

# **Off-Market Buybacks in Australia: Tax Changes and their Consequences**

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**Christine Brown**\*

Department of Accounting and Finance, Monash University

and

**Kevin Davis**

Department of Accounting and Finance, Monash University

Department of Finance, The University of Melbourne

and

The Australian Centre for Financial Studies

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## **ABSTRACT**

Planned changes to the taxation arrangements for off-market share buybacks in Australia raise several questions. How will the buyback price established by tender be affected by the planned reduction in tax benefits to participants? What effect will the removal of the Australian Tax Office effective limit on buyback pricing (of a 14 per cent maximum discount to the market price) have? This paper quantifies the likely effects and also addresses the merits of the proposed changes.

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\* Contact details: Christine Brown, [christine.brown@monash.edu](mailto:christine.brown@monash.edu), Phone 613 99031793, Kevin Davis, [kevin.davis@australiancentre.com.au](mailto:kevin.davis@australiancentre.com.au), Phone 613 9666 1001.

In October 2011, the Australian Treasury released draft new legislation on the tax treatment of off-market share buybacks<sup>1</sup>. While yet to be enacted (at mid 2012), the proposed changes mean that the future of this popular capital management tool is open to question. That popularity has occurred partly because the existing tax arrangements provided significant tax benefits to participants which have meant that Australian off-market buybacks have generally occurred at a discount to the current market price. This is in contrast to buybacks in most other countries which occur at a premium to market price.

The proposed Australian changes, outlined below, will reduce the tax benefits to participants and consequently reduce the likely discount of the buyback price to current share market price. This makes them less attractive to companies as a capital management technique, as any such reduced discount is of less benefit (possibly controversially, given past concerns<sup>2</sup>) to non-participating shareholders.

While, in the past, a 14 per cent cap on the discount permitted by the Australian Tax Office has distorted pricing and participation, the analysis below indicates that its planned removal (in conjunction with the planned tax change) is likely to be of minor significance. The numerical calculations later in this paper suggest that it is unlikely that tender outcomes will often, under the proposed regime, lead to discounts in excess of 14 per cent.

The proposed changes appear somewhat *ad hoc* in nature and designed to reduce the cost to government tax revenue. This raises the question of what is the appropriate tax treatment of off-market buybacks? Also open to question are the merits of the practice of allowing companies to “staple” together a return of capital with a franked dividend in an off-market buyback.

The paper proceeds as follows. In section 1 we provide a brief background to the arrangements for, and use of, off-market buybacks in Australia. This is followed in section 2 by an outline of the proposed tax changes. In section 3 we model the potential effects of the proposed changes on buyback pricing. Section 4 addresses the

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<sup>1</sup> Australian Treasury, *Exposure Draft: Tax Laws Amendment (2011 Measures 3 No. 9) Bill 2011: Buy-backs*. The taxation rules dealing with buybacks are in Division 16K of Part III of the ITAA 1936.

<sup>2</sup> See Christine Brown and Kevin Davis ‘Taxes, tenders and the design of Australian off-market share repurchases’ *Accounting and Finance*, forthcoming, (Article first published online: 12 SEP 2011 | DOI: 10.1111/j.1467-629X.2011.00445.x)

questions of whether the proposed tax arrangements make economic sense and why buybacks of this form are allowed. Section 5 concludes.

### *1. Off-Market Buybacks in Australia*

Despite the global financial and economic gloom persisting since the onset of the Global Financial Crisis, there is ongoing discussion about some Australian companies contemplating returning surplus cash to investors, including by way of off-market share buybacks. These have been popular in the past because designation of some (small) part of the repurchase price as the “capital component / sale price”<sup>3</sup> generated capital losses for tax purposes for participants, while the remainder of the price was a franked dividend.<sup>4</sup> Those tax benefits to participants meant that the buyback price emerging from the generally used tender process was at a discount to the current share market price. Whether the size of the discount provided sufficient benefit to non-participating shareholders to offset the loss of tax (franking) credits distributed to participants was an issue causing some to complain of inequitable treatment between shareholders.

Companies wishing to undertake an off-market buyback currently apply to the Commissioner of Taxation for a tax ruling on the proposed structure of the off-market buyback with regard to the dividend and capital mix.<sup>5</sup> The buyback price in essence consists of a franked dividend component (subject to income tax) and a capital component (with tax consequences from deemed capital gains or losses arising) ‘stapled’ together. In most other countries shareholder proceeds from selling shares into an off-market buyback are taxed purely as capital gains. It appears that the current tax treatment of off-market buybacks in Australia was influenced by (i) relaxing of conditions that allowed companies to fund some part of the repurchase of shares from accumulated profits (and hence be deemed a dividend for tax purposes)

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<sup>3</sup> Tax Office rulings have meant that the capital component specified in the buyback is adjusted slightly for capital gains tax purposes in response to movements in overall stock market prices between announcement of the buyback and its completion. For an example See ATO, Class Ruling CR 2011/54 Income tax: off-market share buy-back: JB Hi-Fi Limited, <http://law.ato.gov.au/atolaw/view.htm?docid=CLR/CR201154/NAT/ATO/00001>

<sup>4</sup> Superannuation funds (which have low tax rates) found the tax arrangements particularly valuable, and this investor demand was reflected in the scale of applications to participate which, given pricing constraints, led to massive scaling back of amounts allocated to winning bidders relative to their offers.

<sup>5</sup> Off-market buybacks as they currently occur are outside the requirements of Section 257B of the Corporations Act (2001). Although the Act states that ‘the offers are to be made to every person who holds ordinary shares to buy back the same percentage of their ordinary shares’ the Australian Securities and Investment Commission (ASIC) currently facilitates off-market buybacks by allowing companies to invite shareholders to tender some or all of their shares using a ‘Dutch auction’ system.

and (ii) the creation of the concept of a share capital account which made it easier for companies to make a distribution of capital.<sup>6</sup> Another reason for allowing the dividend/capital component breakdown in off-market buybacks was to keep the tax treatment of off-market buybacks consistent with that of returns of capital, cancellations and liquidations.

Corporate legislation that made the process for companies undertaking buybacks less onerous was enacted at the end of 1995.<sup>7</sup> Over the period from 1996 to 2008 Brown and Davis<sup>8</sup> report that around \$27 billion was returned to shareholders in 62 buybacks, buying back on average 5.3 percent of outstanding shares. Over that period the franking credits distributed to shareholders totalled \$7.7 billion and the total dollar discount involved in the buybacks was \$2.9 billion. The most recent buybacks have been BHP's \$6 billion buyback in February 2011 of 4.4 percent of its shares, JB HiFi's \$170 million buyback of 10 per cent of its shares in March 2011, and Perpetual's \$70 million buyback of 7.5 per cent of its shares in October 2011. Shareholder interest in participating in off-market buybacks remains high with "scalebacks" of 78, 68 and 81 percent respectively for these recent buybacks.<sup>9</sup> However, this is a much reduced usage of the technique compared to a few years ago when tax uncertainty contributed to something of a hiatus in usage.

## 2. *The Proposed Legislative Changes*

That uncertainty about tax treatment still persists, although draft legislation to introduce suggested changes from the Australian Tax Board was released on the Treasury website in October 2011.<sup>10</sup> These proposed changes will create new uncertainties about the potential benefits to both companies contemplating buybacks and investors contemplating participation.

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<sup>6</sup> In 1995 the requirement for companies to exhaust the share premium account before funding from profits was relaxed. In 1998 the concept of the share premium account was removed while the concept of the share capital account was introduced. See, Board of Taxation, Review of the Taxation Treatment of Off-Market Share Buybacks: Discussion Paper, July 2007.

[http://www.taxboard.gov.au/content/reviews\\_and\\_consultations/off\\_market\\_share\\_buybacks/discussion\\_paper/downloads/off\\_market\\_share\\_buybacks\\_discussion\\_paper.pdf](http://www.taxboard.gov.au/content/reviews_and_consultations/off_market_share_buybacks/discussion_paper/downloads/off_market_share_buybacks_discussion_paper.pdf)

<sup>7</sup> The First Corporate Law Simplification Act.

<sup>8</sup> Brown and Davis, *Op cit*

<sup>9</sup> A scaleback of "x" per cent means that bidders offering to sell shares at the price established in the tender were only able to sell "1-x" per cent of the shares they offered. The scalebacks resulted from the lower bound on the allowable price consistent with the Tax Office ruling on maximum discount.

<sup>10</sup> Responses to the draft legislation are still under consideration at the time of writing.

There are two major changes in prospect. One (not part of the draft legislation, but recommended by the Board of Taxation)<sup>11</sup> is the removal of the effective restriction (due to tax rulings by the ATO) on buybacks taking place at prices which involve a discount of more than 14 per cent to the current market price. This was a binding constraint on many buybacks, and without it, the discounts would have exceeded 14 per cent, often quite substantially.<sup>12</sup> Consequently there was major scaling back of participant offers, and a cost (of a higher than equilibrium buyback price) imposed on non-participating shareholders.

The second change is to reduce participant claims of large capital losses for tax purposes because of the designated capital component being only a small part of the buyback price. In essence, where the designated capital component is lower than the investor's original purchase price (cost base), the draft legislation proposes that the adjusted capital component (sale price for tax purposes) where a capital loss is to be claimed will be the minimum of the investor's purchase price and the buyback price. Whereas, for example, an investor who had previously bought stock at \$15 and participated in a buyback at \$12, of which only \$4 was the capital component, could claim a capital loss for tax purposes of \$11, the allowable capital loss will now only be \$3. An investor also participating who had previously bought at \$8 would have previously had a capital loss for tax purposes of \$4, and now will have a zero tax loss.

These changes in allowable tax losses appear large and might be expected to have significant impact on the attractiveness to investors of such buybacks. While, as we show later, there is an impact reflected in lower equilibrium discounts arising from the tender process, it is less than might be initially thought. As a result of the change participants will have lower deemed tax losses available to offset other capital gains. For superannuation funds with a marginal tax rate of 15 percent, and who are the marginal investors whose bids determine the ultimate discount<sup>13</sup>, the net cost of the change is thus only 15 percent of the change in the deemed sale price. In fact, the

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<sup>11</sup>Board of Taxation, Review of the Taxation Treatment of Off-Market Share Buybacks A report to the Treasurer, June 2008.

[http://www.taxboard.gov.au/content/reviews\\_and\\_consultations/off\\_market\\_share\\_buybacks/report/downloads/off\\_market\\_share\\_buyback\\_report.pdf](http://www.taxboard.gov.au/content/reviews_and_consultations/off_market_share_buybacks/report/downloads/off_market_share_buyback_report.pdf) . See also The Treasury Discussion Paper Taxation Treatment Of Off-Market Share Buybacks, 2009,

<http://archive.treasury.gov.au/contentitem.asp?NavId=&ContentID=1550> .

<sup>12</sup> Brown and Davis *op. cit.*

<sup>13</sup> Brown and Davis *op. cit.* show that the marginal, price setting, participant in the buyback will be low tax rate investors such as super funds who have short term capital gains taxable at 15 per cent to offset.

Board of Tax noted that “that denying notional losses to participating shareholders will not undermine the viability of off-market share buybacks.”<sup>14</sup>

The issues arising for companies and investors are as follows. For companies, will the discount of the repurchase price to current market prices be sufficient to warrant using this approach to returning cash to shareholders (rather than some other form of capital management such as special franked dividends)? For (particularly retail) investors the risk arises from participating in the tender with a “final price” bid (as most do) – where they agree to sell at whatever price is established in the tender. The risk they face is that the discount could be unexpectedly high.

The tax changes suggest, as our analysis below confirms, that the equilibrium discount of buyback prices to current market price established by a tender will be less than in the past. This smaller discount is to the disadvantage of companies (and their non-participating remaining shareholders). While that lesser discount is to the advantage of participating shareholders, their reduced ability to claim losses from the buyback for capital gains tax purposes acts as an offset to that benefit (but is a benefit to government tax revenue).

Low tax rate investors will still be attracted by the franked dividend component of the buyback and willing to participate at a buyback price below the market price. And there is still some benefit on the capital gains/loss tax side (because of the use of the buyback price rather than current market price in working out gains or losses) – but that benefit is less than previously. Because of this reduced appeal of participation to investors, the discount of the buyback price to market price should be lower.

Hence, even though the 14 per cent maximum discount is to be removed, it may no longer have been relevant anyway. While it prevented the size of the discount from reaching the equilibrium level, thus leading to massive scale-backs of offers, equilibrium discounts seems unlikely to often substantially exceed 14 per cent if the general structure (capital and franked dividend mix) of buybacks is unchanged.

Estimating the likely discount for new off-market buybacks is problematic, and depends upon the specific characteristics of the buyback (size of buyback, capital component, likely franked dividend amount etc). In the following section we outline

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<sup>14</sup> Board of Taxation, 2008, *op. cit.* at 2

the likely consequences of the tax change for discounts established via tender processes.

### 3. *Modelling the Potential Effects of New Tax Arrangements*

Brown and Davis<sup>15</sup> develop a model for the determinants of equilibrium discounts in off-market buybacks by noting that arbitrage should drive the buyback price to the lowest value at which no shareholder will be better off from participating rather than selling stock on market. Investors with realized short-term (fully taxable) capital gains from sales of other assets will receive higher benefits from participating than those with only long term capital gains. The reason is that the deemed capital losses available to them from participation provide a larger shield to the higher capital gains tax liability on short term versus long term capital gains.<sup>16</sup> Such investors are thus the marginal price setting participants in the tender for the buyback price and we focus solely upon them. Our approach is to find the minimum price at which such investors would be willing to participate, since this will, via the tender, be the price established for the buyback.

We use the following notation:

- The buyback occurs at price  $B$  of which  $D$  is franked dividend and  $S = B - D$  is capital component
- The shareholder (potential participant) has a cost base of  $P_c$  and individual tax rate of  $t_p$
- Current market price is  $P$

We ignore the market adjustment to the capital component to keep the exposition simple.<sup>17</sup> Previously, the capital loss for tax purposes from participation was  $P_c - (B -$

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<sup>15</sup> Brown and Davis (2012) op. cit.

<sup>16</sup> A super fund (with a tax rate of fifteen percent) which uses one dollar of capital losses to offset one dollar of short term capital gains will reduce its tax bill by fifteen cents. But if used to offset one dollar of long term capital gains (where only two-thirds of capital gain is subject to tax) the tax bill will be reduced by only ten cents.

<sup>17</sup> The capital component is determined under Draft Taxation Determination TD 2004/D1, which since 2004 implies that there may be an adjustment to the capital component announced by the company, based on the change in overall stock prices between the date of announcement and the tender date.

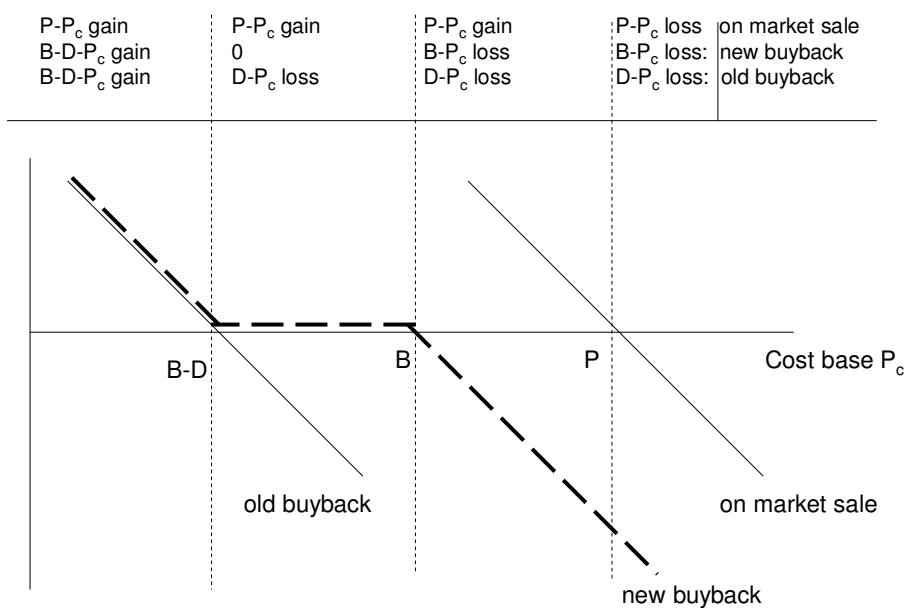
D), since B-D was treated as sale price. Now, the tax treatment will define the capital gain or loss as follows:

- If  $P_c > B$  (purchase price greater than buyback price), a loss of  $P_c - B$ , since B will be treated as the sale price for tax purposes
- If  $B-D < P_c < B$  (purchase price between capital component and buyback price), a zero capital loss, since deemed sale price is adjusted up to a maximum of B such that no capital gain or loss is deemed to occur for tax purposes
- If  $P_c < B-D$  (purchase price less than capital component), a capital gain of  $B - D - P_c$

The tax treatment of the franked dividend component remains unchanged.

Figure 1 shows the effect of the changed tax treatment on deemed capital gains for investors with different cost bases ( $P_c$ ). There is still a capital gains advantage compared to an on-market sale, but for individuals with cost base  $P_c > B$  the tax loss has been reduced by the amount (B-D), ie the loss is smaller,. For individuals with a cost base between B-D and B, the loss is now 0.

Figure 1: Deemed Capital Gains and Losses\*





*\*The formulae for deemed capital gains and losses for on market sales, new buybacks and old buybacks are presented in the upper panel of this figure. The lower panel gives a graphical representation.*

For investors with a cost base  $P_c$  in excess of  $B$  it is relatively straightforward to work out the impact of the tax change on the incentive to participate at any given value of  $B$ .

Previously, buyback participation at price  $B$  led to an after-tax cash flow of:

$$B - t_p(B - D - P_c) - \frac{(t_p - t_c)}{1 - t_c} D$$

where the first term is cash received, the second term is the capital loss tax cash flow (ie the shielding of tax on other short term capital gains) and the third term is the franking credit tax cash flow.<sup>18</sup>

If the individual sold on market instead at the price  $P$ , they would receive after tax:

$$P - t_p(P_c - P)$$

where the first term is cash received and the second term is the capital loss tax cash flow.

Comparing these amounts, the individual would participate if:

$$B > P - \frac{t_c}{1 - t_c} D \text{ or } B > P - 0.43D \text{ using the current corporate tax rate value of } t_c = 0.3.$$

Note that the decision to participate does not depend upon the individual tax rate, although the gain from participating is higher for lower individual tax rates (Brown and Davis, 2012). The decision to participate also requires a higher value of  $B$  for individuals who do not have short term capital gains to offset (Brown and Davis, 2012).

If, for example, the franked dividend component was half of the buyback price, ie  $D = 0.5B$ , the participation threshold under the existing tax regime would be  $B > 0.8 P$ , while if the dividend were 80 per cent of the buyback price ( $D = 0.8B$ ), the threshold is  $B > 0.75P$

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<sup>18</sup> The cash dividend  $D$  is “grossed up” by division by  $(1 - t_c)$  and tax levied at the personal tax rate  $t_p$  and a tax credit at rate  $t_c$  given on that grossed up amount. Note that in all calculations we ignore the adjustment made to the capital component under ATO draft determination (TD2004/D1).

Once the tax changes have been introduced, participation (for individuals with a cost base  $P_c > B$ ) leads to an after-tax cash flow of:  $B - t_p(B - P_c) - \frac{(t_p - t_c)}{1 - t_c} D$  which is to be compared to on-market sale after tax receipt of  $P - t_p(P_c - P)$ .

Participation is warranted if:  $B > P - \frac{(t_c - t_p)}{(1 - t_c)(1 - t_p)} D$

Note that now the individual tax rate is relevant, because of the asymmetric treatment of capital gains or losses relative to dividend income. If more of a given buyback price were franked dividend, there would be no change in the capital gains tax consequences, but the investor would receive more franking credits (and imputed income) with the overall tax effect depending on the investor's personal tax rate.

To illustrate potential consequences, consider an investor with a marginal tax rate of  $t_p = 0.15$ , such as is the case for superannuation funds, and who will generally be the price-setting participants in the tender..

If  $D = 0.5B$  then the investor would participate if  $B > 0.88P$  (compared to  $0.8P$  previously), while if  $D = 0.8B$ , the participation threshold is  $B > 0.83P$  (versus  $0.75P$  previously).

For the 27 Dutch auction buybacks with a franked dividend component considered by Brown and Davis (2012) the average capital component was 37 per cent of the buyback price (and 63 per cent was the franked dividend component  $D$ ). That is approximately halfway between the example values given in the previous paragraph, with associated equilibrium discounts of 12 and 17 per cent. This suggests that the likely average size of discount under the changes proposed would be in the order of 14-15 per cent. Of course, the tax changes could also induce a change in the composition of the buyback price between franked dividend and capital component, but that seems unlikely given the allowable methods for calculating the capital component.<sup>19</sup>

In the preceding analysis, a given buyback price has been assumed and the question of whether investors would wish to participate addressed. In practice, with most

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<sup>19</sup> While the company can nominate the capital/dividend split, the ATO in its Practice Statement PS LA 2007/9 suggests that the average capital per share is the preferred methodology for determining the capital/dividend split. There are other acceptable methods noted in the Practice Statement which depend on the company's circumstances.

buybacks occurring via a Dutch Auction process, the buyback price is established via a tender process in which individuals signal the minimum buyback price at which they will be willing to participate. In such a tender situation, it can be expected that these investors (whose net gains at any given buyback price have been reduced by the tax changes) would not be willing to bid at as high a discount to the current market price (ie as low a buyback price) as previously.

For individuals whose cost base  $P_c$  is relatively low, such that  $B - D < P_c < B$ , the threshold buyback price for participation will have also increased, but not by as large an amount. This is most easily seen by noting from Figure 1 that as the cost base approaches B-D, the deemed capital losses under the new tax regime converge towards those under the old regime. For an investor whose cost base is B-D or below, there is no effective change in the tax treatment.

Because of this non-linearity in the deemed capital gains loss schedule, it is not easy to predict precisely the likely consequences of the change in tax arrangements on the likely discounts to emerge from the tender process. While low marginal tax rate investors with short term capital losses from sales of assets in their portfolio to offset will still be the marginal price-setting investors, the tender outcome may be sensitive to the average price (cost base) at which such investors purchased the shares. Moreover, their willingness to participate (and tender offers) will be influenced by the expected mix of franked dividends and capital component of the buyback.

#### *4. Assessing the Proposed Changes*

The Australian experience of buybacks occurring at a discount to the market price appears to be unique internationally and arises from allowing some part of the buyback amount to be paid as a franked dividend. In other jurisdictions with classical tax systems, dividends are tax disadvantaged relative to capital gains, and investors thus prefer the whole of the buyback price to be treated as a capital component rather than as a dividend. (The same applies in Australia if dividends are unfranked).

This uniqueness prompts two questions. First if a franked dividend component is included, what is the logical tax treatment of the buyback? Second, why should companies be allowed to structure buybacks in this way?

On the first question, it can be argued that the past tax treatment, even though appearing anomalous, had some economic logic behind it.<sup>20</sup> That logic involves thinking of a buyback as being akin to a liquidation of part of the company, and noting that in a liquidation some part of the funds disbursed to shareholders is a return of capital and some part a distribution of accumulated profits. The capital component is subject to the capital gains tax rules and distribution of accumulated profits treated as a dividend (which would be franked if the company has an adequate franking account balance).

On this logic, the buyback could be thought of as analogous to a division of the company into two parts – one of which is to be liquidated. In the analogy, shareholders receive pro rata shares in both parts, and would be able to trade shares in one part for shares in the other with other shareholders. A relative price between the shares would be established based on investor tax preferences, akin to the buyback price relative to the market price. Some investors, who after trade are holding only shares in the part to be liquidated ultimately receive a cash amount comprising capital and franked dividends, just as in a buyback.

The proposed tax treatment also appears somewhat arbitrary, and designed primarily to reduce the cost to government tax revenue. But there is a logic to it, based on that cost to government tax revenue. Essentially, participants in the buyback who claim tax losses under the past system will have bought shares on the market at a higher price than the capital component. The investors who sold those shares (or some previous sellers in a chain of sales) will have been subject to capital gains tax on the difference between their sale price and the capital component (essentially the subscribed capital). Thus the tax losses offset previous tax payments with the net effect (ignoring timing and other complications) being that overall government tax revenue from return of capital subscribed is, as it should be, zero.

However, as the Australian Tax Board<sup>21</sup> notes, previous sellers of shares in the company may not have been subject to “full” taxation on their capital gains. Non-resident investors do not generally pay capital gains tax on sale of shares, and domestic investors who have sold shares after a holding period of one year or more are taxed on capital gains at a concessional rate. Given these tax distortions, there is a

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<sup>20</sup> See, for example, the discussion at Board of Taxation, 2008, *op. cit.* at para 4.31.

<sup>21</sup> See *ibid* at paras 4.30 - 4.50.

“tax neutrality type” argument (albeit one which has not been subject to empirical analysis) for disallowing notional capital losses calculated relative to the capital component of off-market buybacks.

Given the tax complications which off-market buybacks create, a second question is immediately apparent. Why allow off-market buybacks to contain a franked dividend component? Companies can alternatively distribute cash to shareholders by separate returns of capital and payment of special franked dividends. What are the merits of allowing companies to “staple” together a return of capital and franked dividend in an off-market buyback?

There appear to be two potential benefits for companies, although on closer examination those benefits are more apparent than real. First, excess franking credits can be distributed without having to increase normal dividend rates or declaring a special dividend. Companies generally prefer to maintain a stable dividend payout policy, although large occasional “special” dividends can be compatible with such a policy, and used as a positive signal by company managers.<sup>22</sup> Hence dividend policy considerations do not appear to provide a rationale for allowing buybacks which incorporate a dividend component.

Second, it might appear that franking credits are effectively “streamed” to domestic investors who attribute value to them and participate in the buyback. Foreign investors, who do not value them, do not participate and the franking credits are thus not “wasted”. However, Paragraph 177EA(5)(a) of the ITAA 1936 is used by the Tax Office to determine an additional debit to the Franking Account Balance for the franking credits which would have otherwise accrued to non-resident shareholders, thereby offsetting this effect..

Since a company could achieve the same distribution of cash to shareholders by way of separate transactions (a special franked dividend and a separate return of capital), there seems little reason, other than perhaps some reduction in transactions costs, to allow the unusual off-market buyback structure we have developed.

## 5. *Conclusion*

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<sup>22</sup> Managerial preference for stable dividends was shown by Lintner, J., ‘Distribution of incomes of corporations among dividends, retained earnings and taxes’ (1956) 46 *American Economic Review* 97, and reconfirmed in numerous subsequent studies. However, deAngelo, H, deAngelo L., and D. Skinner ‘Special dividends and the evolution of dividend signalling’ (2000) 57 *Journal of Financial Economics* 309 argue that large, infrequent special dividends can perform a valuable signalling role.

The proposed legislative changes to the tax treatment of off-market buybacks do not appear to be so drastic as to cause off-market buybacks to become extinct. Government tax revenue will benefit from the reduction in allowable capital gains tax losses generated. Consequently, discounts of the buyback price to market price will be smaller. This is not to the benefit of non-participating shareholders (although the previous 14 per cent cap on the discount prevented them from reaping full benefits from the tender mechanism). Although there may be some changes in the mix of capital component and franked dividend in the buyback price, if the previous mix prevails, it could be expected that discounts in the region of 14-15 per cent will emerge from the tender process. Thus, the two changes (removal of the cap and changed tax treatment of notional losses) would appear to approximately offset each other in terms of the consequences for non-participating shareholders.

More generally, it remains an unanswered question as to why off-market buybacks are permitted to be structured as a “stapled” combination of capital component and franked dividends. There are no obvious social benefits from this structure, and significant tax complications, and companies could return the same combinations of cash and franked dividends to shareholders by way of paying separate special franked dividends and returns of capital.