thinksmart Limited

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Class Ruling

Income tax: off-market share buy-back: Thinksmart Limited

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❶ 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)
- 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
- section 128B of the ITAA 1936
- Division 16K of Part III 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)
- Division 67 of the ITAA 1997

- section 104-10 of the ITAA 1997
- section 104-165 of the ITAA 1997
- section 106-5 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 202-45 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 207-20 of the ITAA 1997
- section 207-35 of the ITAA 1997
- section 207-145 of the ITAA 1997
- Division 725 of the ITAA 1997
- Division 727 of the ITAA 1997
- Subdivision 802-A of the ITAA 1997
- section 855-10 of the ITAA 1997, and
- section 855-15 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 Thinksmart Limited (Thinksmart) who:

- (a) disposed of their ordinary shares in Thinksmart under the Thinksmart off-market share buy-back which was announced by Thinksmart on 18 November 2014 and which is described in paragraphs 7 to 27 of this Ruling (the 'Thinksmart Buy-Back'), 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 Thinksmart 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, these ordinary shareholders of Thinksmart are referred to as 'Participating Shareholders'.

Qualifications

4. 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 7 to 27 of this Ruling.

5. 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

6. This Ruling applies from 1 July 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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

7. 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.

8. Thinksmart is a public company listed on the Australian Securities Exchange (ASX).

9. The share capital of Thinksmart is comprised solely of fully paid ordinary shares. The audited Statement of Financial Position of Thinksmart as at 30 June 2014 shows share capital of approximately \$48.1 million, reserves of approximately \$150,000 (in debit balance) and retained profits of approximately \$11 million.

10. Thinksmart's ordinary shareholders are a mix of individuals, companies, trusts, partnerships and superannuation funds, some of whom are non-residents.

11. On 18 November 2014, Thinksmart announced (First Announcement Date) its intention, subject to shareholder approval, to undertake an off-market buy-back of its own shares. Thinksmart proposed to buy back up to 64,516,129 ordinary shares, representing approximately 43.9% of its issued capital at that time. Thinksmart retained the discretion to buy-back a lesser number of shares, or no shares at all.

12. The Thinksmart Buy-Back formed part of Thinksmart's capital management program following the sale of its Australian and New Zealand operations in early 2014.

13. The Thinksmart Buy-Back was conducted through a tender process during a specified tender period and was open to all eligible shareholders who were registered as such on 26 November 2014 (Record Date).

14. Participation in the Thinksmart Buy-Back was voluntary. Eligible shareholders who did not want to participate were not required to do anything. Non-Participating Shareholders did not receive any property, dividends or distributions as compensation for not participating in the Thinksmart Buy-Back.

15. As required by section 257C of the *Corporations Act 2001*, the terms of the Thinksmart Buy-Back were approved by Thinksmart shareholders at an Extraordinary General Meeting held on 22 December 2014.

16. The Thinksmart Buy-Back tender period opened on 23 December 2014 (Opening Date) and closed on 23 January 2015 (Closing Date).

17. Under the tender process, eligible shareholders could offer to sell some or all of the shares they held at the Record Date at the specified prices within the Tender Range and / or as a Final Price Tender. The Tender Range was 31 cents to 42 cents (inclusive), in 1 cent intervals. The Final Price Tender was the buy-back price as finally determined by Thinksmart under the tender process.

18. Subject to any scale-back of offers, tenders at prices equal to or below the Buy-Back Price or as Final Price Tenders would be successful. Tenders at prices above the Buy-Back Price would not be accepted.

19. The Buy-Back Price was subject to the overriding limit that Thinksmart would not buy-back shares at a discount greater than 14% to the VWAP of Thinksmart shares over the five trading days up to and including the Closing Date (23 January 2015).

20. Depending on the Buy-Back Price, Thinksmart intended to frank (the frankable part of) the Dividend Component. The frankable part of the Dividend Component of the Buy-Back Price would be dependent on the market value of a Thinksmart share at the time of the Thinksmart Buy-Back as determined by TD 2004/22.

21. On 27 January 2015 Thinksmart announced that:

- it had successfully completed the buy-back of 49,998,962 Thinksmart shares
- the total amount of capital repurchased under the Thinksmart Buy-Back was \$20,999,564 representing 34.2% of the issued capital of Thinksmart
- the final price for the Thinksmart Buy-Back was set at 42 cents per share (Buy-Back Price)
- tenders below the Buy-Back Price and Final Price Tenders were accepted in full and were not scaled back

- a scale back was required for tenders at the Buy-Back Price
- before the scale back was applied, a Priority Allocation of 5,797 shares was bought back
- in addition, shareholders who would have been left with 1,449 shares or less after the scale back had all of their shares bought back in full, and
- subject to the above qualification, shareholders who tendered their shares at the Buy-Back Price had 66.47% of their shares tendered in excess of the Priority Allocation bought back.

22. The Buy-Back Price of 42 cents represented a premium to both the prevailing ASX price and the market value determined under TD 2004/22.

23. The Dividend Component of the Buy-Back Price, being 12 cents, was comprised of a franked part (4 cents per share) and an unfranked part (8 cents per share).

24. Under the Thinksmart Buy-Back, 30 cents per share was debited to Thinksmart's untainted share capital account, and the balance of the Buy-Back Price was debited to Thinksmart's retained profits.

25. Thinksmart has not transferred any funds into its share capital account from other accounts. As a result, Thinksmart has an untainted share capital account for tax purposes.

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

27. Thinksmart shares were not indirect Australian real property interests (as defined in section 855-25 of the ITAA 1997) at the time CGT Event A1 happened as a result of the Thinksmart Buy-Back.

Ruling

Off-market purchase

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

The Dividend Component

29. Participating Shareholders are taken to have been paid a dividend of 12 cents (the Dividend Component) for each share bought back under section 159GZZZP. The Dividend Component is taken to have been paid to Participating Shareholders on 27 January 2015.

30. 4 cents of 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. 8 cents of the Dividend Component is an unfrankable distribution pursuant to paragraph 202-45(c) of the ITAA 1997, and is not capable of being franked in accordance with section 202-5 of the ITAA 1997.

31. No part of the Dividend Component includes conduit foreign income within the meaning given by Subdivision 802-A of the ITAA 1997.

32. 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

33. The Dividend Component of 12 cents and, subject to 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 Thinksmart Buy-Back in the income year in which the Thinksmart Buy-Back occurred (subsection 44(1) and subsection 207-20(1) of the ITAA 1997). For Participating Shareholders who have not been granted leave to adopt a substituted accounting period, the Thinksmart Buy-Back occurred in the income year ending 30 June 2015.

34. Australian resident individual and corporate shareholders and trustees of resident complying superannuation funds who participated in the Thinksmart Buy-Back 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

35. The Dividend Component of 12 cents and, subject to being a qualified person, the amount of the franking credit on 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 under section 90.

Trusts

36. The Dividend Component of 12 cents and, subject to being a qualified person, the amount of the franking credit on 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 under subsection 95(1).

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 Participating Shareholders

38. As the Dividend Component is partially franked, non-resident Participating Shareholders are not liable to pay Australian withholding tax on the franked part of the Dividend Component (4 cents per share bought back) (paragraph 128B(3)(ga)).

39. However, non-resident Participating Shareholders are liable to pay Australian withholding tax on the unfranked part of the Dividend Component (8 cents per share bought back) (subsection 128B(1) and (4)).

Sale Consideration

40. Participating Shareholders are taken to have received 30 cents as consideration in respect of each share bought back under the Thinksmart Buy-Back (Sale Consideration) on 27 January 2015 in accordance with section 159GZZZQ, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

41. The market value substitution rule in subsection 159GZZZQ(2) does not deem an increase in the consideration received by Participating Shareholders. This is because the Buy-Back Price for each share bought back under the Thinksmart Buy-Back was greater than the market value of a Thinksmart share for the purpose of subsection 159GZZZQ(2), as determined in accordance with TD 2004/22.

42. 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

43. The shares are taken to have been disposed of for CGT purposes on 27 January 2015 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

44. The Sale Consideration of 30 cents represents the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997. 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) of the ITAA 1997).

45. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Thinksmart share sold into the Thinksmart Buy-Back by the partnership (subsection 106-5(2) of the ITAA 1997). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of Thinksmart shares into the Thinksmart Buy-Back.

Shares held on revenue account

46. Where shares were held as trading stock, the Sale Consideration of 30 cents per share is included in assessable income under section 6-5 of the ITAA 1997. Participating Shareholders (other than partnerships) who held shares as trading stock will also make a capital gain or capital loss calculated as discussed at paragraph 44 of this Ruling. However, under section 118-25 of the ITAA 1997 any capital gain or capital loss these Participating Shareholders make will be disregarded if at the time of the CGT event the shares are held by them as trading stock. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

47. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of 30 cents per share exceeds the cost of each share is included in the Participating Shareholder's assessable income. Correspondingly, if the cost exceeds the Sale Consideration of 30 cents per share the difference is an allowable deduction. Where the Sale Consideration per share exceeds the cost base of that share these Participating Shareholders (other than partnerships) will also make a capital gain. However, under section 118-20 of the ITAA 1997 any capital gain these Participating Shareholders make will be reduced if, because of the event, an amount has otherwise been 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) of the ITAA 1997). 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) of the ITAA 1997). There is a similar reduction for partners in partnerships (paragraph 118-20(1)(b), paragraph 118-20(2)(b) and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating Shareholders: CGT consequences

48. A Participating Shareholder who was a foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happened to a Thinksmart share as a result of the Thinksmart Buy-Back will disregard a capital gain or capital loss made from CGT event A1, unless the Thinksmart share:

- has been used at any time by the Participating Shareholder 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
- is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Qualified persons

49. For the purposes of 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 Thinksmart Buy-Back, if:

- the shares sold into the Thinksmart Buy-Back were acquired on or before 21 November 2014, 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 Thinksmart Buy-Back, the making of an invitation to shareholders to offer to sell their Thinksmart shares nor the making of an offer by a shareholder to Thinksmart in respect of a Thinksmart share will affect whether the shares bought back under the Thinksmart Buy-Back are held 'at risk' for the purposes of Division 1A of former Part IIIAA.

50. The 'last-in first-out' rule in former subsection 160APHI(4) has no effect for the purposes of the Thinksmart Buy-Back in respect of Thinksmart shares acquired on or after 24 November 2014 (the Ex-entitlement Date) which do not confer an entitlement to participate in the Thinksmart Buy-Back.

Value shifting rules

51. There will be no consequences for a Participating Shareholder under Divisions 725 and 727 of the ITAA 1997 as a result of participating in the Thinksmart Buy-Back.

The anti-avoidance provisions

52. 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.

53. 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.

54. 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 Taxation

25 February 2015

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Off-market purchase

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

56. Division 16K of Part III categorises a buy-back as either an 'on-market purchase' or an 'off-market purchase'.

57. 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)).

58. Although Thinksmart's ordinary shares are listed for quotation in the official list of the ASX, the Thinksmart Buy-Back was not made in the ordinary course of trading on the ASX. As a result, for the purposes of Division 16K of Part III, the Thinksmart Buy-Back is an off-market purchase within the meaning given by paragraph 159GZZZK(d).

The Dividend and Capital Components

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

- a Dividend Component, and
- a Capital Component.

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

The Dividend Component

61. 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 share capital account is taken to be a dividend paid by the company to the seller on the day the buy-back occurs.

62. The Buy-Back Price of each Thinksmart share was 42 cents, of which 30 cents per share was debited against amounts standing to the credit of Thinksmart's share capital account (Capital Component). As a result, the Dividend Component is taken to be 12 cents per share, and is taken to be paid to Participating Shareholders on 27 January 2015.

63. Thinksmart's ability to frank the Dividend Component was affected by the Buy-Back Price representing a premium to the market value of a Thinksmart share determined in accordance with TD 2004/22. The Dividend Component is unfrankable to the extent that the Buy-Back Price exceeded the market value of a Thinksmart share determined in accordance with TD 2004/22 (paragraph 202-45(c) of the ITAA 1997).

64. The market value of a Thinksmart share determined in accordance with TD 2004/22 was 34 cents per share. The Buy-Back Price of 42 cents per share exceeded the market value of a Thinksmart share by 8 cents per share. As a result, 8 cents of the Dividend Component of the Buy-Back Price is unfrankable. The remaining 4 cents of the Dividend Component of the Buy-Back Price is frankable (section 202-40 of the ITAA 1997).

65. No part of the Dividend Component includes conduit foreign income within the meaning given by Subdivision 802-A of the ITAA 1997.

Assessability of the Dividend Component and tax offset

Direct distributions

66. 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 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.

67. Subject to the 'qualified person' rule, these 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***

68. 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.

69. 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 the partnership for the purposes of computing the net income of the partnership under section 90.

Trusts

70. 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).

71. 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 the trustee for the purposes of computing the net income of the trust under subsection 95(1).

Refundable tax offset

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

Non-resident Participating Shareholders

73. Section 128B(1) provides that dividends derived by a non-resident and paid by a resident company are subject to withholding tax.

74. As the Dividend Component of the Buy-Back Price is partially franked, non-resident Participating Shareholders are not liable to pay Australian withholding tax on the franked part of the Dividend Component (4 cents per share bought back) (paragraph 128B(3)(ga)).

75. Non-resident Participating Shareholders are liable to pay Australian withholding tax on the unfranked part of the Dividend Component (8 cents per share bought back) at the dividend withholding tax rate of 30%. This rate is generally reduced to 15% for countries which have a double tax agreement with Australia.

The Capital Component

Calculation of Sale Consideration

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

77. 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 42 cents received for each Thinksmart 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.

78. 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.

79. For the purposes of determining the application of subsection 159GZZZQ(2) the following methodology has been proposed by Thinksmart and accepted by the Commissioner in accordance with TD 2004/22: The market value of a Thinksmart share is the VWAP of a Thinksmart share over the last five trading days before the first announcement of the Thinksmart Buy-Back, adjusted for the percentage change in the S&P/ASX 200 Index from the commencement of trading on the First Announcement Date (18 November 2014) to the close of trading on the date the buy-back closed (23 January 2015).

80. Under this methodology, the market value of a Thinksmart share bought back was calculated to be 34 cents for the purposes of TD 2004/22. As the market value is less than the Buy-Back Price of 42 cents, subsection 159GZZZQ(2) does not deem an increase in the Sale Consideration.

81. Pursuant to subsection 159GZZZQ(3), the deemed consideration of 42 cents is reduced by a 'Reduction Amount'. The Reduction Amount is an amount calculated under subsection 159GZZZQ(4). In the circumstances of the Thinksmart Buy-Back, the Reduction Amount is equivalent to the Dividend Component (12 cents), unless a Participating Shareholder is a corporate tax entity to whom subsection 159GZZZQ(8) applies. As a result, the Sale Consideration for each Thinksmart share disposed of under the Thinksmart Buy-Back is 30 cents (42 cents less 12 cents).

82. 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 159GZZZQ(8), if such a participating 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 Thinksmart share bought back under the Thinksmart Buy-Back, the Sale Consideration is increased by an off-settable amount determined under subsection 159GZZZQ(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.

83. Participating Shareholders are taken to have disposed of their shares accepted under the Thinksmart Buy-Back on 27 January 2015 (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

84. The Sale Consideration of 30 cents per share represents the capital proceeds for CGT purposes pursuant to section 116-20 of the ITAA 1997. A Participating Shareholder (other than a partnership)¹ 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)² 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).

85. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Thinksmart share sold into the Thinksmart Buy-Back by the partnership (subsection 106-5(2) of the ITAA 1997). Each partner is allocated an appropriate share of the Sale Consideration received by the partnership for the disposal of Thinksmart shares into the Thinksmart Buy-Back.

¹ Any capital gain will be made by the partners individually: subsection 106-5(1) of the ITAA 1997.

² Any capital loss will be made by the partners individually: subsection 106-5(1) of the ITAA 1997.

Shares held on revenue account

86. Where shares were held as trading stock, the Sale Consideration of 30 cents per share is included in assessable income under section 6-5 of the ITAA 1997. 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 loss is disregarded under section 118-25 of the ITAA 1997. There is a similar exemption for partners in partnerships (paragraph 118-25(1)(b) of the ITAA 1997).

87. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of 30 cents per share exceeds the cost of each share is included in assessable income. Correspondingly, if the cost exceeds the Sale Consideration of 30 cents 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) will also make a capital gain. However, Participating Shareholders who held 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. There is a similar reduction for partners in partnerships (paragraph 118-20(1)(b), paragraph 118-20(2)(b) and subsection 118-20(3) of the ITAA 1997).

Foreign resident Participating Shareholders: CGT consequences

88. 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'.

89. 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).

90. Items 1 and 4 of the table in section 855-15 of the ITAA 1997 do not apply to a Thinksmart share.

91. Item 2 of the table in section 855-15 of the ITAA 1997 also does not apply to a Thinksmart share. This is because at the time CGT event A1 happened to a Thinksmart share as a result of the Thinksmart Buy-Back, a Thinksmart share was not an indirect Australian real property interest (as defined in section 855-25 of the ITAA 1997).

92. As a result, under subsection 855-10(1) of the ITAA 1997, a Participating Shareholder that was a foreign resident, or the trustee of a foreign trust for CGT purposes, just before CGT event A1 happened to a Thinksmart share as a result of the Thinksmart Buy-Back will disregard a capital gain or capital loss made from CGT event A1 unless:

- the Thinksmart share has been used at any time by the Participating Shareholder 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
- the Thinksmart share is covered by subsection 104-165(3) of the ITAA 1997 (item 5 of the table in section 855-15 of the ITAA 1997).

Qualified persons

93. 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 required to include the franking credit in its assessable income or is entitled to claim a tax offset in respect of it. Broadly speaking, to be a qualified person in relation to the Dividend Component paid under the Thinksmart Buy-Back a Participating Shareholder must satisfy both the 'holding period rule' and the 'related payments rule'.

94. 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.

95. 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 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.

96. 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 if the 'net position' in respect of the risks of loss and opportunities for gain of the shareholder results in the shareholder having less than 30% of the risks and opportunities relating to the shares.

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

98. There are at least 45 clear days between 21 November 2014 (the last cum-entitlement date in respect of the Thinksmart Buy-Back) and 27 January 2015 (the date tender offers were accepted). As a result, a Participating Shareholder who acquired shares on or before 21 November 2014 satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days.

99. Generally, under the holding period rule a shareholder will be deemed to have disposed of their most recently acquired shares first (former subsection 160API(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.

100. However, Thinksmart shares acquired by Participating Shareholders which did not confer an entitlement to participate in the Thinksmart Buy-Back (ex-entitlement shares) which were purchased after Thinksmart shares that did confer an entitlement to participate in the Thinksmart 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 160API(4). Ex-entitlement shares do not constitute 'related securities' for the purposes of former subsection 160API(2) to any cum-entitlement shares. Accordingly, for any additional Thinksmart shares that a Participating Shareholder acquired on or after 24 November 2014 (the Ex-entitlement Date) that did not confer an entitlement to participate in the Thinksmart Buy-Back, the 'last-in first out' rule in former subsection 160API(4) will not apply in relation to those shares.

Value shifting rules

101. Division 725 of the ITAA 1997 may apply where there is a direct value shift under a scheme involving equity interests in an entity. For Division 725 of the ITAA 1997 to have consequences, paragraph 725-50(b) of the ITAA 1997 requires, amongst other things, that the 'controlling entity test' be satisfied.

102. The 'controlling entity test' is satisfied if an entity (the controller) controls for value shifting purposes the 'target entity' at some time during the period starting when the scheme is entered into and ending when the scheme has been carried out (section 725-55 of the ITAA 1997). The target entity in this case is Thinksmart.

103. Subdivision 727-E of the ITAA 1997 sets out the circumstances in which an entity will be regarded as controlling another entity for value shifting purposes.

104. No entity, either alone or together with its associates, controlled Thinksmart for value shifting purposes under the tests in section 727-355 of the ITAA 1997 during the period starting when the scheme was entered into and ending when it had been carried out.

105. As the threshold requirement in paragraph 725-50(b) of the ITAA 1997 is not satisfied, Division 725 of the ITAA 1997 cannot have consequences for Participating Shareholders in respect of the scheme.

106. Division 727 of the ITAA 1997 also cannot have consequences for Participating Shareholders in respect of the scheme.

The anti-avoidance provisions

Sections 45A and 45B

107. 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 Thinksmart Buy-Back is treated as an unfranked dividend. Accordingly, the application of these two provisions to the Thinksmart Buy-Back must be considered.

108. 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.

109. Although a 'capital benefit' (as defined in paragraph 45A(3)(b)) is provided to Participating Shareholders under the Thinksmart Buy-Back, the circumstances of the Thinksmart Buy-Back indicate that there is no streaming of capital benefits to some shareholders and dividends to other shareholders. Under the Thinksmart Buy-Back, all Participating Shareholders received both a Capital Component as well as a Dividend Component in equal proportion based on the number of shares they sold into the Thinksmart Buy-Back. Accordingly, section 45A has no application to the Thinksmart Buy-Back.

110. 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)).

111. While the conditions of paragraphs 45B(2)(a) and (b) have been met in respect of the Thinksmart Buy-Back, the requisite purpose of enabling a Participating Shareholder to obtain a tax benefit by way of a dividend disguised as a capital distribution was not present.

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

- the Capital Component of the Buy-Back Price is acceptable and cannot be said to be attributable to the profits of Thinksmart or of an associate of Thinksmart, and
- as a consequence of the Thinksmart Buy-Back, the distribution of share capital resulted in a reduction in ordinary shares in Thinksmart held by Participating Shareholders.

113. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to treat all or part of the Capital Component of the Buy-Back Price as an unfranked dividend paid by Thinksmart.

Section 177EA

114. 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.

115. 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.

116. The conditions embodied in paragraphs 177EA(3)(a) to 177EA(3)(d) are satisfied in respect of the Thinksmart Buy-Back. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme, it would be concluded that, on the part of Thinksmart, its shareholders or any other relevant party, there is a more than incidental purpose of conferring an imputation benefit under the scheme. In respect of the Thinksmart Buy-Back, the relevant taxpayer is each Participating Shareholder and the scheme comprises the circumstances surrounding the Thinksmart Buy-Back.

117. 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 in subsection 177EA(17) 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.

118. The Commissioner has come to the view that section 177EA applies to the Thinksmart 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 Thinksmart Buy-Back reflected in those paragraphs are:

- the greater attraction of the Thinksmart Buy-Back to resident shareholders who could fully utilise the franking credits than to non-resident shareholders who could not.

119. Where section 177EA applies the Commissioner has a discretion pursuant to subsection 177EA(5) to make a determination to debit Thinksmart's franking account pursuant to paragraph 177EA(5)(a), or 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 that the imputation benefit obtained by Participating Shareholders will be denied under paragraph 177EA(5)(b).

Section 204-30 of the ITAA 1997

120. 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 section 204-30 of the ITAA 1997 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), and
- (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).

121. 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).

122. For section 204-30 of the ITAA 1997 to apply, Participating Shareholders to whom distributions are streamed must derive a greater benefit from franking credits than ordinary shareholders of Thinksmart who do not participate in the Thinksmart Buy-Back. 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) of the ITAA 1997 by reference to the ability of a member to fully utilise franking credits.

123. A portion of Thinksmart's ordinary shares are held by non-resident shareholders who do not benefit from franking credits (a feature of the Thinksmart Buy-Back) to the same extent as resident shareholders. As a result, the conditions in subsection 204-30(1) of the ITAA 1997 for section 204-30 of the ITAA 1997 to apply are met. However, the Commissioner will not make a determination under subsection 204-30(3) of the ITAA 1997.

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Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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- deemed dividends
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- dividend income
- dividend streaming arrangements
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- franked dividends
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