CPA Australia Comments on Issues Raised in the Board of Taxation (BoT) Discussion Paper on Review of Taxation Treatment of Off-Market Share Buy-Backs

Q2.1 BoT query on the reasons companies (listed and unlisted) use off-market share buybacks:

CPA Australia believes that the reasons given in the Discussion Paper (DP) for the use by listed and widely-held unlisted companies of off-market share buyback arrangements appear to be broadly correct on the basis of our understanding of the current situation. However, we are more familiar with the position in respect to closely-held unlisted companies and our clear understanding is that buybacks are primarily used by such companies as a mechanism to allow shareholders to exit the company in appropriate circumstances.

We are not aware of any other reasons for the use of off-market share buybacks.

Q2.2 BoT invitation to comment on the alternatives to off-market share buybacks available to companies and the purposes for which they are used:

We note the possible alternative capital management options available to listed and widely-held unlisted companies as specified in the DP at paragraph 2.17 and have no further comments to make on those options.

In relation to the capital management options specified for closely held unlisted companies, we believe that the most common approach for commercial reasons is the option of the company buying back the shares from those shareholders wishing to exit the company. This is generally for the reason that the company concerned has excess capital and thus it is easier in this situation for the company to buy out the shareholders who wish to dispose of their shares rather than, for example, requiring existing shareholders to borrow the necessary finance for this purpose.

Q2.3 BoT invitation to comment on the reasons for growth in use of off-market share buybacks:

As noted above, closely held unlisted companies generally prefer to use the share buyback arrangement to facilitate the exit of departing shareholders for reasons of convenience and practicality. This is broadly consistent with the explanation given in the DP.

The reasons given in the DP (such as changes in taxation arrangements, corporations law and market practices) for the growing use of off-market share buybacks vis-à-vis other alternative capital management options seem appropriate.

Q2.4 -2.7 These questions relate to whether the policy objectives specified in the DP are appropriate, complete, balanced and if there are any other potential tax impacts.

The use of the standard benchmarks of efficiency (neutrality), equity and simplicity together with consistency with broader corporate tax arrangements and any other relevant tax system linkages seems appropriate in this context.

We also note that, in respect to the simplicity criterion, the DP emphasises that a key focus of the government in this area is to reduce unnecessary compliance costs faced by taxpayers, whether arising from the content of the law itself or the relevant administrative process involved in complying with the provisions. We fully endorse this focus on compliance costs as this is often a significant aspect for SME taxpayers in respect to their involvement with the current off-marker share buyback provisions.

Q3.1 *BoT welcomes comments on ATO Practice Statement PSLA 2007/9 on application of the taxation laws to share buybacks*

As noted in the DP, the above practice statement confirms the ATO's use of the methodology for determining the key elements in an off-market share buyback as outlined in TD 2004/22 such as the market value of the company's shares, the relevant capital/dividend split and the potential application of the anti-avoidance provisions.

We are broadly supportive of the ATO's administration of the law in this area as it appears to provide a satisfying result for all parties as compared to the use of other available capital management options. However, we do have some concerns with the ATO's current practice of imposing a *de facto* limit on the discount available on the company's shares of 14% where a tender process is involved as is now commonly the case.

An important outcome of the tender process is the reduced wastage of franking credits that might otherwise arise and thus ensures greater equity between different groups of shareholders such as low and high MTR shareholders. Removal of the current arbitary 14% floor on the discount currently available under PSLA 2007/9 could provide greater equity in this area.

The 14% floor is currently used by the ATO as part of its application of the anti-avoidance provisions to off-market share buybacks and, as noted in the DP, may even be applied by the ATO where the share price discount is less than this but the ATO considers that non-resident to resident streaming is involved.

Removal of the 14% limit could also effectively reduce the potential benefits available to short-term speculative shareholders, particularly given that any increase in the current 45 day holding rule (eg. to 90 days) could have inadvertent implications for genuine longer-term shareholders.

Q4.1 Do off-market share buy-backs generally result in more than a short-term increase in earnings per share, and if so, for how long?

We are not in a position to provide a definitive answer to this question particularly given that the limited empirical evidence available on this point appears to be inconclusive. That said, however, the point is an important one since it is often argued that those shareholders who are on higher MTRs and thus do not participate in off-market share buybacks should nevertheless benefit from the company's higher EPS going forward. If this benefit cannot be clearly supported then it could arguably raise a significant question in respect to the longer-term efficacy of these buyback arrangements, although continued strong growth in low tax superannuation savings could ameliorate this position. Another offsetting factor could be the extent of any subsequent increase in the market value of shares held by non-participating shareholders. Nevertheless, the outcome for these shareholders is still uncertain as noted in the DP, and this would appear to strengthen the argument for removal of the current 14% limit on the share discount imposed by the ATO as discussed above.

Q4.2 If so, is this beneficial, and to whom, or are other measures, such as share prices, more important to shareholders?

Ultimately, it would appear that a company's longer term performance is dependent on more fundamental factors (such as whether it has an enduring competitive advantage, etc) and that a higher EPS arising from a share buyback as such can only ever be a temporary benefit. Again, this likely outcome draws attention to the need to carefully review the impact of these buybacks on different groups of investors and what measures need to be taken to obtain improved outcomes in the future.

Q4.3 Do off-market share buybacks facilitate capital management strategies?

We believe that off-market buybacks can facilitate capital management strategies for listed and widely-held unlisted companies both alone or (more likely) in combination with other alternative capital management options as canvassed elsewhere in the DP (see2.17). The extent to which they will continue to be used in future will no doubt depend on shareholder support and this may depend to some extent on the growth of low MTR shareholders vis-à-vis other shareholders.

As noted above, in respect to closely-held unlisted companies, we believe that they are the most effective mechanism to facilitate the exit of those shareholders who wish to leave the company.

Q4.4 If so, are they more effective than other mechanisms for doing so, and why?

As noted in the DP (paragraph 2.17, etc), there are a range of capital management options/strategies available to listed companies including:

- share buybacks (either on-market or off-market)
- increasing dividends
- special dividends
- demergers, and
- capital reductions (with or without share cancellations).

The effectiveness of each of these options from the company's standpoint may vary depending on the company concerned and the main reason(s) behind a proposed capital reduction or restructure, although we don't really have much to add to what is already contained in the DP on this topic, eg:

- listed companies, in particular, may be reluctant to increase dividend payout rates due to the cyclical nature of trading conditions;

- payment of special dividends can only be paid out of profits and thus may not meet a company's requirements for a capital reduction, nor result in an increase in EPS, and franking credits will also be distributed to all shareholders, but may be appropriate in some circumstances such as for companies with a high price/earnings (P/E) ratio and where the company wishes to minimise compliance costs;

- demergers are quite complex and subject to special conditions prescribed in the tax law which generally make such a mechanism unsuitable as an ongoing capital management strategy;

- capital reductions/returns may be suitable in some cases, particularly where the company concerned is not seeking to release franking credits to shareholders;

- on-market share buybacks may be useful for listed companies in some circumstances as reflected in their ongoing use but they do not allow for release of franking credits; and

- the benefits of off-market share buybacks is that they can facilitate both capital reductions and release of excess franking credits (particularly for low MTR shareholders) as well as certain other changes to a company's shareholder structure to facilitate exit of some shareholders (eg. departing employees who hold shares via an employee share scheme and shareholders with very small parcels of shares). They are also useful for increasing EPS, at least in the short-term

Q4.5 Are there other implications for public companies, particularly when compared with other capital management strategies?

While the use of off-market share buybacks has grown in recent years for a variety of reasons which generally reflect their effectiveness in achieving certain objectives of importance to both listed and unlisted companies, there are certain costs and other disadvantages associated with the use of this option, eg:

- implications for non-participating shareholders such as high MTR shareholders but the use of a tender process more recently is partly addressing this issue and could go further in this respect if the current ATO imposed floor on the share price discount of 14% was removed;

- potentially high compliance costs associated with the resource intensive administrative process involved with the use of these buy-back arrangements (particularly ATO rulings and ASIC clearances);and

- the overall revenue cost ($452 million) of off-market share buybacks appears to be significant according to Treasury estimates in its annual Tax Expenditures Statement, although the methodology used for this purpose is contentious.

Q4.6 Why are off-market share buybacks preferred over special dividends for the distribution of volatile profits?

Comments made above in response to Q.4.4 in relation to the role of special dividends are also relevant in this context. Also, companies may be reluctant to make even special dividends out of volatile profits in case shareholders have an expectation that they may be continued in future even if trading conditions deteriorate.

Q4.7 Does the interaction between the provisions for taxation of off-market share buybacks and employee share schemes work appropriately?

We are not aware of any problems in this area.

Q4.8 If not, why, and what changes could be made to ensure a more appropriate interaction?

See response to previous question.

4.9 Are there other implications of the current treatment of off-market share buybacks for unlisted companies and their shareholders?

As noted in the DP, closely held unlisted companies generally tend to use off-market share buybacks to restructure businesses in situations where the company is buying back shares of those shareholders that are no longer continuing in the business. The key issues for these companies are the ease with which they can apply the current provisions in respect to off-market share buybacks and the extent to which the provisions impose unnecessary compliance costs on them.

Q4.10 Are the current provisions easy for unlisted companies to understand and comply with? If not, what changes could be made to reduce compliance costs for unlisted companies?

As noted above, the primary rationale for the use of off-market share buybacks by closely-held unlisted companies is to facilitate the exit of shareholders who are no longer continuing in the business. The key concerns in this respect are:

- the compliance costs associated with the current arrangements, and
- uncertainty associated with application of the relevant anti-avoidance provisions.

We note in this regard that a pro rata approach to the capital/dividend split is implicit in the current ATO Practice Statement but not in respect to the relevant Public Ruling. However, as a matter of practice, the ATO's general position is to disallow franking of the relevant dividend component if a pro rata approach based on the market value of the shares is not adopted. This is against the background of market value in a private company context being somewhat problematic given that it is based on agreement between the parties concerned who do not generally place much value on franking credits.

Accordingly, while closely-held unlisted companies and their advisers are not experiencing any major problems with the current arrangements for off-market share buybacks, there is scope for further clarification of the ATO's administrative processes in this area to minimise compliance costs for taxpayers and reduce uncertainty. The latter could be appropriately addressed via the extension of a 'safe-harbour' for taxpayers from sections 177EA and 45B either via specific legislation or modifications to existing ATO rulings.

As noted in the DP, buy-back arrangements are used by these companies for sound commercial reasons (ie. an exit mechanism for departing shareholders) and are not driven by tax arbitrage considerations.

Q4.11 Do unlisted companies have difficulties in calculating the market value ? If so, what might be some approaches for dealing with these difficulties?

As noted above, there are some difficulties in this regard and our preferred solution would be for this matter to be covered by the approach proposed above regarding the introduction of an appropriate 'safe-harbour' for the relevant taxpayers.

Q4.12 Should there be different taxation arrangements for off-market share buy-backs for listed and unlisted companies?
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We do not see a need for different tax arrangements as such for unlisted companies but simply a need to take the necessary steps as indicated above to minimise compliance costs for these taxpayers to the extent possible, particularly for smaller entities including closely-held unlisted companies.

Q4.13 Should the current arrangements be retained for unlisted companies, with any changes being made for listed companies only?

The current arrangements appear to be broadly appropriate for both listed and unlisted companies subject to the changes suggested above:

- removal of the current 14% cap currently imposed by the ATO under its relevant administrative processes in respect to the allowable discount on shares acquired under off-market share buy-backs by listed companies (and widely-held unlisted companies, if necessary), and

- changes to ATO administrative processes to minimise compliance costs for smaller entities, particularly closely-held unlisted companies.

Q4.14 Are there circumstances in which listed companies should be treated in the same way as unlisted companies?

There do not appear to be any differences in the way that different categories of companies are treated under the current rules applicable to off-market share buy-backs, although some rules (such as the 14% cap mentioned above) appear to be more relevant to some (eg. listed) companies than others. Compliance costs should be minimised for all companies but this is particularly relevant for smaller entities such as closely-held unlisted companies for the reasons mentioned above.

Q4.15 How should widely held unlisted companies be dealt with?

It appears that similar considerations should apply to listed companies and widely-held unlisted companies to the extent that their practices are the same. However, the difficulties mentioned above in respect to the calculation of the market value of the shares involved in such a transaction may also apply in the case of widely-held unlisted companies, in which case appropriate changes to ATO administrative processes to minimise compliance costs in this area for these companies should also be implemented.

Q14.16 Would separate regimes increase compliance and administrative costs?

CPA Australia does not believe that the proposed changes canvassed above would constitute separate regimes as they are simply designed to deal with particular difficulties generally experienced by smaller entities in respect to the operation of the current regime for off-market share buybacks. As already indicated, these changes are designed to reduce compliance costs. Also, we do not believe that such changes would result in any increased administrative costs for the ATO.

Q5.1 Do off-market share buybacks lead to efficient economic outcomes?

We are not able to give a definitive response to this query. While there are clear economic benefits as identified in the DP, particularly in providing a mechanism which enables listed companies (and possibly widely-held unlisted companies) to distribute both excess cash and franking credits to participating shareholders, as well as addressing their capital management requirements, there still remain questions as to whether there may be other more efficient and equitable methods of achieving this outcome, particularly bearing in mind the continuing uncertainty associated with these arrangements for non-participating shareholders. There are also, of course, clear net benefits arising from the use of such arrangements by closely-held unlisted companies as already noted. Also, implementation of the changes suggested above should lead to improved economic outcomes.

Q5.2 If so, do they do so more efficiently than other mechanisms for returning excess cash?

While off-market share buy-backs have the advantage of returning excess cash via franked dividend and capital payments to shareholders, it is arguable that this result could also be achieved by listed companies via a combination of an on-market share buyback and payment of special dividends to shareholders. This approach would appear to avoid the current problems involved with off-market share buybacks such as reduced compliance costs and non-participating shareholders.

Widely-held unlisted companies would need to use a combination of capital reductions and payment of special dividends, which may on balance be less efficient than the off-market approach.

In the case of closely-held unlisted companies, it seems clear that the off-market approach is the most efficient, particularly if the current compliance cost issues can be satisfactorily addressed.

Q5.3 Why are they more efficient?

Off-market arrangements only appear to be more efficient in the case of closely-held unlisted companies and possibly widely-held unlisted companies.

Q5.4 To what extent do the current taxation arrangements drive this outcome? Could the efficiencies be achieved without the current tax arrangements?

Current taxation arrangements are certainly more critical in respect to off-market share buybacks vis-à-vis the other available capital and dividend payment arrangements. The second part of this question is not entirely clear but appears to be covered by our responses to Q.5.2 and Q.5.3 above.

Q5.5 How do Australia's taxation arrangements for off-market share buybacks compare with those of our key trading partners? Are they more or less generous?

As noted in the DP, it is difficult to make comparisons between the treatment of off-market share buybacks in Australia vis-à-vis other the position in other countries under corporations and taxation law in view of the differences between the relevant laws in Australia and other comparable jurisdictions, particularly in respect to the key aspects of Australia's tax arrangements for dividend imputation and also capital gains tax (CGT).

Broadly speaking, it appears that the treatment of off-market share buybacks are treated more generously in Australia vis-à-vis other alternative capital management and dividend payment options but this appears to stem from the unique features of the Australian imputation system and to a lesser extent our CGT regime.

Q5.6 Would changes to our taxation arrangements reduce the competitiveness of our companies operating in international markets or make Australia a less attractive location for corporate operations? If so, how significant are the effects likely to be?

CPA Australia believes that any changes to the current tax arrangements relating to off-market share buybacks to make such buybacks less attractive would adversely impact the competitiveness of Australian companies in international markets and also make Australia a less attractive location for corporate operations unless other offsetting changes were made to Australia's tax regime.

Q5.7 Are there other ways of addressing international competitiveness?

The response to the previous question should be considered in the light of our general view that further reform of Australia's business/corporate tax regime is required to ensure that the overall tax burden on Australian companies remains internationally competitive. Such reforms could involve appropriate changes to the corporate tax base and/or a reduction in the statutory company tax rate to a level below those of other comparable countries.

Q5.8 Is it appropriate that off-market share buybacks enable the optimal use of franking credits?

While off-market share buybacks tend to facilitate the use of a company's franking credits by participating shareholders which generally appear to comprise those shareholders on low MTRs, we note that there are anti-avoidance provisions in the tax law designed to deal with dividend streaming arrangements. We also note from the DP that the Commissioner generally exercises his discretion under 177EA to debit the franking account of the company where the streaming of franking credits from non-resident to resident shareholders can be identified.

In any event, any undue streaming of franking credits under current arrangements needs to be considered in the broader context of the total tax burden on Australian companies as discussed above.

Q5.9 How does this impact on the underlying policy of the imputation system of equal distribution of franking credits over time? In particular, what are the likely impacts on taxation revenue?

We note that the tax expenditure estimate for off-market share buybacks peaked in 2004/05 and there is some anecdotal evidence that this decline may have continued in subsequent years. It also relevant that the published figures are overstated in that they do not take account of other relevant factors such as those discussed at paragraphs 4.31 to 4.34 of the DP, including the debit made to the franking account of the company under the anti-avoidance provisions.

Q5.10 What are the advantages and disadvantages of the approaches outlined at paragraphs 5.22 – 5.26 of the DP?

The approaches discussed are as follows:

- align the tax treatment of off-market share buybacks with the taxation of special dividends or on-market buybacks
- including franking credits in the calculation of market value, and
- deny companies the ability to frank the dividend component.

We generally agree with the pros and cons of these options as canvassed in the DP which appear to broadly conclude that there is no clear-cut solution. Our comments above on the total tax burden on Australian companies and the need for further reform are also relevant in this context.

Q5.11 Are there other ways of reducing or eliminating the tax benefits associated with off-market share buybacks?

One option to reduce tax benefits for participating shareholders in listed (and also perhaps widely-held unlisted companies) might be to remove the current 14% cap on the discount available to the shares acquired under the current arrangements. As noted earlier, this approach might also achieve greater equity for non-participating shareholders.

It should be noted that any tax benefits are not significant in relation to shares acquired by departing shareholders of closely held unlisted companies.

Q5.12 If there is not a separate regime for unlisted companies, what would the implications of these approaches be for those companies?

The main implications of changing the current regime for off-market share buybacks would depend on the nature of the particular changes adopted, but could be something along the following lines:

- widely held unlisted companies may be required to use special dividends and capital reductions, with consequent increases in compliance costs arising from the latter

- closely held unlisted companies may no longer be able to facilitate the exit of departing shareholders by simply buying their shares – in this event they would probably be forced to use more costly options such as a selective capital reduction or requiring the continuing shareholders to purchase the shares of those wishing to exit.

Q5.13 Do non-participating shareholders benefit from off-market share buybacks?

There are costs and benefits arising to non-participating shareholders from such buybacks.

The costs relate to the loss of franking credits diverted to participating shareholders while the benefits may comprise the discount to the market price received by the participating shareholders for selling their shares under tender arrangements designed by the company. The actual outcome depends on the value attached to franking credits and there does not appear to be any conclusive view on this, although it appears to turn in large part on whether they would otherwise have been distributed to shareholders with dividends either now or in the future. Any potential inequities though may be addressed via market-based mechanisms used by the company concerned, such as the participation rights issued by St. George Bank I its 2005 off-market share buyback.

The upshot of this is that it is still uncertain whether non-participating shareholders benefit from an off-market share buyback (which would be by way of an increased EPS and/or an increase in the value of the company's shares after the buyback) unless the company concerned seeks to specifically address this issue.

Q5.14 Under what conditions would this be the case?

See answer to Q. 5.13 above.

Q5.15 To what extent do off-market share buybacks limit the ability of companies to frank future dividends?

The evidence to date suggests that companies involved in off-market share buy-backs are still continuing to pay out fully franked dividends going forward and thus it appears that buy-backs are being used to distribute cash in excess of the needs of ordinary dividend policy.

Q5.16 Does the market attribute value to franking credits?

Companies with profitable Australian operations and paying significant amounts of company tax tend to accumulate a large and growing stock of franking credits which may not be distributed to shareholders in the ordinary course of events. In the absence of specific capital management measures, these 'surplus' franking credits may not be valued very highly by the market.

In other cases such as a company that generates a significant share of its profits from foreign operations, the company is probably unlikely to have 'surplus' franking credits and thus the credits being earmarked for early distribution would generally be valued more highly by the market. Accordingly, these companies are much less likely to use buy-back arrangements to return surplus credits to shareholders.

Q5.17 Are their possible market mechanisms that could address any inequities between shareholders? If so, what are their advantages and disadvantages? Are there any impediments to their development?

We are not aware of any impediments to market mechanisms to address any real or perceived inequities between shareholders such as the special 'rights' as used in the St. George Bank case. However, as mentioned previously, removal of the current administrative 14% cap would appear to be the most effective way to address this problem.

Q5.18 Should investors be able to buy shares following the announcement of a buy-back and participate in the buy-back?

The existing 45-day rule should be sufficient to deal with any problem in this area, while at the same time protecting the rights of genuine investors. A signalling of a buy-back by the company usually occurs at an earlier time in any event.

Q5.19 If not, how could this be prevented? In particular, would there be issues associated with anticipatory trading?

We doubt whether it would be practical to attempt to prevent anticipatory trading since it appears that it is not difficult for investors and their advisers to predict the type of company that is more likely than others to engage in a buyback. Common factors would include high Australian earnings, a high franking account balance and strong cash flows.

Q5.20 In what circumstances should section 177EA apply?

It is not clear to us why section 177EA should be applied to buybacks at all in the absence of artificial or contrived arrangements since anti-avoidance provisions of this kind are not intended to raise revenue but to prevent taxpayers from entering into certain transactions in the first place.

Q5.21 Should companies be required to disclose the impact of an off-market share buy-back on their franking account balance?

As we understand that many publicly listed companies already provide information about the expected impact of these buyback arrangements on their franking account balances, there would not appear a need for such a disclosure requirement to be included in the Corporations Law.

Q5.22 Should there be a cap on the level of discount in a tender-style off-market share buy-back? If not, why not and what might the implications be?

While ATO Practice Statement PS 2007/9 provides little by way of a rationale for the cap, we understand that the 14% cap was developed by the ATO for the purpose of limiting resident-to-resident streaming. As franking penalties for resident-to-resident streaming can lead to double taxation, we see no policy rationale for the 14% cap.

Depending on the capital/dividend split in particular buyback transactions, the removal of the cap would generally result in higher discounts, leading to improved outcomes for non-participating shareholders. We believe it would be best for the market to determine the extent of the discount through an unfettered tender process.

Q5. 23 If a cap should be retained, is 14% an appropriate level of discount to deny franking credits to participating shareholders? If not, how should the acceptable level of discount be determined?

For the reasons indicated above, we do not believe that the cap should be retained.

Q5.24 Should franking accounts be debited for resident-to-resident streaming? If not, why?

We do not see any merit in this approach due to in part to the practical compliance problems that would be involved and also because we do not think that the application of the anti-avoidance provisions in this area is an appropriate solution. The most effective approach would be to remove the existing 14% cap as indicated above.

Q5.25 If so, what would be an appropriate methodology for calculating resident-to-resident streaming?

Please see response to the previous question – in our view, there is no valid basis for any franking adjustment in respect to resident-to-resident streaming.

Q5.26 How could the ATO identify company shareholding patterns?

We doubt whether such action would be practicable which is presumably why the ATO has not already attempted it. Non-residents are easily identified from addresses but special notification requirements would presumably need to be developed for residents which in our view seems inappropriate.

Q5.27 Would it be appropriate to use some proxy measure to overcome timing difficulties?

We do not see any merit in this approach for the reasons indicated above and also for the additional compliance burdens that would be imposed on Australian companies.

Q5.28 How could nominee issues be dealt with?

As we understand that problems with nominee shareholders have arisen in relation to the continuity of ownership test for company losses, it seems unlikely that a solution could be found in the buyback context (and we do not believe there is a problem here in any event).

Q5.29 What is the appropriate methodology or methodologies for determining the capital/dividend split?

We note that as per PS 2007/9 the most commonly used methodology for determining the capital/dividend split is the average capital per share method ('ACPS') but other methodologies may be more appropriate depending on the circumstances (eg. the slice approach as discussed in *A Tax System Redesigned* by the Review of Business Taxation).

Q5.30 Should the methodology vary depending on the circumstances? If so, in what circumstances should a particular methodology be used?

See above. Also, the slice approach may be more appropriate for well established companies with a history of earnings but ultimately it should be for the company itself to determine which method best suits its circumstances so long as that is reasonable.

Q5.31 Should the methodology be specified in the tax law? What should the consequences be of a split that differs from the methodology?

We believe that certainty can be achieved by way of a binding public ruling from the ATO which sets out the various methodologies. ACPS could be the automatic safe harbour method as it is the most commonly used methodology. However, the ruling could also provide guidance on the use of other methodologies in appropriate circumstances and thus extending the safe harbour approach and obviating the need for further private rulings.

Q5.32 Is it appropriate for shareholders who receive tax free dividends also to realise a capital loss by participating in an off-market share buyback?

The reference to tax free dividends seems incorrect since the dividend plus the imputation credit forms part of the taxpayer's assessable income but with an offset for the imputation credit. We believe that it is appropriate for a capital loss to arise where the capital component of the sale price is les than the reduced cost base of the shares as this overcomes the potential for double taxation that might otherwise arise.

Q5.33 If not, how should double taxation be prevented in this situation?

There does not appear to be any alternative way to avoid the double taxation problem.

Q5.34 Should the same treatment be provided for both listed and unlisted companies?

On the grounds of consistency and fairness, we believe that the same treatment should be applied to both listed and unlisted companies unless there are sound reasons (eg. undue compliance burdens for smaller companies, particularly closely held unlisted companies) for not doing so.

Q5.35 How could the compliance and administration costs of the provisions be reduced?

Our recommendations on the removal of the discount cap and safe harbours in respect to the capital/dividend split would assist in reducing these costs.

Q5.36 To what extent should current ATO practice, as outlined in its practice statement, be specified in the tax law? Are there any issues or difficulties with doing so?

The release of PS 2007/9 has already improved the transparency of the buyback process and this is a positive development. We do not see a need for the relevant rules in this area to be legislated subject to the proposed modifications to them as recommended above.

Q5.37 Should there be a specific provision for dealing with dividend and/or capital streaming in the context of off-market share buy-backs, rather than relying on more generic anti-avoidance provisions.

To help provide certainty and to make it clear that the anti-streaming rules have no application in this area, there should be specific provisions dealing with buybacks. Under the current structure of the tax law, these rules would appear to fit in Division 16K of Part 111 of the 1936 Act.

Q5.38 Does the current approach to calculating market value cause any difficulties? What might the alternatives be?

We understand that listed companies have concerns about the current rules around market value and believe that they should be clarified and revised to ensure that they do not impact adversely on investors. These issues should be appropriately addressed in the current review.

Q5.39 How could the provisions be simplified to assist unlisted companies and smaller shareholders to understand their operation.

The tax rules on buybacks should be kept as simple as possible in order to avoid undue compliance costs for smaller companies. The placing of all the tax rules for buybacks in Division 16K, as well as eliminating a number of complex and unnecessary rules, may go some way towards simplifying things for both listed and unlisted companies as well as for smaller investors and their representatives.

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