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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TREASURY LAWS AMENDMENT (OFF-MARKET SHARE BUY-BACKS) BILL  
2022

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EXPOSURE DRAFT EXPLANATORY MATERIALS



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## **Glossary**

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This Explanatory Memorandum uses the following abbreviations and acronyms.

<b>Abbreviation</b>	<b>Definition</b>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
The Bill	<i>Treasury Laws Amendment (Off-Market Share Buy-Backs) Bill 2022</i>



# **Chapter 1:**

## **Off-market share buy-backs**

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### Outline of chapter

- 1.1 This Bill improves the integrity of the income tax system by aligning the tax treatment of off-market share buy-backs undertaken by listed public companies with the tax treatment of on-market share buy-backs. It also inserts new provisions into the income tax law in respect of selective share cancellations to ensure these amendments are effective by aligning the income tax treatment across capital management activities for listed public companies.

### Context of amendments

- 1.2 The share buy-back provisions provide different income tax treatment for shareholders who participate in share buy-backs undertaken by companies off-market compared with those undertaken on-market. Part of the purchase price in respect of an off-market share buy-back can be taken to be a dividend in the hands of the shareholder. For on-market buy-backs, no part of the purchase price is taken to be a dividend for shareholders.
- 1.3 References in this Chapter to legislation are to the ITAA 1936 unless otherwise stated.
- 1.4 For both off-market and on-market share buy-backs, the buy-back and any subsequent share cancellation is disregarded for the purposes of determining whether an amount is assessable income, deductible, or gives rise to a capital

gain or loss for the company. This ensures a buy-back is tax neutral for the company.

- 1.5 The share buy-back provisions apply equally to non-share equity interests in the same way as they apply to shares. A shareholder who participates in a buy-back is therefore, referred to as the seller.

### **Current tax treatment of off-market buy-backs**

- 1.6 For off-market buy-backs generally, the part of the purchase price in respect of the buy-back that is not debited against the company's share capital account or non-share capital account is treated as a dividend paid to the seller as a shareholder by the company out of profits on the day that the buy-back occurs (see subsection 159GZZZP(1)).
- 1.7 The seller is treated as having received the full purchase price as consideration for the sale of the share or non-share equity interest for the purposes of determining whether an amount is assessable income, deductible, or gives rise to a capital gain or loss for the seller (see subsection 159GZZZQ(1)). The purchase price that the seller is taken to have received as consideration for the sale of the share or non-share equity interest is increased to market value (as if the buy-back had not occurred) if the buy-back was undertaken at a discount (see subsection 159GZZZQ(2)).
- 1.8 That increased purchase price is adjusted to exclude any amount that constitutes an assessable dividend for the seller and may be further adjusted to prevent a seller (that is a corporate tax entity) from making or increasing a loss as result of the seller being entitled to a tax offset under Division 207 of the ITAA 1997 (see subsections 159GZZZQ(3) to (9)).
- 1.9 This results in the seller being assessed on the deemed dividend, typically under section 44, and on either the revenue gain or loss, or capital gain or loss, the seller makes from selling the share or non-share equity interest under the buy-back.

### **Current tax treatment of on-market buy-backs**

- 1.10 For on-market buy-backs, no part of the purchase price in respect of the buy-back is taken to be a dividend (see section 159GZZZR). The seller is taken to have received the purchase price in respect of the buy-back as consideration for the sale of the share or non-share equity interest for the purposes of determining whether an amount is assessable income, deductible, or gives rise to a capital gain or loss for the seller (see section 159GZZZS).
- 1.11 To improve the integrity of the imputation system, a franking debit arises in the franking account of the company that undertakes an on-market buy-back. The amount of the franking debit is equal to the franking debit that would have arisen for the company if the buy-back had been undertaken off-market. This ensures that shareholders continue to benefit from imputation credits proportionate to their shareholding in the company after the buy-back occurs (see item 9 of the table in subsection 205-30(1) of the ITAA 1997).



## Non-alignment of off-market and on-market buy-backs

- 1.12 The buy-back provisions in Division 16K were inserted into the income tax law in 1990. Changes to the income tax laws since the commencement of Division 16K now makes the distinction between off-market and on-market buy-backs for listed public companies inappropriate.

## Comparison of key features of new law and current law

**Table 1.1 Comparison of new law and current law**

<b>New law</b>	<b>Current law</b>
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 is taken to be a dividend.	Where a company undertakes an off-market buy-back of a share or non-share equity interest, part of the purchase price in respect of the buy-back may be treated as a dividend in the hands of shareholders depending on whether the company debits any part of the purchase price to its share capital account or non-share capital account.
If a listed public company undertakes an off-market buy-back, a franking debit arises in the company's franking account. The amount of the debit is equal to the debit that would have arisen if the company were not a listed public company and the purchase were a frankable distribution (because the whole or part of the purchase price were not debited to the company's share or non-share capital account) that was franked at the company's benchmark franking percentage, or at a franking percentage of 100% if the company doesn't have a benchmark franking percentage for the franking period.	If any part of the purchase price in respect of an off-market buy-back undertaken by a company is taken to be a dividend and the company chooses to frank that dividend, a franking debit arises in the company's franking account. The purchase price will be taken to be a dividend to the extent that is not debited to the share capital account or non-share capital account of the company, which will constitute a frankable distribution. The amount of debit is equal to the frankable distribution franked to the company's benchmark franking percentage for the franking period.
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 is unfrankable.	A distribution by a company that is consideration for the cancellation of a membership interest in itself as part of a selective reduction of capital is a dividend to the extent that it is not debited to the share capital account or non-share capital account of the company. This dividend is a frankable distribution.

<b>New law</b>	<b>Current law</b>
<p>If a listed public company makes a distribution that is consideration for the cancellation of a membership interest in itself as part of a selective reduction of capital, a franking debit arises in the company's franking account. The amount of the debit is equal to the debit that would have arisen if the company were not a listed public company and the distribution were a frankable distribution (because the whole or part of the purchase price were not debited to the company's share or non-share capital account) that was franked at the company's benchmark franking percentage, or at a franking percentage of 100% if the company doesn't have a benchmark franking percentage for the franking period.</p>	<p>If a company makes a distribution that is consideration for the cancellation of a membership interest in itself as part of a selective reduction of capital, that distribution constitutes a dividend to the extent that the distribution is not debited to the company's share or non-share capital account. This dividend is a frankable distribution, and a franking debit arises in the company's franking account if the company chooses to frank that dividend. The amount of the debit is equal to the frankable distribution franked to the company's benchmark franking percentage for the franking period.</p>

## Detailed explanation of new law

- 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. This Bill also amends the income tax treatment for selective reductions of capital which may be used to achieve similar outcomes.
- 1.14 The amendments apply in respect of buy-backs undertaken by 'listed public companies' using the definition of that term in subsection 995-1(1) of the ITAA 1997. ***[Schedule 1, item 11, Subsection 6(1) of the ITAA 1936 definition of 'listed public company']***
- 1.15 As Division 16K of the ITAA 1936 applies in respect of buy-backs of both shares and non-share equity interests, the amendments also cover such interests. Shareholders and non-share equity holders are referred to in the existing provisions as 'sellers'.

### Tax treatment of off-market buy-backs

- 1.16 Similar to on-market buy-backs, the amendments ensure that no part of the purchase price in respect of an off-market buy-back undertaken by a listed public company is taken to be a dividend. ***[Schedule 1, items 2 and 3, sections 159GZZZP and 159GZZZPA of the ITAA 1936]***

- 1.17 Under subsection 159GZZZQ(1), sellers who participate in an off-market buy-back undertaken by a listed public company are taken to have received (or to be entitled to receive) as consideration for the sale of the share or non-share equity interest, an amount equal to the purchase price in respect of the buy-back. This treatment applies for the purposes of determining whether an amount is assessable income, deductible or gives rise to a capital gain or capital loss for the seller.
- 1.18 Where the buy-back is undertaken at a discount, subsection 159GZZZQ(2) increases the amount of consideration that the seller is taken to have received (or to be entitled to receive) in respect of the sale of the share or non-share equity interest to what the market value would have been disregarding the buy-back.
- 1.19 As no part of the purchase price in respect of an off-market buy-back undertaken by a listed public company is taken to be a dividend, subsections 159GZZZQ(3) to (9) do not apply. These subsections adjust the amount of consideration the seller is taken to have received (or to be entitled to receive) for the sale of the share or non-share equity interest under the buy-back to exclude that part of the purchase price that constitutes an assessable dividend (disregarding dividends that are non-assessable non-exempt income under the withholding tax provisions and the conduit foreign income provisions). That amount of consideration the seller is taken to have received (or to be entitled to receive) may be further adjusted to prevent a seller that is a corporate tax entity from making a loss as result of the seller being entitled to a tax offset under Division 207 of the ITAA 1997. This Bill amends these provisions so that they have no application given no part of the buy-back purchase price for an off-market buy-back carried out by a listed public company constitutes a dividend.  
*[Schedule 1, items 4, 5 and 6, subsections 159GZZZQ(3) and (3A) and paragraph 159GZZZQ(8)(aa) of the ITAA 1936]*
- 1.20 As a result, sellers who participate in an off-market buy-back undertaken by a listed public company are not assessed on any part of the purchase price as a dividend. Rather, each seller will be assessed on the sale of the share or non-share equity interest as a revenue gain or loss, or as a capital gain or loss.

### **Franking debit for off-market buy-backs undertaken by listed public companies**

- 1.21 To improve the integrity of the imputation system and to align the income tax treatment of off-market share buy-backs undertaken by listed public companies with that of on-market share buy-backs, this Bill inserts a new franking debit provision for off-market buy-backs undertaken by listed public companies, so that in both cases, the company is required to debit its franking account for the part of the buy-back price not debited to the company's share capital account.  
*[Schedule 1, item 9, item 9A of the table in subsection 205-30(1) of the ITAA 1997]*
- 1.22 The amount of the debit is worked out by assuming that the company were not a listed public company, and the purchase were a frankable distribution

because the whole or part of the purchase price was not debited to the company's share or non-share capital account. The amount of the debit is equal to that frankable distribution franked at the company's benchmark franking percentage, or at a franking percentage of 100% if the company doesn't have a benchmark franking percentage for the franking period.

**[Schedule 1, item 9, item 9A of the table in subsection 205-30(1) of the ITAA 1997]**

- 1.23 This rule improves the integrity of the imputation system by ensuring that shareholders continue to benefit from imputation credits proportionate to their shareholding in the company after the buy-back occurs.

### **Franking debit for on-market buy-backs**

- 1.24 The amount of the franking debit that arises for on-market share backs is determined by reference to the franking debit that would have arisen if the on-market buy-back had instead been an off-market buy-back, subsequently permitting all or part of the purchase price to be treated as a dividend. The franking debit that arises is that amount of the purchase price that would have been treated as a dividend, franked to the company's benchmark franking percentage for the franking period, or to 100% if the company does not have a benchmark franking percentage for the period (see item 9 in the table in subsection 205-30(1) of the ITAA 1997).

- 1.25 As this Bill amends the off-market buy-back provisions by inserting section 159GZZZPA for buy-backs undertaken by listed public companies, to preclude any part of the purchase price being treated as a dividend, it also amends the franking debit provision in subsection 205-30(1) of the ITAA 1997 to ensure the amount of the franking debit is determined assuming the company were not a listed public company.

**[Schedule 1, items 3, 7, and 8, subsection 159GZZZPA of the ITAA 1936, item 9 of the table in subsection 205-30(1) of the ITAA 1997]**

### **Selective share cancellations**

- 1.26 To ensure alignment across the capital management activities of listed public companies, this Bill inserts a new paragraph in the list of unfrankable distributions in section 202-45 of the ITAA 1997. This is an integrity measure designed to prevent companies using selective reductions of capital as an alternative way to take advantage of the concessional tax status of shareholders as part of their capital management activities, as a consequence of these amendments.

- 1.27 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, is unfrankable.

**[Schedule 2, item 1, paragraph 202-45(k) of the ITAA 1997]**

- 1.28 The reference to a 'selective reduction of capital' is intended to be broad and to take its ordinary meaning, so as to include reductions of capital effected through selective cancellations of non-share equity interests and other

reductions of capital that in substance result in a disproportionate cancellation of membership interests.

*[Schedule 2, item 1, paragraph 202-45(k) of the ITAA 1997]*

### **Franking debit for selective share cancellations**

- 1.29 Similar to the amendments to off-market buy-backs undertaken by listed public companies, this Bill inserts a new item in the franking debit table in subsection 205-30(1) of the ITAA 1997 to impose a franking debit in a listed public company's franking account in respect of selective reductions of capital.
- 1.30 If a listed public company makes a distribution that is consideration for the cancellation of a membership interest in itself, as part of a selective reduction of capital, a franking debit arises in the company's franking account. The amount of the debit is equal to the debit that would have arisen if the company were not a listed public company and the distribution were a frankable distribution (because the whole or part of the purchase price were not debited to the company's share or non-share capital account) that was franked at the company's benchmark franking percentage, or at a franking percentage of 100% if the company doesn't have a benchmark franking percentage for the franking period.  
*[Schedule 2, item 2, item 9B of the table in subsection 205-30(1) ITAA 1997]*
- 1.31 This rule ensures alignment of tax treatment for capital management activities undertaken by listed public companies and further improves the integrity of the imputation system by ensuring that imputation credits flow to members of listed public companies proportionate to their membership interests.

### **Other amendments**

- 1.32 This Bill also makes minor technical amendments to related provisions in the ITAA 1997.
- 1.33 Specifically, this Bill inserts the definition of 'listed public company' into the dictionary section in subsection 6(1) to refer to the definition of that term in subsection 995-1(1) of the ITAA 1997. Consequential amendments are made to remove references in the ITAA 1936 to the definition of 'listed public company' in the ITAA 1997.  
*[Schedule 1, items 11, 12 and 13, subsection 6(1) definition of 'listed public company', paragraph 6BA(6)(a) and subsection 45D(2) of the ITAA 1936]*
- 1.34 This Bill also amends paragraph 202-45(c) of the ITAA 1997 to clarify that the reference to 'that Act' in that paragraph, and subsequently in paragraphs 202-45(g) and (h), is a reference to the ITAA 1936. While these provisions have always referred to the ITAA 1936 the repeal of the preceding paragraphs in section 202-45 of the ITAA 1997 resulted in this reference becoming inaccurate.  
*[Schedule 1, item 14, paragraph 202-45(c) of the ITAA 1997]*

## Commencement, application, and transitional provisions

- 1.35 The amendments commence on the first 1 January, 1 April, 1 July or 1 October to occur after the day this Bill receives the Royal Assent.
- 1.36 The amendments made by the Bill apply to buy-backs and selective share cancellations undertaken by listed public companies that are first announced to the market after 7:30pm, by legal time in the Australian Capital Territory, on 25 October 2022 (Budget Time).
- 1.37 A buy-back or selective share cancellation is announced to the market (if the announcement is made before the buy-back or cancellation occurs) when the buy-back or cancellation has been disclosed to the approved stock exchange, on which the shares or membership interests are listed, and that notification has been released to the market as required by the rules of that stock exchange.
- 1.38 For buy-backs and selective share cancellations undertaken by listed public companies that are not announced to the market, or the announcement is made after the back-back or the cancellation, the amendments apply to those buy-backs that occur after Budget Time.