TR 2008/5EC - Compendium

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Ruling Compendium – TR 2008/5

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2008/D1 – Income tax: tax consequences for a company of issuing shares for assets or for services

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Entity/s commenting	Issue raised	Response
1.	1, 2, 3, 4, 5, 7, 8, 9	When a company issues shares as consideration for assets, the provision of the shares is neither a loss nor an outgoing of the company and the company incurs no expenditure by incurring the liability to issue the shares.	Agrees with draft Ruling.
2.	2	Qualification to issue 1: there is a loss or outgoing to the extent of the issue price of the shares.	This view was put to the High Court and rejected in the Kia Ora case, *Pilmer v. Duke Group Ltd (in liq)* (2001) 207 CLR 165. The suggested qualification is contrary to this clear authority and the Commissioner does not accept that the qualification is correct.
3.	2	Qualification to issue 1: as redeemable preference share arrangements that are debt for either tax or accounting purposes entail payment on redemption, this repayment obligation is a loss or outgoing incurred and arises when the redeemable preference shares are issued.	The obligation to repay a debt, including the obligation to redeem a redeemable preference share if the redeemable preference share issue is a debt, is not itself a loss or outgoing or an expenditure on the purpose to which the borrowed money is put. The obligation to repay (or to redeem) a borrowing is itself an obligation of a capital nature. It is also an obligation which is not incurred when the loan (generally or by way of redeemable preference share issue that is a debt) is made, but only when and as the obligation to repay arises.

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			Loan repayment, and redemption of redeemable preference shares, are not losses or outgoings of a company which can be deductible under section 8-1 whenever the obligation is incurred. The application of the ruling to redeemable preference shares is discussed in relation to issue 12, below.
4.	2 (arguably, at point 9(a))	Contrary to Issue 1: A company that issues shares for non-monetary consideration loses something – it loses the right to demand payment of the subscription price in cash. So there will be a loss or outgoing to the extent that the subscription price exceeds the value of the non-monetary consideration.	There is no such loss or outgoing. This is the assertion put to, and rejected by, the Full Court of the High Court in *Pilmer v. Duke Group Ltd (in liq)* (2001) 207 CLR 165; [2001] HCA 31 *(Kia Ora)* at paragraphs 57 – 60.
4.	3, 8, 9	When a company issues shares for a vendor's trading stock, the vendor is treated as having been paid the market value of the stock, the company is treated as having paid that value, and the company has a cost of the trading stock of that value.	Agrees with draft Ruling.
5.	3	Qualification to issue 4: some taxpayers may miss or overlook that this does not apply where what is acquired is not trading stock of the vendor, and the draft Ruling should be expressly amended to make this clearer in the Ruling section.	The Commissioner has accepted this qualification by clarifying paragraph 6 of the Ruling (formerly 5 of draft Ruling) and its interaction with paragraph 3 (of both Ruling versions).

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6.	2, 8, 9	When a company issues shares for depreciating assets, the market value of the shares is the cost of the assets for the purposes of Division 40.	Agrees with draft Ruling. The Commissioner has improved the clarity of the wording of paragraphs 9 and 10 of the Ruling (formerly 6 and 7 of the draft Ruling) by referring to depreciating assets more explicitly.
7.	2, 9, 10	When a company issues shares for assets, the market value of the shares is a component of the cost base of the assets so acquired for the purposes of the capital gains tax provisions.	Agrees with draft Ruling.
8.	2, 3, 4, 5, 6, 7	The Ruling should extend to the issue of shares for services.	The Ruling has been extended to the issue of shares for services, with some consequent adjustment of the Explanation section as well as of the Ruling section.
9.	2	The Ruling should extend to the issue of options or rights in relation to the issue of shares.	Options and rights involve additional and independent technical issues and potential matters of policy. The Ruling has not been extended to deal with them specifically. The Commissioner notes that no submissions discussed or explained practitioner views on these matters beyond inviting the Commissioner to deal with them.
10.	2	The Ruling should extend to the issue by a trustee of units, of options or rights to units, in exchange for assets or services.	The basis on which trustees may issue units, or options or rights in relation to units, in exchange for assets or services is sensitive to the terms of the particular trust and to the nature of the obligations on trustees as a matter of trust law. Because the underlying legal framework differs from company law, the Commissioner prefers not to address such issue by trustees in the present Ruling, noting that no submissions discussed or explained practitioner views on these matters beyond inviting the Commissioner to include them.

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11.	6	The Ruling should specifically address the position where a company issues 'treasury shares' under applicable foreign systems.	The Ruling has not been extended to include a specific discussion of issuing 'treasury shares'. The range of possible legal and commercial contexts for such issues makes their specific inclusion inappropriate to this Ruling.
12.	2	The Ruling should specifically address the position where a company issues redeemable preference shares. Where such shares are debt for tax or for accounting purposes, the promise to pay on redemption is arguably a loss or outgoing.	The Ruling is concerned with companies issuing shares for in-kind consideration. It applies to all such issues of shares, and so to redeemable preference shares where they are subscribed for by providing in-kind consideration.
13.	4	The Ruling does not explain how the issue of shares to enable payment by the company is dealt with under the commercial debt forgiveness provisions, Division 245 in Schedule 2C of the ITAA 1936. Subsection 245-35(5) may alter the normal effect of payment by set-off.	The Ruling is not concerned with situations in which a commercial debt is forgiven or taken to be forgiven. Suppose subsection 245-35(5) applies. In that case, a company owes someone money and that someone subscribes for shares in the company so as to enable the company to pay. This isn't an issue of shares for in-kind consideration, but for money. It would be likely to be a situation in which the amounts owing to the person, and to the company by the person, would be paid (and probably not by set-off). Subsection 245-35(5) overrides the common law. It deems the debt to be forgiven so far as it is paid from the amount subscribed. However, subsection 245-65(4) is relevant. If the market value of the shares is the same as the total subscribed, there will be no difference between the consideration for the forgiveness and the amount of the debt forgiven. Only if the market value is less will the consideration be (correspondingly) less than the debt forgiven. This is important because only so much of the debt as exceeds the consideration is included in the gross forgiven amount of the debt under section 245-75.

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14.	1	The Ruling does not sufficiently distinguish incurring a loss, outgoing or expenditure from paying it. The cases on whether there is payment by set-off and relating to whether there were independent obligations in cash to be paid by set-off are not persuasive as to whether there is a loss, outgoing or expenditure of the company issuing shares.	The cases on payment in cash by set-off begin with cases on the former requirement of the company law that shareholders were liable for the nominal capital of their shares except so far as they had subscribed the amount in cash. Those cases distinguished situations in which a shareholder's shares were issued in satisfaction of a liability of the company to pay cash for in-kind consideration from the shareholder (so that the shareholder paid cash for the issue of the shares by set-off), and situations in which a shareholder's shares were issued as what was required under the arrangement by which the shareholder provided in-kind consideration (so that the shareholder did not pay cash for the issue of the shares, as payment of cash by set-off did not occur and there was no other payment of cash). Those cases establish that in at least some situations in which the shareholder must give in-kind consideration and can only receive or demand the issue of shares there is no entitlement of the shareholder to cash that is paid by set-off when the shares are issued. An obligation on a company to issue shares is not itself a loss, outgoing or expenditure of the company. If there is no loss, outgoing or expenditure then there can be no loss, outgoing or expenditure capable of being satisfied by set-off against an obligation to subscribe for shares. The Explanation section of the Ruling has been adjusted for greater clarity.

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15.	1, 2	*JC Williamson's Tivoli Vaudeville Pty Ltd v. Federal Commissioner of Taxation* (1929) 42 CLR 452 and *The Crown v. Bullfinch Proprietary (WA) Ltd* (1912) 15 CLR 443 are to be preferred to *Messer v. Deputy Federal Commissioner of Taxation* (1934) 51 CLR 472 and *Federal Commissioner of Taxation v. Becker* (1951-52) 87 CLR 456. Kitto J in Becker distinguished the other cases, not as depending on their particular statutory provisions, but on the basis of whether the detailed transaction steps or the character of the overall arrangement were relevant to the question at hand.	The Commissioner prefers the more recent authority and distinguishes the earlier authority as *Becker* did. 'It is important to observe with respect to each of these three cases, as indeed the Court pointed out in the last of them [Messer at page 482], that the question at issue depended upon the true interpretation of the relevant enactment rather than upon the character of the transaction which had taken place. The cases cannot be regarded as [467] establishing, as a principle of general application, that where there is a sale of property for a money sum to be satisfied by an issue of fully-paid shares, there are two separable and substantive transactions, a sale of the property for a cash price and an issue of fully-paid shares, so that if the shares are subsequently sold any excess over the amount paid up on them constitutes a profit.' Kitto J at pages 466-467 of *Becker*. This passage supports the Commissioner's interpretation of the basis on which the earlier cases were distinguished and is inconsistent with the contrary submission.
16.	2	*Federal Commissioner of Taxation v. Becker* (1951-52) 87 CLR 456 is concerned with Mr Becker's overall profit from his whole arrangement, including both the sale of his land to his company and the sale of the shares in the company. Therefore it is not authority that the company did not incur a liability to pay £8,000 for the land.	The Commissioner of Taxation in *Becker* was concerned with Mr Becker's liability for tax in relation to the proceeds of £12,000 that he derived from selling his shares in his company, conditionally on transferring his land to his company. By contract, the company was to pay a nominated £8,000 for the land in (and only in) shares paid up to £8,000. The question was whether Mr Becker made a profit in selling of the shares for £12,000. In finding that he didn't, the High Court had to find that he had not acquired the shares for £8,000, but rather had acquired the shares for the land, the true value of which was the same amount he derived from selling the shares.

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			'The question then is, what really was the cost to the respondent of the shares which he sold for £12,000? The plain fact of the matter is that the cost was the land which he transferred to the company. It simply is not true to say that the cost was only £8,000. But the respondent did not sell his land for £8,000 payable in money, and he did not receive or become entitled to receive the 8,000 shares upon paying £8,000 in money. The sale agreement provided for only one method of completion: it bound the respondent to transfer his land to the company and it bound the company to issue fully-paid shares to him.' Kitto J, at page 467 of *Becker*. 'When the taxpayer transferred the land to this company, which owned nothing else and had no liabilities, and in return got all the shares of the company but one, he cannot be said to have made a profit. He got nothing more valuable than he gave: he received the exact equivalent of what he gave.' Webb J, at page 463 of *Becker*. In finding that there was no profit in relation to the shares, the High Court was not adopting a 'commercial' rather than a 'jurisprudential' analysis. The court found that Mr Becker's gain arose only in relation to the land (in relation to which it was not taxable), and he made no gain on the shares, because there was no difference between what he paid for the shares and the sale price of the shares.

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17.	2, 3	The relevant current accounting standards recognise an outgoing at its fair value (reference Accounting Standard AASB 2 and AASB 3; and IAS 2 and IAS 3). The fair value of equity instruments is worked out by reference to their observable market price where this can be determined, and otherwise by reference to the fair value of the underlying net assets exchanged. (This reading of the submissions results from some ambiguity in their words. In consultation on the submissions, it emerged that some intended their submission to be read consistently with the view of the current accounting standards outlined in this Compendium as the Response. However it is appropriate to summarise the alternative reading and to explain a Response to it.)	There is no view or alternative view of the operation of the law that is consistent with the effect of current accounting standards. The Ruling cannot be aligned with the standards. The relevant current accounting standards do not recognise the issue of shares for in-kind consideration as an outgoing. AASB 2 (and its international model, IAS 2) apply to the reporting of any share-based payment transaction, other than certain transactions in which the entity acquires goods as part of the net assets acquired in a business combination: then AASB 3 (and its international model, IAS 3) apply. In some limited circumstances exceptions apply AASB 132 or 139 (IAS 32 or 39 respectively) instead: as those exceptions don't apply to 'contracts that were entered into and continue to be held for the purpose of receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements' they won't apply to instances where shares are issued as or to satisfy consideration for assets or for services the issuer wants. Quoting AASB 2: 7 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

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			8 When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses. 9 For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted. Similarly, where there is a business combination, AASB 3 applies the 'purchase method', under which the acquirer allocates the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed. No outgoing is recognised under AASB 2. There are only two accounting entries: the fair value of the thing acquired, and a corresponding increase in shareholders' funds (a liability); there is a liability to cash only to the extent of the value of the thing acquired and only where the transaction is settled in cash equal to the value of equity rather than in equity. The discussion at paragraphs BC29 – BC 60 of the Basis for Conclusions on IFRS 2 *Share-Based Payment* IFRS 2 BC explains the underlying accounting principles.

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18.	2, 3	Section 21 means that if a company issues shares as consideration for a transaction then the company will be deemed to have paid/given the money value of those shares for all the purposes of the Tax Acts – not just for the purpose of determining the income of the recipient but also for calculating the deductions available to the company. Section 21 deems a payment to be made in money.	Section 21 has the effect that where consideration is given in kind it is taken to be given to the money value of the consideration in kind. However, if consideration is given that is not a loss or outgoing, or expenditure, of the taxpayer then section 21 has no effect that makes it into a loss, outgoing or expenditure of the taxpayer. All section 21 does is fix the money value amount for tax purposes. Observations of Hill J in *FC of T v. Energy Resources of Australia Ltd* (1994) 54 FCR 25; (1994) 126 ALR 161; 94 ATC 4923; (1994) 29 ATR 553 arose in the context of a claim for the Commissioner that the section provided an independent basis of assessment – a claim rejected by the court.
19.	3	The treatment of a company issuing shares should be the same whether it does so for cash, paid in cash or paid by set-off against an antecedent obligation of the company to pay cash for a transaction, or whether shares are issued for non-cash consideration.	The law does not apply identically or similarly to these different scenarios. This issue is raised because submission implicitly asserts that a change to the law is desirable. The Ruling cannot address the merits of, or the options for, such a change.
20.	2	The Commissioner had a general administrative practice contrary to the position stated in the draft Ruling. Therefore the Ruling should only ever have prospective application.	The Ruling should apply both before and after it is issued. The Commissioner is required to apply the law and to take a view as to the operation of the law both before and after the issue of the Ruling, which expresses the Commissioner's view as to what the effect of the law has always been. The Commissioner had no general administrative practice contrary to the position taken in the Ruling.

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			The Commissioner's general views on the system of public rulings following the introduction of the self-assessment amendments to implement the Government's response to the ROSA report are found in Taxation Ruling TR 2006/10: 63. Generally however, public rulings will have both a past and future application because they represent the Commissioner's opinion as to what the correct interpretation of the law has always been. 64. The fact that the Tax Office has not previously publicly stated an interpretative or administrative policy does not mean a public ruling should not have a past application. Even if uncertainty existed previously in an industry, market or among taxation advisers and taxpayers, a public ruling that issued to clarify this uncertainty is to have both a past and future application (subject to the exceptions mentioned in paragraph 62 and 70 of this Ruling). The general limitation on effect of a Ruling that changes the Commissioner's general administrative practice is a specific legislative limit under subsection 358-10(2) of Schedule 1, *Taxation Administration Act 1953* (the TAA), and where it applies it may be reasonable for a Ruling to be given effect expressly only from when the general administrative practice changed. (This will often be from the issue of a draft of the Ruling to the same effect as the final Ruling, because the draft will often expressly change the Commissioner's general administrative practice where this is contrary to the draft, in the same way that a draft of a Ruling will often expressly withdraw a conflicting earlier public ruling from the issue of the draft.) However this principle has no application to this Ruling.

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			Here there was no contrary general administrative practice, or if there was it was a practice consistent with the Ruling: 72 General administrative practice will usually be established by the Tax Office having consistently communicated to a wide range of entities on a particular issue. A general administrative practice is usually adopted for the efficient administration of the taxation system and would generally be documented in products such as: • Law Administration Practice Statements; • General Administration Law Administration Practice Statements; • a Tax Office policy document (such as the ATO Receivables Policy); and • other precedential material. 73 Importantly though, not all precedential material (such as ATO Interpretative Decisions (ATO IDs)) indicate a general administrative practice. An ATO ID will only be accepted by the Tax Office as representing general administrative practice where the view contained therein is supported by other evidence of a pattern of Tax Office treatment of the issue consistent with the view expressed in the ATO ID (for example, a significant number of private rulings on the same matter which reach the same conclusion). 74 Other situations where a general administrative practice is not necessarily established include: • Where there are merely several private rulings on a matter. However, a significant number of uncontradicted private rulings on a matter over time will tend to support the establishment of a general administrative practice. • A bare failure by the Commissioner to take some action within his or her power. However, a repeated failure to exercise that power after the issue is drawn to the Commissioner's attention will tend to support the establishment of a general administrative practice.

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			• Mere silence or failure to issue a public ruling on a matter. However, a general administrative practice may be established where, following the identification of an issue, the Tax Office has accepted the practice as a basis on which entities should treat the issue in a range of situations. There were no applicable Rulings, Law Administration Practice Statements, Tax Office policy documents or other precedential materials other than some ATO IDs including those identified in submissions. There had been a public ruling, TD 93/233, consistent with the draft Ruling but withdrawn with effect from 2 September 1998 because: Whether or not there is 'expenditure incurred' under section 73B depends on whether there is expenditure actually made or expenditure arising from a presently existing liability. This point was not made sufficiently clear in the Taxation Determination. Further, the question is one to be determined on the facts of each case, and it is not possible to cover all the relevant principles and their application to various factual situations in a Taxation Determination. The draft Ruling deals with the issue of whether there is expenditure actually made or expenditure arising from a presently existing liability, as TD 93/233 did not. Another general public ruling, IT 2483, is mentioned in submissions. It concerns the treatment of certain financial institutions realising shares they hold and receiving other shares in exchange. This ruling is not inconsistent with the draft Ruling in any way. It does not concern the treatment to such institutions of the issue of their own shares, whether as consideration or otherwise.

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			A number of private rulings were cited in submissions, and so were five ATO IDs. Of these, some private rulings were consistent with the draft Ruling, as was one of the IDs. One private ruling, and an ID which has been withdrawn, were inconsistent with the draft Ruling; and three IDs did not address the same issues as the draft Ruling (these concerned the position of an employer providing money to the trustee of an employee share trust, with the trustee using the money to acquire shares). The private rulings and ATO IDs disclose no significant number of uncontradicted decisions such as might disclose a general administrative practice: there are instances consistent with the draft Ruling as well as inconsistent instances. In these circumstances, the better view is that there was no general administrative practice of the Commissioner when the draft Ruling was issued. The alternative view would be that there was such a practice, and that it was evidenced by TD 93/233 (withdrawn) and was consistent with the draft Ruling. On either view there was no general administrative practice contrary to the draft Ruling.