TR 94/D5 - Income tax: the capital gains tax implications of varying rights attaching to shares

This cover sheet is provided for information only. It does not form part of *TR 94/D5 - Income tax: the capital gains tax implications of varying rights attaching to shares*

This document has been finalised by TR 94/30.

Generated on: 14 November 2026, 06:13:36 AM

Draft Taxation Ruling
Income tax: the capital gains tax implications of varying rights attaching to shares

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

contents	para
What this Ruling is about	**1**
Ruling	**7**
Date of effect	**13**
Definitions	**15**
Explanations	**18**
Nature of a share	18
Whether a right attaching to a share is a CGT asset	32
Disposal	34
Full disposal	34
Part disposal	40
Deemed disposals - subsections 160M(6) and 160M(7)	43
Subsection 160M(6)	44
Subsection 160M(7)	46
Section 160ZZP rollover	48
Examples	**51**

What this Ruling is about

1. This Ruling clarifies whether any disposal of a right, or a share with that right attached, occurs for the purposes of Part IIIA of the *Income Tax Assessment Act 1936* when the bundle of rights that comprise the share is varied. In particular it considers whether there is:

(a) a full disposal under subsection 160M(1);

(b) a part disposal under section 160R; or

(c) a deemed disposal under subsection 160M(6) or 160M(7).

2. The main types of variations to share rights considered in this Ruling broadly include:

(a) an alteration in voting rights;

(b) a change in entitlements of shareholders to share in the assets of the company upon winding up;

(c) a change in dividend entitlements, including a change from a cumulative right to dividends to a non-cumulative right to dividends or vice versa;

(d) an alteration in rights to participate in other distributions of surplus assets and profits;

(e) conversion of a share from one class to another; and

(f) any other variation in rights where consideration is received or paid in respect of rights relinquished or acquired.

3. Where a disposal does occur, the circumstances under which section 160ZZP rollover relief can be obtained (where shares in a company are exchanged for other shares in the same company) will be examined.

4. This Ruling does not deal with situations where:

(a) rights attaching to units in unit trusts are varied;

(b) share splits or consolidations occur; or

(c) a shareholder receives a payment to refrain from exercising a right or as an inducement to exercise a right in a certain way.

5. This Ruling also does not consider the possible application of the general anti-avoidance provisions of Part IVA. However, it needs to be kept in mind that a variation may attract the application of Part IVA in certain circumstances.

6. Key terms in this Ruling are defined in paragraphs 15 to 17 below.

Important note: proposed amendments

On 12 January 1994, the Assistant Treasurer announced that the Government proposes amendments of the capital gains tax provisions to incorporate value shifting rules. The amendments are proposed to apply to material shifts in value of shares held by a person who 'controls' (as defined) a company. The Assistant Treasurer's announcement foreshadowed that the amendments are to apply to material shifts of value made after 12:00 midday Eastern Summer Time on 12 January 1994. Details of the proposed amendments are contained in attachment B to Assistant Treasurer press release No.3, dated 12 January 1994. Legislation to give effect to the announcement has not yet been introduced into the Parliament. *The proposed amendments have not been reflected in this draft Taxation Ruling.*

Ruling

7. A variation in rights attaching to a share (including those variations outlined in paragraphs 2(a) to (e) above) does not result in a full disposal of an asset for the purposes of Part IIIA unless there is a cancellation or redemption of the share. In determining whether a disposal has occurred under Part IIIA, it is not relevant to consider whether the variation is slight (such as a small change to the nominal value of shares) or more significant (such as disposing of the preference to receive dividends).

8. A variation in rights attaching to shares does not result in a part disposal of an asset under section 160R.

9. Similarly, a variation in rights does not constitute a deemed disposal under subsection 160M(6). However, a variation in share rights for money or other consideration does give rise to a deemed disposal under subsection 160M(7) where the other requirements of that subsection are met. The same results arise both before and after the amendments made by the *Taxation Laws Amendment Act (No.4) 1992* (Act No.191 of 1992) to those subsections.

10. There is clearly a disposal for the purposes of Part IIIA where shares are redeemed or cancelled because in these circumstances paragraph 160M(3)(c) specifically deems a change in ownership to have occurred for the purposes of subsection 160M(1).

11. Rollover relief is available under section 160ZZP where there has been a disposal in terms of subsection 160M(1) (when read with paragraph 160M(3)(c)) and where certain prerequisites are satisfied. The most pertinent of these conditions is that the shares of a particular class must actually be redeemed or cancelled by the company. Following this the company issues new shares in substitution for the original holding of shares, but no other consideration must flow to the taxpayer as a result of the redemption or cancellation.

Date of effect

13. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

14. If a taxpayer has a more favourable private Ruling, this Ruling applies, to the extent of the inconsistency, to that taxpayer only in relation to variation of share rights after the date of this Ruling. This is subject to the exception that a public ruling cannot withdraw an earlier inconsistent legally binding private ruling if the year of income to which the private ruling relates has already commenced (see Taxation Determination TD 93/34).

Definitions

15. The following definitions of key terms apply in this Ruling:

Cancel

16. The ordinary meaning of the term 'cancel' is to cross out, to make void, annul or to render invalid for re-use. In the context of corporation law a cancellation usually refers to a class of shares. The cancellation of a *share* means that it ceases to exist and is to be distinguished from the mere cancellation of a *share certificate*. A share certificate is no more than evidence of a share holding, meaning that the cancellation of the certificate does not of itself cancel the share.

Redeem

17. The relevant *Macquarie Dictionary* meaning of the term 'redeem' is 'to buy back or pay off'. In the Corporations Law the term applies to shares originally issued under a company's articles and redeemed out of the company's capital (see section 192 of the Corporations Law).

Explanations

Nature of a share

18. In examining the capital gains tax implications of any variations in the rights which are attached to shares, it is necessary to consider whether a share is one asset or whether a series of assets are contained in the bundle of rights that comprise a share. Furthermore, we need to consider whether a change in rights attaching to a share results in the creation of a new share comprised of a new bundle of rights.

19. The explanation which follows considers the nature of a share and then relates relevant concepts from that discussion to the statutory requirements of Part IIIA.

20. The precise legal nature of a share has not been made clear by the courts but some assistance can be obtained by turning to company law concepts as well as to death duty cases on the subject.

21. The rights of each shareholder in relation to each class of share are usually contained in the memorandum and articles of association

of the company. The rights attaching to a share are not ordinarily thought of as a separate piece of property.

22. An often-used description of a share is that it is an aliquot interest of a shareholder in a company as measured by a sum of money. Farwell J followed this interpretation when describing the legal nature of a share in *Borland's Trustee v. Steele Bros & Co Ltd* [1901] 1 Ch 279 at 288:

> 'The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.'

23. This description was endorsed by Williams J in the High Court decision of *Archibald Howie and Others v. The Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 at 156. Dixon J at 152 also endorsed this approach in the following terms:

> 'While a shareholder has not a proprietary right or interest in the assets of an incorporated company, his "share" is after all an aliquot proportion of the company's share capital with reference to which he has certain rights.'

24. The Corporations Law defines a share as personal property which is transferable or transmissible and, subject to the articles, able to be devolved (section 1085).

25. The nature of a share was considered in the death duty case of *Re Alex Russell, deceased* [1968] VR 285. McInerney J of the Supreme Court of Victoria considered the question of whether the right to convert a preference share to an ordinary share could be transferred at death. His Honour found that this right was still 'locked up' and it could not be separated out of the actual estate. Also examined was the question of whether the right to convert could be separated out from the preference shares. McInerney J commented at 299 to 300:

> 'It follows that while it is correct to speak of the testator's preference shares as consisting of a bundle or congeries of rights, it is not correct to speak of a shareholder owning each of those rights as a separate piece of property, or as a separate chose in action.....It is not permissible, therefore to separate out the various rights appertaining to the holder of preference shares and to treat some of those rights as "actual estate" and others as "notional estate".'

26. Accordingly while shares are comprised of a bundle of rights, those rights are not separate pieces of property capable of being divided out and held separately.

27. The implications of incidental changes to rights attaching to shares was considered in the decision of the New South Wales Court of Appeal in *Rofe & Others v. Commissioner of Stamp Duties (NSW)* 88 ATC 4865. This was a death duty case where the court had to consider whether the conversion of ordinary shares into cumulative preference shares not long before the death of the testator was a 'disposition of property' and so dutiable under the *Stamp Duties Act 1920* (NSW).

28. The special resolution passed by the company in altering the rights and liabilities of the shares set down that the shares after conversion bore the same share numbers but different rights (most notably the new right to a fixed dividend) and privileges than the ordinary shares before conversion. Mahoney JA, in finding that there was a disposition of property, said that the effect of the conversion of ordinary shares to cumulative preference shares was that (at 4874):

> '...The deceased ceased to hold property of one kind and acquired property of another kind... .The rights of the two classes of shares were, of course, fundamentally different.'

29. The reasoning in this case relies heavily on the provisions of the New South Wales Stamp Duties Act. It ultimately was decided in the statutory context of the definition of 'disposition of property' as including estate value shifting concepts. The question in this case was not whether there was a 'disposition of property' as this point was conceded by the executors of the estate. Rather, the question was whether there was a 'disposition of property' because it was a 'transaction entered into with intent to diminish the value of the shares', in the words of the New South Wales Act. Therefore the question of whether there was a disposition arose only because it fell within the extended definition of 'disposition of property' in that Act. As such, the analysis is not applicable in the context of the Income Tax Assessment Act.

30. The High Court has also looked into the nature of a share in the death duty case of *Robertson v. FC of T* (1952) 86 CLR 463. In that case, the articles of the company had been altered so that upon the testator's death the shares standing in the register in his name became No. 2 class shares with very limited rights. The shares were valued by the Court on the basis of these reduced rights. Williams J at 479-480 commented:

> 'The contract between the company and its members created by section 20 of the Companies Act or the contract thereby created

> between the members inter se, if there be any such contract, could not cause the beneficial interest in the shares of one member to pass or accrue to or devolve upon the shares of another member (perhaps "accrue" is the most apt word for present purposes). The property in the shares is the property that exists in the shares themselves. Shares do not give an aliquot proprietary right in the property of the company. The whole effect of Article 6 upon the death of the deceased was to alter the existing contractual rights of the company and inter se. The article did not cause any beneficial interest in any property owned by one person to accrue in any other person. It merely altered the contractual rights upon death of the deceased. It did not alter any proprietary rights.'

31. Clearly in this case there was a change in the relative interests of shareholders following the change in rights. For taxation purposes, the issue that needs to be determined is whether the variation in relative interests in a share amounts to a disposal of that share. A disposal of rights attaching to a share (or asset) for the purposes of Part IIIA of the Act, or a part disposal of the share, envisages that the rights be capable of being separated out of the share or assigned. That is, they would need to be regarded as assets in their own right.

Whether a right attaching to a share is a CGT asset

32. In considering the nature of a share, it has been the prevailing view of the courts that the rights attaching to shares cannot be dealt with separately from the share itself. It is clear that these rights were not assets under the definition of 'asset' in section 160A before being amended by the *Taxation Laws Amendment Act (No.4) 1992*.

33. We also consider that the current extended definition of 'asset' in section 160A, which applies to the construction or creation of assets after 25 June 1992, does not alter this position. The expression 'any other right' is a general provision which, under the rules of statutory interpretation, does not take precedence over a more specific provision. As a share is a chose in action, subparagraph 160A(a)(iii) takes precedence over subparagraph 160A(a)(iv) to the effect that a share itself is the asset and not its constituent rights. The concept of a share as a whole being the relevant asset is also supported by other provisions in Part IIIA: see, for example, paragraphs 160M(5)(a), 160T(1)(c) and 160T(1)(j).

Disposal

Full disposal

34. Section 160M is the provision dealing with disposals for capital gains tax purposes. For a disposal to occur under subsection 160M(1) there must be a 'change in the ownership' of the asset. Generally, this occurs where there is both a disposal of the asset by the person who owned it immediately before the change and an acquisition of the asset by the person who owned it immediately after the change. However, a variation in share rights may not necessarily result in an acquisition by a person (for example where shareholders relinquish rights without any other shareholders gaining those rights).

35. Paragraph 160M(3)(c) is the disposal provision which specifically refers to a share. It provides that a change in ownership of an asset, being a share, is deemed to occur where the share is redeemed or cancelled. Where there is no redemption or cancellation then no disposal takes place in terms of that paragraph.

36. The terms 'cancel' and 'redeem' are defined at paragraphs 16 and 17 above. Cancellation of a share certificate does not mean that the share itself is cancelled. Share scrip is of evidentiary value and may be cancelled for a variety of reasons all of which have no capital gains tax consequences. Examples of where a company may cancel a share certificate include where:

(a) the balance of a partly paid share is later paid by the shareholder. A new certificate may issue to show that the share is now fully paid;

(b) a company changes its name and new certificates are issued;

(c) a share certificate is lost or damaged and a substitute or replacement or substitute certificate is issued;

(d) a shareholder having one certificate as evidence of a share holding transfers part of that share holding . The company may cancel the original share certificates and issue two new certificates; one to evidence the new share holding and the other evidencing the shares transferred. The shares transferred will of course be subject to the provisions of Part IIIA.

37. Of course a company may specify in the articles that a cancellation of shares is to occur at a particular time or on the happening of an event such as giving up the share scrip.

38. The administration of the Income Tax Assessment Act is not constrained by the usage of terms in the Corporations Law. However, if it is clearly a requirement that a transaction calls for a redemption and cancellation of shares, in terms of the Corporations Law, a

disposal has to have taken place for the purposes of the Income Tax Assessment Act, by virtue of paragraph 160M(3)(c).

39. A variation in share rights that does not involve a cancellation or redemption of the share does not amount to a disposal of the share for the purposes of subsection 160M(1).

Part disposal

40. It could be argued that a variation in share rights amounts to a part disposal of the share on the basis that some of the rights are relinquished. Paragraph 160M(3)(c) refers to a redemption of a share in whole or in part. However, the specific section dealing with part disposals is section 160R, which is premised on the basis that Part IIIA applies to that part of an asset which is capable of disposal. If it cannot in fact and at law be separately disposed of, the section does not deem it to be capable of being separately disposed of.

41. The only judicial comment on section 160R is an obiter dictum comment by Deane J in the High Court case of *Hepples v. FC of T* (1991) 173 CLR 492 at 516; 91 ATC 4808 at 4821; (1991) 22 ATR 465 at 480:

> 'It seems to me that the preferable approach is to treat section 160R as applying to a case where there has been a disposal, *in the sense of a change of ownership* of any part of the rights involved in the ownership of an asset, those rights themselves constituting an asset for the purposes of Part IIIA.'(Emphasis added.)

42. His Honour's view still requires that there be a change of ownership for section 160R to apply. We consider that there is no change in ownership of a share (or part of a share) where a company varies one or more of the rights attaching to the share. This is because there is no redemption of part of a share and the rights attaching to a share are not assets separate from the share.

Deemed disposals - subsections 160M(6) and 160M(7)

43. Subsections 160M(6) and 160M(7) are key provisions dealing with situations giving rise to deemed disposals. We consider that section 160M(6) does not apply to a variation in share rights, but that subsection 160M(7) applies when money or other consideration is received as a result of the variation. The same results arise both before and after the 1992 amendments to those subsections.

Subsection 160M(6)

44. Before their amendment by the *Taxation Laws Amendment Act (No.4) 1992* with effect after 25 June 1992, the previous subsections 160M(6) and 160M(7) operated. The former subsection 160M(6) was interpreted by the Full Federal Court in *Hepples v. FC of T* 90 ATC 4497; (1990) 21 ATR 42 to apply only to assets which were created out of or over existing assets. In *Reuter v. FC of T* 93 ATC 4037 at 4051; (1993) 24 ATR 527 at 545, the Federal Court (Hill J) held that this view was also followed by a majority of the Full High Court in *Hepples v. FC of T* (1991) 173 CLR 492; 91 ATC 4821; (1991) 22 ATR 465. We therefore accept that the former subsection 160M(6) applied only to assets created out of or over an existing asset. Accordingly, this subsection did not apply to a variation of share rights during the period of its operation.

45. The present subsection 160M(6) applies to the construction or creation of assets after 25 June 1992. The broad criteria which trigger the new subsections 160M(6) to 160M(6D) are that a person must create an asset, not being corporeal property, which on its creation is vested in another person. As all these requirements are not present when a company resolves to vary the rights attaching to its shares, the subsection will not apply.

Subsection 160M(7)

46. The former subsection 160M(7) deemed a disposal of an asset where an act, transaction or event occurred and money or other consideration was received or was entitled to be received as a consequence of the action or event.

47. The same applies for the new subsection 160M(7) which applies only if the other provisions of Part IIIA do not apply. The present subsection operates where a person who owns an asset has received, or is entitled to receive, consideration by reason of an act or transaction that has taken place in relation to the asset (whether it affects the asset or not) or an event that has affected the asset. It does not matter whether the asset is affected adversely or beneficially or neither adversely or beneficially. Where subsection 160M(7) applies, the person is deemed to have acquired the notional asset created by the disposal immediately before the deemed disposal. There is necessarily a broad spectrum of possible variations to share rights which can be carried out and differing financial implications attached to those situations. However, we consider that the section applies to a variation of share rights where money or other consideration is received or is entitled to be received as a result of the variation.

Section 160ZZP rollover

48. Section 160ZZP has application where there is a reorganisation of share capital and as a result of which a company redeems and cancels all the shares of a particular class.

49. Sections 193 and 195 of the Corporation Law provide that a company can alter its share capital if authorised by the articles of association of the company and this can be achieved in a number of ways:

- increasing the share capital by such sum to be divided into shares of such amount as prescribed by the resolution;
- cancelling certain shares - unissued or unpaid shares;
- by reducing share capital by court-approved returns of capital (see section 195 of the Corporations Law) or by buy-backs (see section 206AA of the Corporations Law);
- consolidating all or some of the share capital of the company into shares of a larger amount than its existing shares;
- splitting shares into shares of a smaller denomination than that fixed by the memorandum, so that the new shares bear the same proportion of paid and unpaid shares as the old shares.

50. The process of altering share capital, in broad terms, involves the cancellation of old shares and the issue of new shares. This qualifies for rollover relief under section 160ZZP where the other requirements of the section are satisfied. In particular, the taxpayer must not receive any consideration other than the new shares by reason of the redemption or cancellation (see paragraph 160ZZP(1)(f)).

Examples

Example 1

Rights attaching to shares for no consideration

51. On 1 July 1994 Ausco holds a meeting of shareholders and obtains approval to transfer all voting rights from B class shareholders to A class shareholders. Russell holds all A class shares and obtains the benefit of this variation of rights attaching to the shares. Jill holds all B class shares and loses the benefit of voting previously attached to her share holding. There is no money or other consideration which is received or receivable by Jill. It is assumed that there is no

cancellation or redemption of the shares. No disposal or deemed disposal has taken place for capital gains tax purposes.

Example 2

Reduction in the par value of shares

52. David holds ordinary shares in Changeco which were issued at $0.50 par value. Changeco obtains court approval to reduce the capital of the company to absorb accumulated losses and properly to reflect the available assets of the company. The par value of shares is reduced to $0.30. No shares are cancelled or redeemed. David is not subject to capital gains tax as he has not disposed of any part of his share holding as a result of the mere reduction of capital.

Example 3

Convertible preference shares

53. On 1 July 1993, 100 convertible preference shares are purchased for $2.00 each, and are expressed as preference shares with a preferential right to dividends . On conversion the preference shares convert to the predetermined fixed value of ordinary shares with a right to a return of capital on winding up and any bonus issues available. These shares **must** be converted to ordinary shares by 1 January 1996, if the shareholder opts to do so.

54. Lester converts his shares on 1 January 1994 when the market value of the shares is $2.50. There is no capital gains tax payable in the 1993-94 income year due to the mere conversion to ordinary shares. As the shares are not cancelled or redeemed prior to conversion to ordinary shares by the company, there is no disposal at this point. The ordinary shares upon conversion will adopt the cost base of the preference shares.

Example 4

Converting preference shares

55. On 1 June 1994 converting preference shares are issued for $1.00, being $0.50 par value and a premium of $0.50. The preference shares offer priority over ordinary shareholders as to payment of dividends. In addition the preference dividends offer a fixed base dividend and a variable supplementary component of dividend. The converting preference shares are not redeemable and convert to the pre determined fixed value of ordinary shares on 1 June 1995. On conversion date the market value of the ordinary shares has risen to

$1.50 and so the converting preference share becomes an ordinary share with a market value of $1.50. It is assumed that there is no cancellation or redemption of the shares.

56. There are no capital gains tax consequences on the conversion of the CPS to the ordinary share.

Example 5

Conversion of ordinary shares to preference shares

57. XCO obtains a special resolution of the company shareholders to convert all its G class ordinary shares to G class cumulative preference shares. The articles of XCO allowed the company to take this course of action and specified the rights of the holders of the new shares as required by section 200 of the Corporations Law. The effect of the resolution is that all the preference shares will at some future date reconvert to ordinary shares.

58. Ian takes up the offer to convert his G class ordinary shares. On conversion the company redeems Ian's shares. Consequently, there is a disposal under paragraph 160M(3)(b) and capital gains tax is triggered on conversion of the shares.

59. When the shares reconvert at some future date to ordinary shares, the treatment would be the same as that for example 3.

Example 6

Change in cumulative rights to dividends to non cumulative rights to a dividends

60. The articles of Bibco allowed it to vary the nature of dividends payable to shareholders. On passage of the shareholders' motion, rights were varied to change dividends to non-cumulative, without cancellation or redemption of the shares. No capital gains tax implications arise.

Commissioner of Taxation

27 January 1994

ISSN 1039 - 0731

Not previously released to the public in draft form

ATO references
NO
BO NOR J36/354/6 Vol 1

Price $1.40

FOI index detail

reference number

subject references

- asset
- capital gains
- disposal
- part disposal
- share rights
- shares
- rollover
- variation in shares rights

legislative references

- ITAA 160A
- ITAA 160M(1)
- ITAA 160M(3)(c)
- ITAA 160M(6)
- ITAA 160M(7)
- ITAA 160R
- ITAA 160ZZP
- ITAA Pt IVA
- ITAA Pt IIIA
- Corporations Law 192
- CL 193
- CL 195
- CL 206AA
- CL 1085

case references

- Re Alex Russell, deceased [1968] VR 285
- Archibald Howie v. C of SD (NSW) (1948) 77 CLR 143
- Borland's Trustee v. Steele Bros & Co. Ltd [1901] 1 Ch 279
- Hepples v. FC of T 90 ATC 4497; (1990) 21 ATR 42
- Hepples v. FC of T (1991) 173 CLR 492; 91 ATC 4808; (1991) 22 ATR 465
- Robertson v. FC of T (1952) 86 CLR 463
- Rofe v. C of SD (NSW) 88 ATC 4865
- Reuter v. FC of T 93 ATC 4037; (1993) 24 ATR 527