CORPORATE TAX
ASSOCIATION
of Australia Incorporated

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The Board of Taxation
C/- The Treasury
Langton Crescent
PARKES ACT 2600

CORPORATE TAX ASSOCIATION OF AUSTRALIA INC SUBMISSION IN RESPECT OF DISCUSSION PAPER ON OFF-MARKET SHARE BUY-BACKS

The Corporate Tax Association, which represents the taxation interests of more than 120 of Australia's largest companies, is pleased to be able to comment on the Board's Discussion Paper on off-market share buybacks ("buybacks"). Given the increasing popularity of buybacks with Australian corporates and their shareholders, we believe the current review represents a welcome opportunity to develop greater clarity and transparency around these important transactions.

Increasingly, Australian listed companies are expected by the market to reduce their overall cost of capital by maintaining an active and effective capital management program. While the precise mix of debt and capital funding will depend on the overall profile of the company, equity is generally a more costly form of capital than debt. From time to time, therefore, optimising the company's capital structure will involve redeeming issued shares in one way or another.

While there are other mechanisms available for returning surplus capital to shareholders, buybacks enjoy a number of advantages:

- They are quick and relatively simple to execute;
- The tender process affords the company a high level of flexibility in determining the size of the buyback amount;
- The discount achieved through the tender process enhances earnings per share ("EPS"), which delivers ongoing benefits to non-participating shareholders; and
- The availability of franking credits in respect of that part of the buyback price which represents a dividend for tax purposes provides a benefit to participating shareholders, which tend to be concessionally taxed entities or low tax individuals.

We have some concerns about aspects of the Discussion Paper which refer to perceived inequities in the current taxation treatment of buybacks (for example, Q5.17). Different taxpayers experience different outcomes because of certain design features of the tax system – namely an exemption of entities that are engaged in specified activities, low rates of tax for superannuation funds, and a progressive income tax scale for individuals that involves low marginal tax rates for low taxable income levels. Buybacks are open to all

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shareholders and there does not seem to us to be anything inequitable about these arrangements.

When one company put a buyback proposal to a vote for its shareholders (Rio Tinto in 2005), the vote from all shareholders who participated in the ballot was overwhelmingly positive. Likewise, apart from a very small but vocal minority of commentators, there is no ground swell of opposition to buybacks. Quite to the contrary, they are very well accepted by the market, and are regarded as being positive by both participating and non-participating shareholders.

Using a benchmark of distributing the dividend slice of the buyback price to resident and non-resident shareholders alike, we note that Treasury puts the cost to the revenue of buyback transactions as being in the order of $500 million in the 2005-06 year. This figure should be seen in the context of company income tax collections which have grown beyond all expectations over the last six or seven years, due not only to the sustained resources boom, but also to buoyant economic conditions and healthy company profits generally. Buybacks promote the efficient operation of our capital markets, which in itself should be regard as a worthwhile policy objective, and in the context of increasing company income tax collections the revenue cost is not high.

More specific comments in respect of each of the questions posed in the Discussion Paper are set out hereunder. We would ask the Board to particularly focus on the following points:

- Buybacks should be explicitly “sanctioned” through an exclusive code dealing with these transactions (Q5.37).
- The imputation anti-avoidance rules in sec 177EA should not apply to buybacks unless the general provisions of Part IVA are triggered due to there being something artificial, blatant or contrived about a particular buyback arrangement (Q5.20).
- The capital benefits anti-avoidance provisions in secs 45A and 45B should not apply to buybacks.
- The 14 per cent cap on the discount level for the tender process should be abolished (Q5.23).
- Compliance and administrative costs could be reduced by setting out the methodology for the capital/dividend split of the buyback amount in a binding ATO ruling, provided the methodology can vary depending on the particular circumstances of the company (Q5.35).
- The current requirement to adjust the market value on the notional basis that the buyback has not taken place should be abolished. These rules are confusing to participants (which include many self-managed superannuation funds), and it makes very little sense to tax investors on amounts they have never received (Q5.38).

Q2.1 The Board invites comment on the reasons companies, both listed and unlisted, use off-market share buy-backs:

- **How significant are each of the above explanations for the use of off-market share buy-backs?**
- **Are there other reasons for the use of off-market share buy-backs?**

Buybacks represent a highly effective mechanism for publicly listed companies to achieve and maintain an optimal capital structure. While other methods of returning excess capital to shareholders are also available, buybacks enjoy significant advantages over those alternative methods, at least in most circumstances. A more detailed comparison is made in our response to Q 2.2.

Buybacks are flexible as to the amount involved, they can be executed relatively quickly, they distribute surplus franking credits to shareholders and deliver value to non-participating shareholders through the discount linked improvement in EPS. This is quite apart from the positive market signal associated with company management acting on its conviction that the company's shares are cheaply priced.

Q2.2 The Board invites comments on the alternatives to off-market share buy-backs available to companies and the purposes for which they are used.

As the analysis hereunder demonstrates, each of the main alternative methods of returning surplus funds to shareholders to some extent suffers in comparison with buybacks:

- *Increasing the company's regular dividends*

  A number of listed companies have in fact increased their regular dividends while at the same time engaging in buybacks. Where high profit levels are regarded as being cyclical, boards are understandably reluctant to create unrealistic expectations on the part of shareholders about what might be a sustainable future dividend pattern. Buybacks are regarded by the market as "one-offs", or at least not part of a regular distribution pattern.

  It should also be noted that, unlike the US, Australia has not seen a pattern of dividend substitution behaviour from listed companies, where buybacks take the place of regular dividends. Given Australia's full dividend imputation system, such an outcome is considered unlikely.

- *Special dividends*

  A special dividend is an obvious alternative method of returning surplus funds to shareholders. Unlike buybacks, franking credits are distributed equally to all shareholders.

  Our understanding about shareholder behaviour, however, is that they are more likely to regard special dividends in much the same way as regular dividends, thereby creating the risk of boards not meeting shareholder expectations once profit levels return to a longer term pattern. Also, special dividends are not EPS enhancing in the same way as buybacks.

- *On-market buybacks*

  From a tax perspective, on-market share buybacks are simply a capital transaction from the point of view of the vendor shareholders, who will not even be aware the company is buying their particular shares. Accordingly, there is no dividend component to the purchase price, although companies can forfeit franking credits if the on-market buybacks are funded with retained earnings.

  Because the shares are acquired on-market, the purchase price will be the prevailing market price, which may in fact increase marginally where the market is aware of the on-market buyback. This makes the exercise much more costly for the company than a buyback. The other drawback associated with on-market buy-backs is that they typically take longer to execute than buybacks – sometimes much longer. They are also less EPS positive than buybacks and do not result in returning surplus franking credits to shareholders.

Q2.3 The Board invites comment on the reasons for the growth in the use of off-market share buy-backs:

- **How significant are the explanations given above in driving the growth of off-market share buy-backs?**
- **Are there other explanations for the growth in the use of off-market share buy-backs?**

We consider the factors set out in the Board's Discussion Paper accurately summarise the main drivers for the growth in buybacks over recent years. They are for the most part well regarded by the market, including non-participating shareholders, and they offer companies an efficient way of optimising their capital structure.

Q2.4 Are these the appropriate policy objectives to consider?

Efficiency, equity and simplicity are the standard objectives against which to measure tax and other public policy measures. We believe that buybacks help achieve improved efficiencies in the operation of the capital markets – a point which is expanded upon below. We are of the view, in spite of arguments to the contrary from some commentators, that in and of themselves buybacks do not create any inequities between groups of shareholders. Certainly, there are different outcomes for different kinds of taxpayers, but that is a design feature of the broader tax system.

Q2.5 Are there other policy objectives that should be considered?

Promoting and facilitating the efficient operation of our capital markets is an important policy objective that should be a factor in shaping the Board's recommendations and ultimately the government's decision in relation to the tax treatment of buybacks.

Having regard to the high levels of scale back in most offers, we would submit that buybacks represent a highly effective mechanism for returning surplus capital to shareholders for subsequent reinvestment or for other purposes. Given the comparative disadvantages of various alternative methods of reducing capital as outlined in our answer to Q2.2, it is in our view questionable whether surplus capital would be returned to shareholders as efficiently and to the same degree as is presently the case.

Q2.6 Is the current balance between them appropriate?

Because there has never been any explicit and transparent weighing up of the various policy objectives around buybacks, the current review represents a timely opportunity to identify relevant policy issues.

A set of administrative practices has been developed by the Tax Office in response to ruling requests. The recent publication of these practices through the release of a Practice Statement is a welcome development. However, the Tax Office's role is an administrative one involving the interpretation and application of the law, and the release of the Practice Statement actually sheds very little light on policy matters.

Aside from the three general policy objectives covered in Q2.4 there are a number of more specific policy issues that are germane to buybacks. One is that the tax and regulatory framework should, wherever possible, facilitate the efficient operation of our capital markets. Such a goal is desirable because it promotes the efficient allocation of productive resources in the Australian economy, which creates benefits for the whole community. Having an efficient and well accepted mechanism for returning surplus capital to shareholders who can then decide how best to reinvest their money helps promote this objective.

Another goal would be to ensure that all shareholders are treated equally in respect of distributions, and the directors always act in the interest of shareholders. This is primarily a matter for the corporate regulator, although it is also important that tax policy and law is broadly consistent with regulatory objectives.

In response to recent public debate, ASIC has made it clear that it is satisfied the interests of non-participating shareholders are being properly considered in buybacks. We strongly agree. The argument that non-participating shareholders are in some way disadvantaged by being denied the benefits of franking credits is in our view misconceived because excess franking credits have little or no value – a view we expand on in our response to Q5.16. We do not assert that all shareholders benefit equally from these arrangements. Tax exempts and superannuation funds are clearly at an advantage, but that is a consequence of broader government policy encouraging certain activities by not taxing some entities at all and others at lower rates.

Finally, it could be claimed there is a policy (evidenced by the anti-streaming rules and some of the anti-avoidance provisions) of ensuring that available franking credits are distributed equally to all shareholders. While those rules are clearly a feature of the tax laws, they do not represent a policy in their own right. Their purpose is no more than to contain the cost to revenue of Australia's full dividend imputation system, which in turn was designed to eliminate the double taxation of company profits that was an outcome of the classical system of taxing dividends.

The legitimate debate at the policy level is whether the cost to revenue of the utilisation of franking credits that occurs under buybacks is warranted when considering the improved efficiencies in the operation of capital markets and having regard to alternative fiscal decisions that might be open to the government. In our view, this question should be answered in the affirmative.

Q2.7 Are there particular linkages and impacts with other parts of the tax system that the Board needs to be aware of?

The application of sec 177EA to further debit the franking account of companies participating in buybacks is in our view unwarranted. This is further explored in our response to Q5.20.

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

While there are a number of variables that impact on a company's actual EPS performance, when looked at in isolation buybacks have a sustained positive impact on EPS. This, in turn, feeds through into the share price.

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

See above.

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

Optimising the capital structure of publicly listed companies is even more of a business imperative than it was, say, a decade ago. Achieving and maintaining the right mix of debt and equity in each company's circumstances and having regard to the relative cost of each, is something the financial markets expect corporate management to focus on.

As a timely and efficient mechanism for retuning surplus cash to shareholders, buybacks are a highly effective way for corporates to achieve their desired capital management objectives.

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

As outlined in our response to Q2.2, the main alternative mechanisms for returning surplus cash all have their drawbacks when compared with buybacks. The chief advantages of buybacks are that they enable companies to return large amounts of surplus capital in a relatively short period of time; they maximise the EPS benefit because of the discount factor; and they distribute surplus franking credits to participating shareholders.

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

None that we can identify.

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

In cases of volatile profits, buybacks are considered less likely than special dividends to be "normalised" by shareholders. The real risk with special dividends is that shareholders will begin to equate them with normal dividends and will then react adversely when the overall dividend levels fall back closer to normal distribution patterns when there is a drop in profits.

In addition, special dividends are not EPS positive.

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

Efficiencies are achieved across the broader economy where buybacks result in surplus capital being returned to shareholders for reinvestment or for other purposes. Left in the corporate structure, there is some risk that managers will invest surplus capital in projects that will not yield an appropriate return. Capital returns therefore impose a useful financial discipline on corporate managers.

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

Buybacks are more efficient than alternative mechanisms for the reasons set out in our response to Q2.2 and Q4.6 above.

Q5.3 Why are they more efficient?

See above.

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

The return of franking credits to participating shareholders certainly adds to the appeal of buyback arrangements, but the transaction is first and foremost one of managing the capital structure of the company.

Q5.5 How do Australian taxation arrangements for off-market share buy-backs compare with those of our key trading partners? Are they more or less generous?

It is difficult to make direct comparisons with other jurisdictions, given Australia's full imputation system. We note, however, that both the UK and the US permit the return of capital to shareholders by way of tender arrangements, which are regarded in those markets as being more timely and efficient than on-market arrangements.

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

Because of their relative indifference to franking credits, non-resident investors tend not to participate in buybacks themselves. However, they (like other non-participating shareholders) appear to support this form of capital management by Australian listed companies, probably because the discount improves EPS. Any policy changes that reduce the attractiveness of buybacks would, in our view, have a somewhat negative impact on the competitiveness generally, although it is impossible to be precise about the extent of such an impact.

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

International competitiveness is determined by a broad range of factors, many of them not tax related. However, it is difficult to see any obvious way of cushioning the adverse impact that adopting the sorts of policy options canvassed paras 5.23 (including the franking credit as part of the market value of the shares bought back) and 5.24 (denying the company the ability to frank the dividend component of the buyback price) of the Discussion Paper would have on Australian capital markets.

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

Treating the buyback as being part dividend and part paid up capital is, in our view, the most appropriate tax treatment, which reflects what has occurred – i.e. participating shareholders have forfeited their rights to capital and profits). Whether that optimises the use of franking credits is beside the point. The equity of a company at any point in time will be made up of money contributed by shareholders (with today's shareholders standing in the shoes of the original subscribers of capital) and partly of profits accrued through the business operations of the company. Accordingly, when the company buys back its equity, shareholders should be treated as having received some of each.

It follows that if a shareholder is treated as receiving a distribution of realised profits then the shareholder should also have the benefit of being able to utilise the franking credits attaching to such a distribution. It would be inappropriate not to allow the dividend component of a buyback to be franked.

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?

The imputation system contains anti-streaming rules and other integrity measures which, it may be argued, reflect a policy of equal distribution of franking credits. However, as we indicated in our response to Q2.6, this is not a policy in its own right so much as a way of containing the cost to revenue of the dividend imputation system. Other policy outcomes that also bear on this issue include the positive impact on the efficient operation of our capital markets, which is not matched to anywhere near the same degree by the alternative methods of distributing surplus capital to shareholders.

It should also be noted that participation in buybacks is open to all shareholders. The fact that in practice tenders for buybacks are taken up by charities, superannuation funds and low marginal rate individuals is more a consequence of our progressive tax system and various tax incentives to encourage or facilitate certain types of activities. Another way of looking at the tax expenditure identified as being attributed to buybacks is as a modest addition to the existing concessional treatment of charities and superannuation funds.

Q5.10 What are the advantages and disadvantages of these approaches?

Either of the methods canvassed in the Discussion Paper – including franking credits in the market value of the share acquired by the company or denying franking on the dividend component – would effectively put an end to buybacks. If the government is minded to achieve this outcome it could do so more directly rather than through the tax system.

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

We do not consider that there are any tax benefits associated with buybacks that need to be reduced or eliminated.

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

Non-participating shareholders benefit from buybacks because the discount below market price at which the shares are bought back by the company creates an EPS benefit which, according to UBS research, is sustained and is superior to alternative methods of returning surplus funds.

There is also a positive signalling associated with these transactions which, all things being equal, will benefit non-participating shareholders through a stronger share price performance.

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

See response to Q13 above.

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

The evidence so far is that engaging in buybacks has not compromised the ability of companies to frank future dividends. Every publicly listed company that has conducted such transactions has been able to maintain a policy of fully franking its dividends, and in most cases these companies have also implemented a progressive dividend policy.

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

The value, if any, attributed to franking credits by the market will depend on a number of factors, including the time delay between when the company pays tax and when shareholders are able to benefit from the franking credits, the amount of Australian tax paid by the company and its distribution policies.

The strong acceptance by the market of buybacks demonstrates that not all franking credits are regarded in the same way by shareholders. Typically, a company returning surplus capital to shareholders using this method has profitable Australian operations producing significant levels of Australian tax. Sometimes those profits are regarded as cyclical, and company boards may not be sufficiently confident about future earnings to factor these volatile earnings into the company's regular dividend policy.

When combined with further profit retention to fund future growth, this can result in an ever-growing stock of franking credits which are unlikely to be distributed to shareholders in the normal course of events. Absent specific capital management measures, these "surplus" franking credits would not be valued very highly by the market.

A company that generates a significant share of its profits from foreign operations is unlikely to have "surplus" franking credits and indeed, some listed companies are not always able to maintain a fully franked dividend. The franking credits such companies have, being earmarked for early distribution, would generally be more highly valued by the market. Naturally, such companies are less likely to use buybacks to return surplus capital.

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

While participating shareholders generally benefit from buybacks to a greater extent than non-participating shareholders, that is a consequence of their differing tax profiles which is, in turn, a function of specific tax policy decisions. In our view, no attempt should be made to redress these outcomes.

The administrative 14 per cent cap on the level of the discount actually limits the EPS benefit that non-participating shareholders gain from the transaction *vis a vis* non-participating shareholders. Removing the cap and letting the market determine the level of the discount would reduce any perceived inequities.

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

Subject to the 45-day rule, we believe that investors should be able to acquire shares in the period following the announcement. We note there is often a significant spike in volume well before the actual announcement, attributable to the company's preceding signalling that it is considering a buyback. This is inevitable under a two stage announcement process.

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

Because 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 (e.g. high Australian earnings, a high franking account balance and strong cash flows), it would not be practical to attempt to prevent anticipatory buying.

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

We think it is inappropriate for sec 177EA to be applied to buybacks at all. Anti-avoidance provisions of this kind should not be used to raise revenue in their own right – they are meant to have the effect of preventing the entering into of certain transactions in the first place (e.g. dividend assignments).

The government should acknowledge that buybacks have a positive effect on the efficient operation of capital markets, which warrants their cost to the revenue, and absent artificial or contrived arrangements the anti-avoidance rules should have no application.

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

We believe that many publicly listed companies already provide information about the expected impact of the buyback on the franking account balance. Little would be gained by requiring such a disclosure under 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 Law Administration PS LA 2007/9 provides little by way of a rationale for the cap, we understand that the 14 per cent cap was developed by the Tax Office as an administrative mechanism for limiting what it considers to be resident-to-resident streaming. Just as we believe that franking penalties for resident-to-resident streaming can lead to double taxation (refer to our response to Q5.24 below), we likewise consider there is no policy rationale for the 14 per cent 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 per cent an appropriate level of discount to deny franking credits to participating shareholders? If not, how should the acceptable level of discount be determined?

The cap should not be retained and policy makers should not be attempting to deny franking credits to participating shareholders.

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

Aside from the almost insurmountable compliance problems of having to somehow determine tax rates of a company's shareholders, debiting the franking account in respect of resident-to-resident streaming would in our view be inappropriate. Again, any resident-to-resident streaming is no more than the natural outcome of progressive income tax scales plus exemptions.

The counterfactual upon which any policy response ought to be based is the receipt of the relevant dividend by higher marginal rate resident taxpayers. The fact that those taxpayers generally do not participate in buybacks is due to the progressive nature of our income tax scales. If they did participate, however, they would benefit to exactly the same extent from franking credits as would the tax exempts and the superannuation funds. Because of the discount, higher tax shareholders are better off not participating in the buyback, but that is not a basis for penalising the company's franking account.

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

See above – there is, in our view, no valid basis for any franking adjustment in respect of resident-to-resident streaming.

Q5.26 How could the Tax Office identify company shareholding patterns?

Unlike non-resident shareholders, which are easily identified from addresses, it would be very difficult in practice to determine shareholder patterns without making intrusive and inappropriate information demands from shareholders.

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

Some sort of proxy could be developed, perhaps supported by sampling techniques, but there would always be concerns that any adjustments made were unfair in particular cases, leading to companies carrying out further work to ascertain whether their actual shareholder profile would lead to a less unfavourable outcome.

Q5.28 How could nominee issues be dealt with?

The problems around nominee shareholders has proved to be an intractable one in relation to the continuity of ownership test for company posses, leading to the development of the notional shareholder concept in respect of shareholdings under 10 per cent. We have no reason to think a solution could be found in the context of buybacks (and in our view, there is no problem to be dealt with in any event).

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

As outlined in PS LA 2007/9, the most commonly used methodology for determining the capital/dividend split is the average capital per share method ("ACPS"). Depending on the circumstances, however, other methodologies might be more appropriate – e.g. the slice approach.

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

The slice approach may be more appropriate for well established companies with a history of earnings. In the end, it should be a matter for the company to determine which method best suits its circumstances.

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 there should be an exclusive code dealing with buybacks (refer response to Q5.37). Those provisions could create an automatic safe harbour for either the ACPS method or the slice approach, at the option of the taxpayer. The law could then provide guidance as to when other methodologies might be more appropriate.

Alternatively, a high level of certainty could also be achieved by way of a binding public ruling.

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 buy-back?

It is incorrect to say that shareholders who receive a franked dividend, either as part of a buyback or in any other circumstance, are in recept of tax free dividends. The amount of the dividend, plus the imputation credit, represents assessable income in the hands of the shareholders, subject to a tax offset in respect of the imputation credit.

Given our comments in relation to the slice approach to capital returns (Q5.8 above), we believe it is entirely appropriate for a capital loss to arise where the capital part of the sale price is less than the reduced cost base of the shares.

The potential for double taxation that would otherwise exist is well set out in the RBT's *A Platform for Consultation*, at p. 453, 454 and again in *A tax System Redesigned*, at p. 455.

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

We can think of no alternative way to avoid double taxation.

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

The CTA represents the interests of mainly (but not exclusively) listed companies. While we recognise that different issues might be relevant for unlisted companies, we would not like to see concerns about unlisted companies significantly influencing the outcome of the review in respect of listed companies. A position should be developed which is aimed principally at listed companies, which after all account for by far the greatest volume of buyback transactions. If there are any special concerns about unlisted companies, they should be dealt with separately.

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

By accepting our recommendations to do away with the discount cap (Q5.22) and the VWAP adjustment to the actual acquisition price (Q5.38). In addition, safe harbours should be developed in respect of the capital/dividend split, thereby obviating entirely the need to obtain class rulings in many cases.

Q5.36 To what extent should current Tax Office 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 LA 2007/9 has already improved the transparency of the buyback process, which is very positive.

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, there should be an exclusive code dealing with buybacks. Under the current structure of the tax law, these rules should be contained in Div 16K of Pt III of the 1936 Act.

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

The current rules around market value are confusing and, in our view, inappropriate. The deemed consideration concept set out in sec 159GZZZQ is clearly aimed at reducing the amount of the CGT loss that would otherwise arise, having regard to the capital/dividend split in the actual price. In effect, the provision ignores the discount and sets a notional market price based on the volume weighted average price, and which is almost invariably higher than the actual purchase price less the dividend component.

Other than simply reducing the potential cost to revenue from CGT losses, the rationale for the market value uplift rule has never been clear. The notion of taxing investors on amounts they have never received runs counter to sound taxation policy, and should be avoided wherever possible. We do not see any compelling policy reason for distorting the underlying economic position of investors through these rules.

That aside, there are currently a number of practical problems associated with the market value rules. These include the fact that the ASX 200 index is not always the best proxy for determining what the market value of the shares would have been absent the buyback. This creates uncertainty due to the need to engage the Tax Office during the tender period to try to settle on an alternative adjusting index. There can also be last minute events which create uncertainty for investors about the notional consideration they will be taken to have received for their shares.

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

As indicated in our response to Q5.34, we would not like to see the rules affecting listed companies unduly complicated because of concerns about unlisted companies. Placing all the tax rules for buybacks in Div 16K, as well as doing away with a number of complex and unnecessary rules, may go some way to simplifying things for everyone, including smaller investors and their representatives.

Thank you again for this opportunity to comment on the Discussion Paper. Please feel free to contact the undersigned should you require any further clarification.

Yours faithfully,

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