Entrust

Off-Market Buybacks

The recent Federal Budget delivered on the 25th of October 2022 saw limited new measures and implications for superannuation and taxation. However, there was one announcement that has gone a little under the radar that will impact super funds, retirees and low-taxed individuals.

The Labor Government has made a proposal relating to franking credits and the tax treatment of off-market share buybacks of listed public companies. More specifically, this is to remove the favourable tax treatment that applies to these buybacks by putting a stop to companies streaming franking credits to low (or nil) tax-paying investors who are able to be refunded the credits in cash.

The Government said it wanted to improve the integrity of the tax system by aligning the tax treatment of off-market share buybacks with the treatment of on-market share buybacks. In the case of an on-market buyback, there are no franking credits as the buyback is not categorised as a dividend.

Off-market buybacks can benefit lots of shareholders. When a company completes an off-market share buyback, it buys the shares from shareholders at a discount to the market price. This is usually a 14 per cent discount. The reason low tax-paying shareholders, including self-managed super fund members in pension phase, jump at this chance is because the proceeds received are made up of a capital component and a fully franked dividend (i.e. providing an enhancement to investment performance). For zero-taxed entities, the franking credits attached to the dividend are particularly attractive as they are refunded in full. This compensates for the willingness to sell the shares back to the company at the 14 per cent discount.

The proposed legislation is set to work its way into Parliament. Meanwhile, companies will still be allowed to conduct on-market buybacks or pay fully franked dividends out of retained profits. We may also see an increased use of ‘special’ dividends in the future.

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