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Law Council
OF AUSTRALIA
Business Law Section

Director
Corporate Tax Policy Unit
Corporate and International Tax Division
Treasury
Langton Crescent
Parkes ACT 2600

By email: OMSBBpublicconsultation@treasury.gov.au

Dear Director

Off-market Share Buy-backs

1. This submission relates to the exposure draft legislation *Treasury Laws Amendment (Off-Market Share Buy-Backs) Bill 2022* (**Draft Bill**) together with the accompanying explanatory material documents (**Explanatory Materials**) that were released by Treasury for public comment on 17 November 2022.

2. This submission is made by the Taxation Committee of the Business Law Section of the Law Council of Australia (**the Committee**).

Key Points

3. The key matters the Committee wishes to draw to Treasury's attention in respect of the Draft Bill are set out below.

4. This submission does not seek to deal more generally with the appropriateness of the proposed prohibition on the conventional capital management arrangement, involving off-market selective share buy-backs by listed companies.

5. We recognise that the Federal Government has expressed a concern in relation to the impact of off-market, selective share buy-backs by some listed companies. In particular, we refer to the extent to which it is suggested that it relates to a streaming of franking credits to particular shareholders.

6. Further, the Explanatory Materials state the intention of the Draft Bill as follows (at [1.13]):

> *"This Bill amends the share buy-back provisions in Division 16K of the ITAA 1936 to align the income tax treatment of off-market share buy-backs undertaken by listed public companies with on-market share buy-backs. Such alignment ensures listed public companies can no longer use off-market purchases and selective reductions of capital to take advantage of the concessional tax status of shareholders as part of their capital management activities."*

7. We believe that it would be possible to alter the arrangements dealing with selective buy-backs in a manner that would appropriately reduce the perceived anomaly and allow selective buy-backs to continue to be undertaken.

8. We would be more than happy to provide a more detailed submission in relation to these matters, if it would be helpful.

9. The balance of our submission proceeds on the assumption that, as a matter of policy, it has been decided to proceed in the manner contemplated.

10. We consider:

    a. The use of share buy-backs and selective reductions in capital resulting in share cancellations are important capital management tools (irrespective of their tax treatment).

    b. Off-market share buy-back arrangements in particular have been commonplace amongst Australian listed public companies.

    c. Tax policy decisions should not have the effect of inadvertently significantly narrowing capital management options available to listed public companies.

    d. It will be important to ensure there is proper alignment, from a legal and administrative perspective, between off-market and on-market share buy-backs.

    e. The application of ancillary but relevant tax laws (such as the 'capital streaming' rules in section 45B of the *Income Tax Assessment Act 1936* (Cth) should apply to off-market share buy-backs in the same way as they have previously been applied to on-market share buy-backs. Taxpayers will need clarity on the extent to which their franking account should be debited (without needing to engage directly with the Australian Taxation Office (**ATO**)).

    f. The ATO should revise its existing guidance and provide additional guidance to ensure the measures do not significantly narrow the capital management options available to listed public companies. In particular, the Committee recommends that guidance be provided, either through the legislation or through the appropriate explanatory materials, making it clear that the outcome of an off-market share buy-back is to be treated in the same way as an on-market share buy-back.

Submissions

<u>Alignment between on-market and off-market share buy-backs</u>

11. The Explanatory Materials state that the proposed measures "align the income tax treatment of off-market share buy-backs undertaken by listed public companies with on-market share buy-backs".

12. It does so by providing that, where a listed public company undertakes an off-market buy-back of a share or non-share equity interest, no part of the purchase price in respect of the buy-back will be taken to be a dividend.

13. The company will also be required to debit its franking account for any part of the buy-back price that is not debited to its share capital account.

14. The franking debit amount should be equal to the debit that would have arisen if the company were not a listed public company (consistent with the on-market

share buy-back rules).

15. The practical impacts of this proposed measure are that:

    (a) shareholders in listed companies will no longer receive a part of the purchase price from the sale of their shares (or non-share equity interests) as a dividend for the purposes of determining whether an amount is assessable income, deductible, or gives rise to a capital gain or loss for the shareholder; and

    (b) listed public companies are likely to seek to debit the entire purchase price in respect of the buy-back to share capital.

16. However, there are also other ancillary tax provisions that are relevant to share buy-backs not addressed in the Draft Bill or the Explanatory Materials.

17. For example, the 'capital streaming' rules in section 45B set out circumstances in which the Commissioner may make a determination under section 45C that an amount of a capital benefit is taken to be an unfranked dividend and to have been paid out of the profits of the company.

18. The ATO issued a practice statement dealing with share buy-backs: Practice Statement Law Administration PSLA 2007/9 (**PSLA 2007/9**). It deals predominantly with the treatment of off-market share buy-backs and the specific rules that applied to them.

19. Various aspects of PSLA 2007/9 focused on the operation of the relevant rules, and in particular, the extent to which share buy-backs with a tender process would operate.

20. In a very general sense, PSLA 2007/9 explains the operation of the series of general provisions and how they apply to off-market share buy-backs.

21. These general provisions are designed to limit the potential for a circumstance to arise as part of a share buy-back, where there is (from the ATO's perspective) an unacceptable level of receipt of franking credits by certain categories of taxpayers.

22. A number of aspects of PSLA 2007/9 are, as a result of the proposed change in law, redundant.

23. PSLA 2007/9 does, however, in the context of specific rulings referred to in paragraph 24 below, in relation to on-market share buy-backs, indicate differences in the approach which has been adopted by the ATO. These differences form the basis of achieving particular tax outcomes under the existing provisions. However, they are likely to lead to different tax outcomes for off-market and on-market buybacks. These are not appropriate policy outcomes.

24. Traditionally, the ATO has taken the position that section 45B should not apply where the entire proceeds of an on-market share buy-back are debited to a company's share capital account. This has meant there would not be any debit to the company's franking account.[1]

[1] See, for example, Class Ruling CR 2020/59 ("Viva Energy Group Limited – return of capital and share consolidation"), Class Ruling CR 2019/68 ("Brambles Limited – return of capital") and Class Ruling CR 2016/46 ("Income tax: Returns of share capital: IPE Limited").

25. Neither the Draft Bill nor the Explanatory Materials address whether section 45B should apply to off-market share buy-backs under the new rules in the same way.

26. If it is intended that the outcome is that an off-market share buy-back should be treated in the same way as an on-market share buy-back, then the same approach that is currently adopted by the ATO in relation to on-market share buy-backs should be applied to off-market share buy-backs.

27. It will be critical that guidance be provided, either through legislation, or through explanatory materials, making this clear.

28. There is also a more significant concern that by introducing the concept of parity of treatment, the position of on-market share buy-backs could be adversely affected through the proposed changes.

29. This would be the case if the administration of the off-market and on-market share buy-back regimes resulted in an application of some of the existing off-market share buy-back rules to future on-market share buy-backs.

30. It will therefore also be important that PSLA 2007/9 be reviewed and adjusted accordingly.

31. This review and adjustment will need to be undertaken in the context of supporting a commercial outcome that an off-market share buy-back should be treated in the same way as a current on-market share buy-back is treated.

32. The Committee is of the view that, to ensure alignment between the tax positions of on-market and off-market share buy-backs, the same position with respect to section 45B and other relevant ancillary tax positions should be taken for off-market share buy-backs conducted by listed public companies.

33. The Committee recommends that additional guidance as to the application of relevant ancillary tax provisions be provided in the form of either a public ruling or administrative guidance (such as a Law Companion Ruling). It is very important that the existing ATO guidance is updated to ensure there is an appropriate policy outcome, in particular that the residual application of the guidance in PSLA 2007/9 does not create inappropriate outcomes.

34. The guidance should be sufficiently specific that taxpayers do not need to approach the ATO for a class ruling each time there is a buy-back or cancellation.

Selective reductions of capital

35. Additionally, the Draft Bill introduces new provisions regarding selective reductions of capital. The Draft Bill provides that a distribution by a listed public company that is consideration for the cancellation of a membership interest in itself, as part of a selective reduction of capital, will be unfrankable. Generally no part of the distribution for a capital reduction of this type should be sourced from profits.

36. If it is sourced from profit despite the amount of the distribution being unfrankable, the company will be required to debit its franking account for any part of the distribution that is not debited to its share capital account.

37. The explanatory materials describe this measure as:

> "… *an integrity measure designed to prevent companies using selective reductions of capital as an alternative way to take advantage of concessional tax status of shareholders as part of their capital management activities*".

38. The term "selective reduction of capital" appears to take on its ordinary meaning under the *Corporations Act 2001* (Cth) (**Corporations Act**).

39. Under the Corporations Act, a selective reduction is a reduction that is not an equal reduction. Subsection 256B(2) provides that an equal reduction is a reduction that:

    (a) relates only to ordinary shares;

    (b) applies to each holder of ordinary shares in proportion to the number of ordinary shares they hold; and

    (c) the terms of the reduction are the same for each holder of ordinary shares.

40. Accordingly, the definition of selective reduction appears to be broad.

41. There is potential for the proposed measure to apply to an intended pro-rata (equal) reduction of capital that, for reasons unrelated to tax, may be considered a selective reduction of capital.

42. For example, foreign securities laws may prevent a foreign shareholder of an Australian resident company from participating in a reduction of capital. This would result in an intended equal reduction being considered a selective reduction for the purposes of the Corporations Act.

43. The Committee is of the view that it is important the Draft Bill should be amended and the ATO should review its guidance to ensure this outcome does not arise, and that other unintended consequences are adequately addressed.

Further contact

Yours faithfully

Philip Argy
Chairman
Business Law Section