



CR 2001/48 - Income tax: Share Buy-Back: Just Jeans Group Limited

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Class Ruling

Income tax: Share Buy-Back: Just Jeans Group Limited

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Preamble

*The number, subject heading, and the **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains **Class Rulings** and **Taxation Rulings** TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner’s opinion on the way in which the ‘tax laws’ identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- section 45A of the Income Tax Assessment Act 1936 (“the 1936 Act”);
 - section 45B of the 1936 Act;
 - section 177EA of the 1936 Act;
 - sections 160APA and 160AQF of the 1936 Act; and
 - section 160AQCBA of the 1936 Act.

Class of persons

3. The class of persons to whom this Ruling applies is the shareholders in the Just Jeans Group Ltd (“JJG”) who dispose of shares under the JJG off-market share buy-back (“the Buy-Back”) announced on the 24 August 2001 described in the Arrangement part of this Ruling.

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Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.
5. The class of persons defined in this Ruling may rely on its contents provided the arrangement described below at paragraphs 11 to 17 is carried out in accordance with the details of the arrangement provided in this Ruling.
6. If the arrangement described in this Ruling is materially different from the arrangement that is actually carried out:
 - (a) this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement on which the Commissioner has ruled, and
 - (b) This Ruling may be withdrawn or modified.
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Date of effect

9. This Ruling applies from 24 August 2001. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Withdrawal

10. This Class Ruling is withdrawn and ceases to have effect after the earlier of the date on which shareholders receive the proceeds of disposal of the shares which they dispose of under the Buy-Back and 31 December 2001. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus,

the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

11. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- the Class Ruling Request from KPMG Melbourne dated 4 July 2001; and
- Letter dated 7 August 2001 from KPMG Melbourne amending the share buy-back capital and dividend components.

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

12. JJG announced an equal access off-market share buy-back offer on the 24 August 2001 ("the Buy-Back"). At the time of the announcement, JJG had approximately 80,300,000 ordinary shares on issue (and no other shares on issue). The shareholder's funds on JJG's consolidated balance sheet as at 27 January 2001 total \$51.3m, consisting of \$26.7 m share capital, \$0.46 m reserves and \$24.1m retained profits.

13. JJG's shareholders are a mix of companies, trusts, superannuation funds and individuals and broadly consist of two groups, being the "majority shareholders" and the "minority shareholders". The majority shareholders, Thistlewood Pty Ltd, Rosstrevor Pty Ltd and Balboa Pty Ltd, are trustee companies of Australian resident trusts and are all associates of Craig Kimberley, the Executive Chairman of JJG and Chrissie Kimberley, non-executive director of JJG. Together with their associates, they hold approximately 59% of JJG's share capital and acquired their interests in JJG prior to 20 September 1985. The other 41% of the shares are held by the minority shareholders and were acquired by these shareholders after 20 September 1985.

14. An independent third party purchaser, Catalyst Investment Managers Pty Ltd (a private equity manager owned by Prudential Plc of the United Kingdom), has offered to purchase all the ordinary

shares in JJG for around \$1.35 per share. The majority shareholders wish to dispose of their interests in the company. The proposed acquisition will be undertaken as a Scheme of Arrangement in accordance with Part 5.1 of the Corporations Law and was announced to the ASX on 27 June 2001.

15. As a result the Buy-Back offer is being made in conjunction with the Scheme of Arrangement. The Buy-Back and the Scheme of Arrangement are conditional upon each other, and the purchase price under the Buy-Back and the purchase price under the Scheme of Arrangement will be equal (approximately \$1.35 per share).

16. Under the Buy-Back offer JJG will invite each of its shareholders to nominate shares for sale in the Buy-Back. Each shareholder can nominate all of the shares of which it was the registered holder at the close of business of the Record Date. The Board expects that half of the minority shareholders (representing approximately 20% of issued JJG shares) will accept the offer. It is understood that the majority shareholders do not intend to participate in the Buy-Back but will instead sell their shares under the Scheme of Arrangement. If acceptances exceed the number of shares that JJG wishes to buy-back, all acceptances will be scaled back.

17. As noted above the buy-back price has been set at a price equal to the proposed purchase price under the scheme of arrangement. For each share bought back on an indicative buy-back price of \$1.35 per share the company proposes to debit \$0.88 per share to the share capital account (the capital component) and \$0.47 per share to retained earnings (the dividend component). The dividend component will be fully franked.

Ruling

18. The dividend component of the consideration that participating shareholders receive pursuant to the buy-back proposal described in the arrangement section of this Ruling will constitute a frankable dividend in terms of section 160APA of the 1936 Act.

19. The Commissioner will not make a determination under paragraph 160AQCBA(3)(b) of the Act to deny franking credit benefits received by participating shareholders pursuant to the proposed buy-back.

20. The Commissioner will not make a determination under paragraph 177EA(5)(b) of the Act to deny franking credit benefits received by participating shareholders pursuant to the proposed buy-back.

21. The Commissioner will not make a determination (under section 45A or 45B of the 1936 Act) that section 45C of the 1936 Act applies to the whole, or any part, of the capital component of the Buy-Back price received by participating shareholders pursuant to the proposed buy-back.

Explanations

Sections 160APA and 160AQF

22. For those shareholders that participate in an off-market buy-back, part of the proceeds received will be taken to be a dividend paid by the company out of profits, called the dividend component, and the other part will be taken not to be a dividend, called the capital component. The amount of each of these components is determined in accordance with section 159GZZZP of the 1936 Act.

23. 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 to the share capital account of the company is taken to be a dividend paid by the company.

24. Paragraph 160APA(ba) provides that this amount is a frankable dividend for the purposes of Part IIIA as long as the purchase price does not exceed the market value of the share at the time of the buy-back.

25. Accordingly, as long as the Buy-Back price does not exceed the market value of the share at the time of the Buy-Back (and there are no indications that it does) the dividend component of the Buy-Back is a frankable dividend and is capable of being franked in accordance with section 160AQF.

26. JJG proposes that the dividend component of the Buy-Back will be fully franked. Accordingly, the anti-avoidance provisions in section 160AQCBA and 177EA, which are concerned with identifying arrangements in which franking credit benefits are obtained inappropriately, must also be considered.

Section 160AQCBA

27. Section 160AQCBA applies where a company streams the payment of dividends, or the payment of dividends and the giving of other benefits, to its shareholders in such a way that:

- (a) franking credit benefits are, or apart from this section would be, received by shareholders (“advantaged shareholders”) who would, in the year of income in

which the dividends are paid, derive a greater benefit from franking credits than other shareholders (paragraph 160AQCBA(2)(a)); and

- (b) the other shareholders (“disadvantaged shareholders”) will receive lesser franking credit benefits or will not receive any franking credit benefits, whether or not they receive any other benefits (paragraph 160AQCBA(2)(b)).

28. If section 160AQCBA applies the Commissioner may make a determination under subsection 160AQCBA(3) either that the streaming company will incur an additional franking debit in respect of each dividend paid or other benefit received by a shareholder or, in the alternative, that no franking credit benefit is to arise in respect of any streamed dividends paid to a shareholder.

29. For the section to apply it must be able to be said that the shareholders to whom the dividend is directed (in this case the minority shareholders) would derive a greater benefit from franking credits than the majority shareholders. The words “derive a greater benefit from franking credits” are defined in subsection 160AQCBA(17) by reference to the ability of the shareholders to fully use franking credits. On the information provided it cannot be said that the minority shareholders have any greater ability to use the franking credits than the majority shareholders. Accordingly, section 160AQCBA will not apply to the dividend component of the Buy-Back.

Section 177EA

30. Section 177EA is a general anti-avoidance provision that applies to schemes to obtain a tax advantage in relation to franking credits. Specifically, subsection 177EA(3) provides that the section applies where:

- (a) there is a scheme for a disposition of shares (or an interest in shares) in a company;
- (b) a frankable dividend has been paid or is payable or expected to be payable in respect of the shares;
- (c) the dividend or distribution was, or is expected to be, franked;
- (d) a person would receive, or could reasonably be expected to receive, franking credit benefits as a result of the dividend or 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 the purpose (whether or not the dominant purpose but not including an incidental purpose) of enabling the relevant taxpayer to obtain a franking credit benefit.

31. If section 177EA applies the Commissioner may make a determination under subsection 177EA(5) that either a franking debit arises to the company in respect of each dividend paid to the relevant taxpayer or, in the alternative, that no franking credit benefit arises in respect of a dividend paid to the relevant taxpayer.

32. In the present case, it would appear that the conditions of paragraphs 177EA(3)(a) to (d) are satisfied. Accordingly, the issue is whether, having regard to the relevant circumstances of the scheme (as provided for in subsection 177EA(19)), it would be concluded that, on the part of JJG, its shareholders or any other relevant party, there is a purpose more than merely an incidental purpose of conferring a franking credit benefit under the scheme.

33. In arriving at a conclusion one must have regard to the relevant circumstances of the scheme which include, but are not limited to, the circumstances set out in subsection 177EA(19). The relevant circumstances listed there encompass a range of diverse matters which taken individually or in conjunction with other matters, listed or not, could indicate the requisite purpose, ie that the delivery of the franking credit benefit is more than an incidental purpose of the scheme.

34. Having regard to the relevant circumstances of the scheme, in particular the increased capital component of the Buy-Back which reflects the substance of the arrangement, it cannot be concluded that JJG or the shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain a franking credit benefit.

Section 45A and 45B

35. As discussed above, part of the proceeds received by a shareholder in return for participating in a buy-back will be taken not to be a dividend for the purposes of the Act. This part instead is treated as being received for the disposal of the share and therefore as a distribution of capital by the company to the shareholder.

36. The amount treated as being received for the disposal of the share is calculated in accordance with sections 159GZZZP and 159GZZZQ. In essence, these sections provide that the purchase price is treated as the disposal consideration and that amount is then reduced by the dividend component, if that component is assessable. It should be noted that there are other rules that further adjust the

amount if the calculation results in a loss and the shareholder obtains an intercompany dividend rebate on the dividend component.

37. Sections 45A and 45B are two anti-avoidance provisions which, if they apply, allow the Commissioner to make a determination under section 45C that all or part of the distribution of capital received by the shareholder under the buy-back is treated as an unfranked and non-rebatable dividend. Accordingly, the application of these two provisions to the Buy-Back must be considered.

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

39. Although JJG will provide shareholders with a 'capital benefit' (as defined in paragraph 45A(3)(b)) under the Buy-Back the circumstances of the Buy-Back, including the shareholder profile of JJG, indicates that there is no streaming of capital benefits to some shareholders, who are advantaged shareholders, and dividends to other shareholders, being disadvantaged shareholders. Accordingly, section 45A has no application to the proposed Buy-Back.

40. Section 45B applies where certain capital payments are paid to shareholders in substitution for dividends. Specifically, the provision 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, 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, entered into the scheme or carried out the scheme or any part of the scheme for a purpose, other than an incidental purpose, of enabling a taxpayer to obtain a tax benefit (paragraph 45B(2)(c)).

41. In the circumstances of this case, it is considered that the conditions of paragraphs 45B(2)(a) and (b) are satisfied, as under the proposed share buy-back those shareholders that participate in the Buy-Back will be provided with a capital benefit and it would generally be the case that shareholders will pay less tax on the returned capital than they would on an equivalent amount of dividend.

42. However, upon having regard to the relevant circumstances of the scheme (which are set out in subsection 45B(5)) it cannot be

concluded that either JJG or the shareholders entered into or carried out the scheme for the purpose of enabling the shareholders to obtain a tax benefit. In particular, the capital component of the Buy-Back cannot be said to be attributable to the profits of the company, nor do the pattern of distributions indicate that it is being paid in substitution for a dividend. Accordingly, section 45B would not apply to the proposed Buy-Back.

Detailed contents list

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Commissioner of Taxation

19 September 2001

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 92/20
TR 97/16

Subject references

- dividend streaming arrangements
- franking credits
- share buy backs

Legislative references:

- ITAA 1936 45A
- ITAA 1936 45A(3)(b)

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- ITAA 1936 45B
 - ITAA 1936 45B(2)(a)
 - ITAA 1936 45B(2)(b)
 - ITAA 1936 45B(2)(c)
 - ITAA 1936 45B(5)
 - ITAA 1936 45C
 - ITAA 1936 159GZZZP
 - ITAA 1936 159GZZZQ
 - ITAA 1936 160APA
 - ITAA 1936 160APA(ba)
 - ITAA 1936 160AQF
 - ITAA 1936 160AQCBA
 - ITAA 1936 160AQCBA(2)(a)
 - ITAA 1936 160AQCBA(2)(b)
 - ITAA 1936 160AQCBA(3)
 - ITAA 1936 160AQCBA(3)(b)
 - ITAA 1936 160AQCBA(17)
 - ITAA 1936 177EA
 - ITAA 1936 177EA(3)
 - ITAA 1936 177EA(3)(a)
 - ITAA 1936 177EA(3)(b)
 - ITAA 1936 177EA(3)(c)
 - ITAA 1936 177EA(3)(d)
 - ITAA 1936 177EA(5)
 - ITAA 1936 177EA(5)(b)
 - ITAA 1936 177EA(19)
 - ITAA 1936 Part IIIAA
 - TAA 1953 Part IVAAA
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ATO References

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