


# ***CR 2016/23 - Income tax: off-market share buy-back: Caltex Australia Limited***

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## Class Ruling

### Income tax: off-market share buy-back: Caltex Australia Limited

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#### **📌 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

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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
- paragraph 128B(3)(ga) of the ITAA 1936
- Division 16K of the ITAA 1936
- section 159GZZZK of the ITAA 1936

- section 159GZZZP of the ITAA 1936
- section 159GZZZQ of the ITAA 1936
- Division 1A of former Part IIIAA 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
- 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 202-40 of the ITAA 1997
- section 204-30 of the ITAA 1997
- section 207-20 of the ITAA 1997
- Subdivision 207-B of the ITAA 1997
- section 207-145 of the ITAA 1997, and
- section 855-10 of the ITAA 1997.

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

### **Class of entities**

3. The class of entities to which this Ruling applies is the ordinary shareholders of Caltex Australia Limited (Caltex) who:

- (a) disposed of their ordinary shares in Caltex under the off-market share buy-back (the 'Buy-Back') that was announced by Caltex on 23 February 2016 as described in paragraphs 7 to 26 of this Ruling, and
- (b) are not subject to the taxation of financial arrangements rules in Division 230 of the ITAA 1997 in relation to gains and losses on their Caltex 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 Caltex are referred to as 'Participating Shareholders'.

**Note:** capitalised terms in this Ruling have the meaning as defined in the *Caltex Australia Limited Off-Market Buy-Back Booklet* dated 26 February 2016.

### **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 26 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**

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6. This Ruling applies from 1 July 2015 to 30 June 2016. This Ruling continues to apply after 30 June 2016 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

### **Scheme**

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7. The following description of the scheme is based on the following documents, or relevant parts of them, and information provided by the applicant and form part of and are to be read with this Ruling:

- application for Class Ruling dated 28 January 2016
- *Caltex Australia Limited Off-Market Buy-Back Booklet* dated 26 February 2016, and
- further particulars 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. Caltex is an Australian resident public company listed on the Australian Securities Exchange (ASX).

9. As at 30 June 2015, Caltex had approximately 270 million fully paid ordinary shares on issue. The financial statements disclosed total share capital of \$543 million and retained profits of \$2,227 million.

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

11. On 23 February 2016, Caltex announced its intention to undertake an off-market share buy-back of its ordinary shares. Caltex announced it was targeting the repurchase of around \$270 million worth of its shares. However, Caltex reserved the right to decrease the size of the buy-back or not buy back any shares.

12. The Buy-Back forms part of Caltex's continuing capital management strategy which is aimed at achieving a balance between returning capital to shareholders, retaining sufficient flexibility to invest capital for growth and maintaining a strong balance sheet.

13. Caltex anticipates that the Buy-Back will have positive effects over the longer term on earnings per share and return on equity, increased long-term holdings by institutional investors, and maintenance of investment grade credit ratings.

14. The Buy-Back was conducted through a tender process and was open to all shareholders that held ordinary shares on 1 March 2016, except for ordinary shares:

- acquired on an ex-entitlement basis on or after 26 February 2016, or
- held by certain non-residents described as 'Excluded Foreign Shareholders'.

The Board determined that specific Caltex directors and senior management involved in determining the final pricing and size of the Buy-Back would not participate in the Buy-Back in respect of shares held legally or beneficially by them. Also, the trustee of the Caltex Rewarding Results Plan chose not to participate in the Buy-Back in respect of shares held under the trust.

15. The tender period opened on 14 March 2016 and closed on 8 April 2016.

16. Participation in the Buy-Back was voluntary. Hence, shareholders not wishing 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 Buy-Back.

17. Under the tender process, eligible shareholders could make an offer to sell some or all of their ordinary shares to Caltex at specified discount percentages (Tender Discounts) to the volume weighted average price (VWAP) of all trades on the ASX excluding not 'at-market' trades of Caltex's ordinary shares over the last five trading days up to and including 8 April 2016. The Tender Discounts

ranged from 10% to 14% inclusive (at 1% intervals) to the Market Price. Eligible shareholders also had the option of offering to sell their shares as a Final Price Tender, which was the final Buy-Back Price determined by Caltex after the close of the Buy-Back.

18. Eligible shareholders who held 50 ordinary shares or less, and who wished to participate in the Buy-Back, were required to tender all of their shares at either one specified Tender Discount, or as a Final Price Tender.

19. Tenders at prices above the Buy-Back Price, or which were subject to a specified Minimum Price that was greater than the Buy-Back Price, were not accepted.

20. Tenders at prices equal to or less than the Buy-Back Price (and Final Price Tenders) were successful (subject to any specified Minimum Price). As the number of shares tendered (that satisfied the Buy-Back criteria), exceeded the number of shares Caltex had determined to buy back, Caltex scaled back successful tenders.

21. A Priority Allocation of 130 shares was bought back from each successful tendering shareholder. In addition, shareholders that successfully tendered all their shares and would otherwise be left with a Small Holding (50 shares or less) as a result of the scale back had their tenders accepted in full.

22. All shares bought back received the same Buy-Back Price per share, even if the shares were tendered at a greater discount percentage than that finally accepted in determining the Buy-Back Price.

23. The Buy-Back Price was subject to two overriding limits:

- Caltex would not buy back shares at a discount greater than 14% applied to the VWAP of all trades on the ASX excluding not 'at-market' trades of Caltex shares over the five trading days up to and including 8 April 2016, and
- the Buy-Back Price would not exceed the market value of a Caltex share determined in accordance with the methodology in Taxation Determination TD 2004/22 *Income tax: for Off-Market Share Buy-Backs of listed shares, whether the buy-back price is set by tender process or not, what is the market value of the share for the purposes of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936?*

24. On 11 April 2016, Caltex announced that:

- it had successfully bought back 9,189,481 Caltex shares, representing 3.4% of the issued shares of Caltex
- the total amount of the Buy-Back Price for shares repurchased under the Buy-Back was approximately \$270.1m.

- the actual Buy-Back Price was set at \$29.39 per share, which represented a discount of 14.0% to the VWAP of \$34.17 of all trades on the ASX excluding not 'at-market' trades of Caltex Shares over the five days up to and including 8 April 2016
- tenders at a 14.0% Tender Discount or as a Final Price Tender were successful, subject to any Minimum Price
- tenders at a Tender Discount less than 14.0% were not accepted, and
- due to the significant oversubscription for the Buy-Back, a 86.08% scale-back of Tenders was required.

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

26. Under the Buy-Back, \$2.01 per share was debited to Caltex's untainted share capital account, and the balance of the Buy-Back Price (the Dividend Component) was debited to Caltex's retained profits. The Dividend Component of the Buy-Back Price was fully franked.

## Ruling

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### **Off-market purchase**

27. 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**

28. Participating Shareholders are taken to have been paid a dividend of \$27.38 (Dividend Component) on 11 April 2016 for each share bought back (section 159GZZZP).

29. 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.

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

### **Assessability of the Dividend Component and tax offset**

#### ***Direct distributions***

31. The Dividend Component of \$27.38 per share and, subject to the shareholder being a 'qualified person', the amount of the franking credit on the Dividend Component, is included in the assessable income of Australian resident individuals and corporate shareholders, and trustees of resident complying superannuation funds who participated in the

Buy-Back in the income year in which the Buy-Back occurred (subsection 44(1), and subsection 207-20(1) of the ITAA 1997).

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

### ***Indirect distributions***

#### *Partnerships*

33. The Dividend Component of \$27.38 per share and, subject to being a 'qualified person', the amount of the franking credit attached to the Dividend Component, is included in the assessable income of a Participating Shareholder that is a partnership for the purposes of computing the net income of the partnership pursuant to section 90.

#### *Trusts*

34. The Dividend Component of \$27.38 per share and, subject to being a 'qualified person', the amount of the franking credit attached to the Dividend Component, is included in the assessable income of a Participating Shareholder that is a trustee of a trust for the purposes of computing the net income of the trust pursuant to subsection 95(1).

#### *Partners and Beneficiaries*

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

### ***Refundable tax offset***

36. The tax offsets are subject to the refundable tax offset rules in Division 67 of the ITAA 1997. Certain trustees and corporate tax entities are not entitled to the refundable tax offset rules in accordance with subsections 67-25(1A) to 67-25(1DA) of the ITAA 1997.



## ***Non-resident Participating Shareholders***

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

## **Sale consideration**

38. A Participating Shareholder is taken to have received \$6.73 per share as consideration in respect of each share bought back under the Buy-Back on 11 April 2016 in accordance with section 159GZZZQ, unless the Participating Shareholder is a corporate tax entity to which subsections 159GZZZQ(8) and 159GZZZQ(9) apply.

39. If the Buy-Back Price for each share bought back under the Buy-Back was less than what would have been the market value of the share if the Buy-Back did not occur and was never proposed to occur, then the market value rule in subsection 159GZZZQ(2) applies to the Buy-Back. Taxation Determination TD 2004/22 outlines the Commissioner's approach for determining what would have been the market value of the share at the time of the Buy-Back if the Buy-Back did not occur and was never proposed to occur for the purposes of subsection 159GZZZQ(2).

40. The effect of the rule is that if the Buy-Back Price is less than the market value (which is determined in accordance with TD 2004/22), the difference is included in the consideration received for the disposal of the share, in addition to the amount of \$2.01 per share debited to Caltex's share capital account. Accordingly, the Sale Consideration is \$6.73 per share.

41. 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***

42. The shares are taken to have been disposed of for Capital Gains Tax (CGT) purposes on 11 April 2016 pursuant to section 104-10 of the ITAA 1997 (CGT event A1).

43. The Sale Consideration of \$6.73 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) 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).

44. Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Caltex share sold into the 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 Caltex shares into the Buy-Back.

### ***Shares held on revenue account***

45. Where shares were held as trading stock, the Sale Consideration of \$6.73 per share is included in assessable income pursuant to section 6-5 of the ITAA 1997. Participating Shareholders (other than partnerships) that held shares as trading stock also made a capital gain or capital loss calculated as discussed at paragraphs 42 and 43 of this Ruling. However, under section 118-25 of the ITAA 1997, 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) of the ITAA 1997).

46. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$6.73 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 \$6.73 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 of the ITAA 1997, 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) 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 (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3) of the ITAA 1997).

### ***Foreign resident Participating Shareholders: CGT consequences***

47. Under section 855-10 of the ITAA 1997, foreign resident shareholders who participate in the Buy-Back will only have CGT consequences if the shares purchased under the Buy-Back are 'taxable Australian property'.

### ***Qualified persons***

48. For the purposes of paragraph 207-145(1)(a) of the ITAA 1997 which refers to Division 1A of former Part IIIA, Participating Shareholders will be considered to satisfy the holding period rule under former section 160APHO, and be qualified persons

(as long as the related payments rule is also met), in relation to the Dividend Component received under the Buy-Back, if:

- the shares sold into the Buy-Back were acquired on or before 25 February 2016, and
- during the period when the shares were held, the Participating Shareholders had sufficient risks of loss or opportunities for gain in respect of the shares (as defined in former section 160APHM) for a continuous period of at least 45 days. Neither the announcement of the Buy-Back, the making of an invitation to shareholders to offer to sell their Caltex shares nor the making of an offer by a shareholder to Caltex in respect of a Caltex share affect whether the shares bought back under the Buy-Back are held 'at risk' for the purposes of Division 1A of former Part IIIAA.

49. The 'last-in first-out' rule in former subsection 160APHI(4) has no effect for the purposes of the Buy-Back in respect of Caltex shares acquired on or after 26 February 2016 which did not confer an entitlement to participate in the Buy-Back.

### **The anti-avoidance provisions**

50. 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.

51. 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.

52. 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.

## **Appendix 1 – Explanation**

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

### **Off-market purchase**

53. 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)).

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

55. 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)).

56. Although Caltex's ordinary shares are listed for quotation in the official list of the ASX, the Buy-Back was not made in the ordinary course of trading on the ASX. 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 Component and Capital Component**

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

- a Dividend Component, and
- a Capital Component.

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

### **The Dividend Component**

59. 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 11 April 2016 being the day the buy-back occurred.

60. The Buy-Back Price was \$29.39 per share, of which \$2.01 (the Capital Component) was debited against amounts standing to the credit of Caltex's share capital account. As a result, the Dividend Component is taken to be \$27.38 per share.

61. The Dividend Component of \$27.38 per share is frankable, but only to the extent that the Buy-Back Price does not exceed the market value of a Caltex share at the time of the Buy-Back if the buy-back did not occur and was never proposed to occur (paragraph 202-45(c) of the ITAA 1997).

62. TD 2004/22 sets out the Commissioner's view as to how to determine what would have been the market value of a Caltex share at the time of the Buy-Back if the buy-back did not occur and was never proposed to occur. In respect of the Buy-Back, the Buy-Back Price per share did not exceed the market value determined in accordance with TD 2004/22. As a result, the entire Dividend Component is frankable.

## **Assessability of the Dividend Component and tax offset**

### ***Direct distributions***

63. 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.

64. 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***

65. 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.

66. Under subsection 207-35(1) of the ITAA 1997 (and subject to the 'qualified person' rule), 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***

67. 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).

68. 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).

#### *Partners and Beneficiaries*

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

#### ***Refundable tax offset***

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

#### ***Non-resident Participating Shareholders***

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

#### **The Capital Component**

##### ***Calculation of Sale Consideration***

72. For the purposes of determining the amount of a gain or loss (for Caltex shares either 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.

73. 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 \$29.39 received for each Caltex 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.

74. 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.

75. For the purposes of determining the application of subsection 159GZZZQ(2) the following methodology has been proposed by Caltex and accepted by the Commissioner as outlined in TD 2004/22: the relevant market value of a Caltex share is the VWAP of all trades on the ASX excluding not 'at-market' trades of a Caltex share over the last five trading days before the first announcement of the Buy-Back, adjusted for the ex-dividend component and the percentage change in the S&P/ASX 200 index from 23 February 2016 to the close of trading on 8 April 2016.

76. Under this methodology, the market value of a Caltex share bought back was calculated as \$34.11. As a result, Participating Shareholders are taken to have instead received consideration of \$34.11 for the sale of each Caltex share rather than \$29.39.

77. Pursuant to subsection 159GZZZQ(3), the deemed consideration of \$34.11 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 \$27.38, unless a Participating Shareholder is a corporate tax entity to whom subsection 159GZZZQ(8) applies (see paragraph 78 below). As a result, the Sale Consideration for each Caltex share disposed of under the Buy-Back is \$6.73 (being \$34.11 less \$27.38).

78. However, where a Participating Shareholder is a corporate tax entity that is entitled to a tax offset under Division 207 of the ITAA 1997 in respect of the Dividend Component, a further adjustment may be made to the Sale Consideration. Under subsection 159GZZZQ(8), if such a Participating Shareholder would also make either a capital loss or a deductible loss (or any increase in such a loss) in respect of the sale of a Caltex share bought back under the Buy-Back, the Sale Consideration is increased by an off-settable amount determined under subsection 159GZZZQ(9). The Reduction Amount (being the Dividend Component) is itself reduced by so much of the off-settable amount that does not exceed the capital loss or the deductible loss.

79. Participating Shareholders are taken to have disposed of their shares accepted under the Buy-Back on 11 April 2016 (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***

80. The Sale Consideration of \$6.73 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) will make a capital gain in respect of the disposal of a share if the Sale Consideration per share exceeds the cost base of the share. The capital gain is the amount of the excess. Similarly, a Participating Shareholder (other than a partnership) will make a capital loss in respect of the disposal of a share if the Sale Consideration per share is less than the reduced cost base of the share (subsection 104-10(4) of the ITAA 1997).

81. Where the Participating Shareholder is a partnership, any capital gain or capital loss will be made by the partners individually (subsection 106-5(1) of the ITAA 1997). Each partner in a partnership has a separate cost base and reduced cost base for the partner's interest in each Caltex share sold into the 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 Caltex shares into the Buy-Back.

### ***Shares held on revenue account***

82. Where shares were held as trading stock, the Sale Consideration of \$6.73 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 capital loss is disregarded pursuant to 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).



83. Where shares were held as revenue assets, but were not trading stock, the amount by which the Sale Consideration of \$6.73 per share exceeds the cost of each share is included in assessable income. Correspondingly, if the cost exceeds the Sale Consideration of \$6.73 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 of the ITAA 1997. There is a similar reduction for partners in partnerships (paragraphs 118-20(1)(b) and 118-20(2)(b), and subsection 118-20(3) of the ITAA 1997).

***Foreign resident Participating Shareholders: CGT consequences***

84. A foreign resident shareholder who participates in the Buy-Back disregards any capital gain or capital loss made in respect of a share bought back under the Buy-Back if the share is not 'taxable Australian property' under the tests in section 855-10 of the ITAA 1997. A Caltex share that is disposed of in the Buy-Back will constitute taxable Australian property if the share:

- is an indirect Australian real property interest (item 2 of the table in section 855-15 of the ITAA 1997)
- was used by the foreign resident in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997), or
- is a CGT asset that is covered by subsection 104-165(3) of the ITAA 1997 (choosing to disregard a capital gain or capital loss on ceasing to be an Australian resident) (item 5 of the table in section 855-15 of the ITAA 1997).

**Qualified persons**

85. 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 Division 1A of former Part IIIAA is required to include the franking credit in its assessable income or is entitled to claim the franking credit as a tax offset. Broadly speaking, to be a qualified person in relation to the Dividend Component paid under the Buy-Back, a Participating Shareholder must satisfy both the 'holding period rule' and the 'related payments rule'.

86. 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.

87. 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.

88. 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 opportunity for gain of the shareholder results in the shareholder having less than 30% of the risks and opportunities relating to the shares.

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

90. There are 45 clear days from 26 February 2016 (the Ex-entitlement Date for the Buy-Back) and 10 April 2016 (the date prior to the date tender offers were accepted). As a result, a Participating Shareholder who acquired shares on or before 25 February 2016 that were bought back under the Buy-Back satisfies the holding period rule as long as those shares were held at risk for at least 45 continuous days. A Participating Shareholder who acquired shares after 25 February 2016 that were subsequently bought back under the Buy-Back may not be a qualified person in relation to the dividend paid under the Buy-Back for the purposes of Division 1A of former Part IIIAA except in certain circumstances.

91. Generally, under the holding period rule a shareholder will be deemed to have disposed of his, her or its most recently acquired shares first (former subsection 160APHI(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. Accordingly, Participating Shareholders who, after 25 February 2016, acquired any additional Caltex shares, which conferred an entitlement to participate in the Buy-Back, may not qualify for the franking credits attached to the dividends paid on some or all of the shares sold into the Buy-Back.

92. Where a Participating Shareholder acquired ex-entitlement Caltex shares and participated in the Buy-Back with cum-entitlement shares (which conferred an entitlement to participate in the Buy-Back), the shareholder will not be considered for the purposes of the 45 day rule to be subject to the last-in-first-out rule in former subsection 160APHI(4) and so will not be considered to have participated with the 'ex-entitlement' shares. Ex-entitlement shares do not constitute 'related securities' for the purposes of former subsection 160APHI(2) in relation to any cum-entitlement shares. Caltex shares commenced trading on an ex-entitlement basis on 26 February 2016. Accordingly, for any additional Caltex shares that a Participating Shareholder acquired on or after 26 February 2016 on an ex-entitlement basis, the 'last-in first-out' rule in former subsection 160APHI(4) will not apply in relation to those shares.

### **The anti-avoidance provisions**

#### ***Sections 45A and 45B***

93. 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.

94. 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.

95. 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.

96. 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)).

97. 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.

98. 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 \$2.01 per share accords with average capital per share and could not be said to be attributable to the profits of Caltex
- the pattern of distributions of Caltex does not indicate that the distribution of share capital of \$2.01 per share reflects amounts in substitution for a dividend
- the Buy-Back is not expected to alter Caltex's dividend policy, and
- as a consequence of the Buy-Back, the distribution of share capital resulted in the cancellation of ordinary shares in Caltex held by Participating Shareholders and a corresponding loss of dividend, voting and other rights.

99. Accordingly, the Commissioner will not make a determination under subsection 45B(3) that section 45C applies to treat all or part of the distribution of share capital of \$2.01 per share as an unfranked dividend paid by Caltex.

### **Section 177EA**

100. 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.

101. 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.

102. The conditions of paragraphs 177EA(3)(a) to 177EA(3)(d) are satisfied in respect of the 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 Caltex, 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 Buy-Back, the relevant taxpayer is the Participating Shareholder and the scheme comprises the circumstances surrounding the Buy-Back.

103. 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 that subsection 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.

104. The Commissioner has formed the view that section 177EA applies to the 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 Buy-Back reflected in those paragraphs is the greater attraction of the Buy-Back to resident shareholders of the franking credits than for non-resident shareholders.

105. Where section 177EA applies the Commissioner has a discretion pursuant to subsection 177EA(5) to make a determination to debit Caltex'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**

106. 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)
- (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).

107. If section 204-30 of the ITAA 1997 applies, the Commissioner has 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).

108. 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 Caltex who do not participate in the 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.

109. A portion of Caltex's ordinary shares are held by non-resident shareholders who do not benefit from franking credits 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.

**Appendix 2 – Detailed contents list**

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