TR 2012/1EC - Compendium

Ruling Compendium – TR 2012/1

This is a compendium of responses to the issues raised by external parties to draft Taxation Ruling TR 2010/D8 – Income tax: retail premiums paid to shareholders where share entitlements are not taken up or are not available.

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.	Issue raised	ATO Response/Action taken
1.	**Some stakeholders contend that:** • **No amount representing the Retail Premium amount is ever paid or credited to the company;** • **Therefore, the Retail Premium is never credited or forms part of the company's share capital or share capital account; and** • **Therefore the company does not pay the Retail Premium to its Non Participating shareholders.** The premise of this view is that under particular legal arrangements entered into as part of a capital raising and under instructions which may be given to the underwriter/Lead Manager, the issuing company is only entitled to the Offer Price and not to the Clearing Price under the Bookbuild. The underwriter/Lead Manager (or some other entity) is required to pay some or all of the balance of the Bookbuild proceeds to the Non Participating Shareholders as a Retail Premium. Accordingly, it is contended that the issuing company never owns, controls or receives the Retail Premium component of the Clearing Price amount and therefore this amount is not share capital of the company and cannot be credited to its share capital account. So when the Retail Premium is paid it is not paid by the company and cannot be debited to the share capital account of the company.	The Commissioner considers that Retail Premium amounts are clearly contributed to the issuing company as share capital of the company. This view is based on the position that **all amounts** paid in consideration for the issue of shares are share capital of the company (which should be credited to the company's share capital account). A Retail Premium is sourced from share subscription amounts, paid by third parties as the consideration for the issue to them of shares in the issuing company. The third party subscribers pay all of the Clearing Price as consideration for the purchase of shares under the share issue (whether in a Bookbuild process or otherwise). Accordingly, the total consideration by third parties for the shares is part of the share capital of the issuing company and should be properly credited to the share capital account of the issuing company. No arrangements for the application of the consideration subscribed, or to be subscribed, for the issue of a company's shares can have the effect that the company is not entitled to the consideration. Were an underwriter/Lead Manager to direct any part of that consideration other than as the company has arranged, the company can enforce the arrangement because it is entitled to the consideration. The Commissioner's position that Retail Premium amounts are paid to the issuing company and constitute part of its share capital is supported by the Corporate Law texts, Explanatory Memorandums and case law stated

Issue No.	Issue raised	ATO Response/Action taken
	It is also contended that the issuing company would never be entitled to demand that the underwriter/Lead Manager or other entity pay the Retail Premium amount over to the company. Based on the above, it is asserted that the Non Participating Shareholders receive the Retail Premium component of the Clearing Price *ab initio*, so that what happens is not the application of money belonging to the company on its behalf, after the company has received or derived those amounts. It is also contended that the cases mentioned in the Ruling to support the ATO view like *Re The Swan Brewery Co Ltd* (1976) 3 ACLR 164 (*Swan Brewery)*, *Archibald Howie Proprietary Ltd & Ors v. Commissioner of Stamp Duties (NSW)* (1948) 77 CLR 143 (*Archibald Howie)* and *St George Bank Ltd v. Commissioner of Taxation* (2009) 176 FCR 424; [2009] FCAFC 62; 2009 ATC 20-103; (2009) 73 ATR 148 (*St George)* are not relevant as: • none of these cases is about capital raising arrangements by an equity float; and • these cases were not directly about whether all of the consideration subscribed for the issue of shares was properly part of the company's share capital. It was contended that part of the discussion quoted from the *St George* case in particular (about assets being owned by the company and share capital being owned by shareholders) is not related to the issues the draft Ruling was addressing. It is also asserted that the analysis regarding section 975-300 of the *Income Tax Assessment Act 1997* (ITAA 1997) had no relevance, as Retail Premium amounts were never part of the share capital of the issuing company to begin with and so could not be part of any account the company keeps of its share capital.	in paragraphs 31 to 50 of the Explanation of the Ruling. The assertion that the issuing company 'never' owns, controls, or receives the Retail Premium component of the Clearing Price and 'never' pays it is inconsistent with actual arrangements examined by the Commissioner. There are underwriting agreements seen by the Commissioner under which the underwriter/Lead Manager is required to pay to the company on account of the Retail Premium component, and under which the company is required to use the payment to pay the Retail Premium. It is also clear that the Non Participating Shareholders **do not in any case to which the Ruling applies** receive the Retail Premium funds *ab initio*. They have no entitlement to pursue the third party subscribers, or intermediaries such as the underwriter/Lead Manager, for the Retail Premium. If they have any entitlement, it is against the company. The payment of the Retail Premium to the Non Participating Shareholders is still an application on behalf of the company of its own money which it receives and derives from the Bookbuild sale. The fact that the company may prearrange for these funds to be paid to another party via its agents and may legally preclude itself from asking for these funds back from its agent, does not alter this fact. This is supported by the analysis in paragraphs 123 to 139 of the Alternative Views section of the Ruling. Also the quoted case and other authorities in paragraphs 31 to 50 of the Explanation section of the Ruling are directly relevant to the Commissioner's position. Some extended quotes from the *St George* case have been omitted from the final ruling as unnecessary to support the Commissioner's analysis.

Issue No.	Issue raised	ATO Response/Action taken
2	**The interpretation of the definition of 'dividend' in the context of a Rights Issue transaction is inconsistent with both the legal position and commercial substance of the transactions.** The purpose of a Rights Issue is to raise much needed capital or to restructure a company's capital structure. Companies do not undertake rights issues or raise capital from its shareholders to effect a dividend distribution to another group of shareholders, contrary to the essence of the position of the Australian Taxation Office (ATO), but only to raise the net amount (generally the offer price, where the Retail Premium is the excess of the Clearing Price over the offer price). The Retail Premium is not part of the net amount the company raises but is only part of the cost of the arrangements by which the company raises the net amount. Put simply, no Australian company pays anything to Non Participating Shareholders. TR 2010/D8 merely states that a Retail Premium is a distribution within the meaning of subparagraphs 6(1)(a) & 6(1)(b) of the *Income Tax Assessment Act 1936* (ITAA 1936) without providing a detailed analysis to support its position. Cases such as *Ord Forrest Pty Ltd v. Federal Commissioner of Taxation* 130 CLR 124, 2 ALR 403 (*Ord Forrest)*, *Federal Commissioner of Taxation v. Slater Holdings Ltd* (1984) 156 CLR 447; 84 ATC 4883; (1984) 15 ATR 1299 (*Slater*) and *Condell v FC of T* [2007] FCAFC 44 (*Condell)* suggest that whether or not a distribution is a dividend for income tax purposes, has to be assessed from the company's viewpoint. In the present case, an issuing company would not debit any amount from its retained earnings or share capital account in relation to Retail Premium payments. In most cases, the issuing company is not entitled to receive the Retail Premium amount from subscribing shareholders. It is only ever entitled to receive the Offer Price of each new share that is issued.	The Commissioner takes the view that Retail Premium payments are distributions from the assets of the issuing company to their Non Participating Shareholders. The Retail Premium payments come within the definition of dividend under subparagraphs 6(1)(a) and 6(1)(b) of the ITAA 1936. The reasons for this view are stated in paragraphs 13 to 30 of the Explanation section of the Ruling. The reasons why the Commissioner does not accept the alternative views, stated in Issues 1 & 2 of this Compendium, are given in detail at paragraphs 13 to 75 of the Explanation section and paragraphs 123 to 139 of the Alternative Views section of the Ruling. As it is the Commissioner's position that Retail Premium payments are sourced from the assets of the respective company and made by it to its shareholders, it is submitted that the Commissioner's view is entirely consistent with the reasoning of the decisions of *Ord Forrest*, *Slater* and *Condell*. It should also be noted that the Full Federal Court judgment in *Condell* (by Kenny & Allsop J) quoted and affirmed the principles of *MacFarlane v. Federal Commissioner of Taxation* (1986) 13 FCR 356; 86 ATC 4477; (1986) 17 ATR 808 (*MacFarlane)* that the formal accounts of a company may not necessarily reflect, from the company's perspective, the true source of a dividend or distribution it makes. It is from the company's viewpoint that the Commissioner considers the Retail Premium to be sourced from the assets of the company, to be made to the company's shareholders as such, and to be a dividend. If the company does not carry out accounting entries showing the Retail Premium part of the clearing price to be included in the share capital of the company, and does not show the company to be paying the Retail Premium debited either to share capital or to other company assets, this does not alter the character of the Retail Premium part of the clearing price or of the Retail Premium payment for tax purposes. Whether the payment of the Retail Premium is a capital reduction by the company which is required to be authorised according to the *Corporations*

Issue No.	Issue raised	ATO Response/Action taken
		Act 2001 does not affect the character either of the Retail Premium part of the clearing price or of the Retail Premium payment for tax purposes.
3	**A Retail Premium is paid for, or for the lapsing or ending of, Entitlement rights to subscribe for shares and therefore may come under section 59-40 of the ITAA 1997.** **It is also contended that both the 'ordinary income' and 'dividend' arguments in the Ruling are inconsistent with Federal *Commissioner of Taxation v McNeil* (2007) 229 CLR 656; [2007] HCA 5; 2007 ATC 4223; (2007) ATR 431 (*McNeil*) and the introduction of section 59-40 of the ITAA 1997.** It is contended that the Commissioner's view that Retail Premium rights are separate rights to the Entitlement rights granted to a company's shareholders, contradicts the findings of the High Court in *McNeil's* case. This alternative view states that the High Court in *McNeil* identified two rights - the first being the bundle of rights which make up the share and the second being the put option rights created by the deed polls. At the time the put option rights lapsed, the High Court did not recognise a third set of rights created at that point - that right being the right to the proceeds. Instead the High Court dealt with the rights to participate in the share buy-back and the right to receive the proceeds of sale on the lapse of the right as the one right. The analysis of the High Court is consistent with the legal position of rights issuances generally. In effect, the shareholder acquires the right to receive any Retail Premium as part of the Entitlement. If a shareholder exercises their Entitlement rights, they forgo their right to a Retail Premium. The only link that the right to a Retail Premium has to the amounts subscribed by third party shareholders is then limited to the fact that the Clearing Price is an element of the	The Commissioner takes the view that Retail Premium rights are separate rights to Entitlement rights and that this is entirely consistent with both the High Court's judgment in *McNeil* and with the terms and purpose of section 59-40 of the ITAA 1997. The alternative view asserts that the High Court dealt with the rights to participate in the share buy-back and the right to receive the proceeds of sale on the lapse of the right as the one right. This is not evident in the High Court's judgment in *McNeil*. What the High Court stated, in both paragraphs 18 and 51 of their judgment in *McNeil*, was that as the Court accepted the Commissioner's primary argument that the sell back rights were income at time of receipt, it was 'unnecessary to consider the income nature of the receipt of proceeds on 2 April 2001.' Even if call option rights and the proceeds of sale of the call option rights were one right, this would not be relevant to Retail Premiums as these (and any right to them) are different and separate rights to Entitlement put or call option rights. The Commissioner accepts that the bundle of rights which make up a share are different from a put option or a call option in relation to the equity. However, the entitlement of a shareholder to a Retail Premium is neither by way of an entitlement to the proceeds of selling the shareholder's equity or of selling the shareholder's put or call option rights. For a Non Participating Shareholder, the equity remains unaffected, and any call option rights lapsed unexercised. A shareholder who participates does not give up their right to a Retail Premium: rather, no right to a Retail Premium ever arises for them. The reasons why Retail Premium rights are different and separate rights from Entitlement rights (and therefore do not come within section 59-40 of the ITAA 1997, which is concerned with put option rights), is explained in

Issue No.	Issue raised	ATO Response/Action taken
	calculation of the Retail Premium. Therefore, as Retail Premium amounts are paid for the ending of Entitlement rights, the amounts come within the ambit of section 59-40 of the ITAA 1997. Also, the Second Reading Speech and EM for this provision make it abundantly clear that the government did not intend for call options to be treated as dividends or ordinary income. Section 59-40 of the ITAA 1997 was enacted in response to the adverse capital market implications of the decision of the High Court in *McNeil's* case. The Commissioner's position undermines what Parliament sought to achieve by the introduction of section 59-40 and will inhibit the ability of companies to raise capital.	paragraph 20 of the Explanation section and paragraphs 143 to 163 of the Alternative Views section of the Ruling. Retail Premium amounts do not come within section 59-40 of the ITAA 1997. Nothing in that section, or in the Second Reading Speech and Explanatory Memorandum (EM) relating to that section, supports the view that the section was intended to deem transactions in call options or in the equity obtained by exercising them to be necessarily on capital account. The EM says no more than that such transactions (for the capital account shareholders to whom the section is confined) will ordinarily also be on capital account. The impact of *McNeil* on capital markets arose because the issue of put and by implication call rights to equity holders gave rise to assessable income of the value of those rights when they issued. The purpose of section 59-40 of the ITAA 1997 was to stop there being a taxing point then, and to defer any tax implications. Correctly dealing with the issue of call rights is unaffected by the subsequent treatment of Retail Premium payments, as those payments are not unrealised assets and do not give rise to potential tax liability on a different amount to that realised or at a different time from realisation. The Commissioner is not responsible for the policy in relation to capital raising arrangements - the Commissioner of Taxation is responsible for the interpretation and administration of tax laws. Treasury has primary responsibility for advising on tax policy and the design of tax laws.
4	**The tax consequences of receiving a Retail Premium are different depending on whether the shareholders are:** • **Eligible shareholders who choose not to exercise their entitlements; or** • **Shareholders who are not eligible to receive entitlements.** For eligible shareholders who choose not to exercise their	It is the Commissioner's view that Retail Premium rights are different and separate rights from Entitlement rights. Retail Premiums are not paid for the lapsing or ending of Entitlement rights for eligible shareholders. The reasons why Retail Premium rights are different and separate rights from Entitlement rights is explained in paragraph 20 of the Explanation section and paragraphs 143 to 163 of the Alternative Views section of the Ruling.

Issue No.	Issue raised	ATO Response/Action taken
	Entitlements, the Retail Premiums paid to them should be regarded as capital proceeds received in respect of CGT Event C2 happening to their Entitlements. For ineligible shareholders who do not receive Entitlements, any Retail Premiums received may be ordinary income (rather than a capital gain), as they are not amounts received in respect of any Entitlement arising from an original share. Accordingly, non-resident shareholders who receive a retail premium where there is no corresponding Entitlement to acquire shares may be taxable on this income based on the reasoning in *McNeil's* case.	While this alternative view acknowledges that Retail Premiums paid to ineligible shareholders would be ordinary income under the principles stated in *McNeil's* case, it is the Commissioner's view that Retail Premiums paid to **all** Non Participating Shareholders (both eligible and ineligible) would be ordinary income if these payments were not assessable dividends. The reasons for this view are stated in paragraphs 91 to 105 of the Explanation section of the Ruling.
5.	**Rights received by Incapable shareholders are still considered to have been 'issued' and come within the ambit of section 59-40 of the ITAA 1997** Incapable shareholders are described in paragraph 109 of TR 2010/D8 as Non Participating Shareholders who 'are not permitted to exercise rights under an Entitlement'. At paragraph 116 in TR 2010/D8, it is argued that Incapable Shareholders are not able to benefit from the operation of section 59-40 of the ITAA 1997 because the Commissioner considers no rights are issued to them or the rights which are issued to them are not rights to acquire shares. However it is submitted that a reading of section 59-40 of the ITAA 1997 does not have any such reference requiring the exercise or the ability to exercise a call option right. All that section 59-40 of the ITAA 1997 requires is that a right to acquire shares be issued to the taxpayer. Whether that right is exercised or is capable of being exercised is irrelevant for the application of section 59-40.	The Commissioner does not accept that Incapable shareholders can be distinguished from Ineligible shareholders. A shareholder who is not permitted to exercise rights or to transfer them to someone who can exercise them is a shareholder without rights. Under the Scheme arrangement (Scheme) described in paragraph 2 of the Ruling, ineligible shareholders do not receive Entitlements, either directly or indirectly through a nominee. Details why the Commissioner does not accept the alternative view is explained in paragraphs 143 to 163 of the Alternative Views section of the Ruling. However, where rights can be assigned by or for a shareholder, the shareholder does have the rights even if the shareholder is themselves precluded from directly exercising them. This does not occur in the cases to which this Ruling applies. It may occur where rights are able to be assigned, and where those rights will be sold for the shareholder. The actual arrangements in *McNeil* illustrate how, apart from Retail Premium cases, assignable rights may be arranged to be sold on behalf of shareholders who do not, or cannot, exercise them or who do not get them.

Issue No.	Issue raised	ATO Response/Action taken
	The alternative view also submits that all shareholders are issued Entitlements directly or indirectly (via a nominee). The Corporations Law does not prevent the company from issuing rights even in respect of the Incapable shareholders.	
6.	**The position adopted in TR 2010/D8 creates considerable uncertainty as to the meaning of 'share capital' for the purposes of the tax laws. The position goes beyond the well established commercial and legal meaning of 'share capital'.** Also, it is not accepted that the company receives the entire Clearing Price and there is no basis to conclude that this proposition is endorsed or supported by the decision in the *St George* case. In adopting this position, the Commissioner has created real uncertainty for taxpayers when dealing with the equity accounts of the company. There is the risk for companies that there will be other instances where the Commissioner will form the view that a transaction involves 'share capital' of a company, in circumstances where that is not so in a commercial or legal sense.	The meaning of 'share capital' as stated in the Ruling is entirely consistent with the commercial and legal meaning of the term. This is explained in detail at paragraphs 31 to 50 of the Explanation section of the Ruling along with case authority supporting this view. The reasons why the Commissioner is of the view that the entire Clearing Price is share capital of the company are also explained at paragraphs 31 to 50 of the Explanation section of the Ruling. The Full Federal Court case of *St George* is also directly relevant; it endorses and applies previous case authority as to what constitutes share capital. In the quote in paragraph 41 of the Explanation of the Ruling Perram J in *St George* stated: *'The 'capital' of the company is the money or money's worth derived by the company from the issue of shares: Re The Swan Brewery Co Ltd (1976) 3 ACLR 164 at 166 per Gillard J.* There is no suggested legal sense in which the meaning of 'share capital' excludes any part of the consideration provided for the issue of shares by a company. Any suggested commercial meaning of 'share capital' would exclude so much of the proceeds of an equity raising as is committed by the company to be applied in some way. There seems no consistent commercial meaning that would exclude so much of the proceeds as is the basis of a Retail Premium, while including so much of the proceeds as is the basis of clearing a debt or committed to some other obligation.

<table>
<tr><th>Issue No.</th><th>Issue raised</th><th>ATO Response/Action taken</th></tr>
<tr><td>7.</td><td> The draft Ruling relies on too wide an application of the definition of ‘share capital account’ as defined in section 975-300 of the ITAA 1997.
The definition of share capital account in section 975-300 of the ITAA 1997 was introduced by the Tax Laws Amendment (2006 Measures No 3) Act 2006. The definition was required to implement the share tainting provisions contained in Division 197 of the ITAA 1997.
When examining the share tainting provisions in Division 197 of the ITAA 1997, it is quite clear that the phrase ‘share capital account’ is restricted to the financial accounts kept by the company itself and in terms which are consistent with those accounts being only those on the balance sheet of that same company.
It is contended that the reference in section 197-5 of the ITAA 1997 to amounts being transferred to ‘a company’s share capital account from another of the company’s accounts’ and section 197-10 of the ITAA 1997 reference to transferred amounts ‘identified in the books of the company’ supports the above view.
It is contended that in the above context, the draft Ruling’s reasoning that ‘an entitlement of the company to an account’ or the accounts of another entity, are part of the share capital account of the issuing company is wrong.
Based on the above view, it is contended that section 975-300 of the ITAA 1997 ‘is correctly limited to the financial accounts of the relevant company’. </td><td> Section 975-300 of the ITAA 1997 does not permit a company to choose <u>not</u> to include share capital in the accounts which together constitute its share capital account.
The provision is a re-enactment of the cognate provisions which accompanied and formed part of the provisions relating to dividends paid out of capital from the introduction of such provisions. While section 975-300 of the ITAA 1997 does cover share tainting issues, its ambit is not limited to those provisions. This is evident in Item 30 of the Application provision of section 975-300 in the Tax Laws Amendment (2006 Measures No 3) Act 2006 which stated:
<blockquote>The amendments made by Divisions 1 and Division 2 apply for the purpose of determining whether an account is a share capital account when applying a provision of the Income Tax Assessment Act 1997 or the Income Tax Assessment Act 1936 in relation to a time that is after the commencement of the amendments, even if the account was in existence before that commencement [emphasis added].</blockquote>
It is the Commissioner’s view that the ambit of section 975-300 of the ITAA 1997 has to be determined by the clear wording of the actual provision itself and consistently with the ambit of the earlier provisions it re-enacts. Subparagraph 975-300(1)(b) of the ITAA 1997 makes clear that a share capital account is any account (whether or not called a share capital account) that was created to hold or credit share capital of the company.
It is submitted that the alternative view that section 975-300 of the ITAA 1997 should be ‘correctly limited to the financial accounts of the relevant company’ is contrary to the clear wording of section 975-300 and its EM. It promotes an interpretation of section 975-300 where inclusion in share capital accounts would be a nominal rather than factual matter. It is submitted such an interpretation would be inconsistent with the critical concept on which the provision depends.
The alternative view that section 975-300 of the ITAA 1997 should only be </td></tr>
</table>

Issue No.	Issue raised	ATO Response/Action taken
		based on the financial accounts as stated by the relevant company, is also contrary to clear judicial authority in Federal Court cases like *Macfarlane*, *Condell* and *Consolidated Media Holdings Ltd v Commissioner of Taxation* [2011] FCA 367 (*Consolidated Media*). Both *Macfarlane* and *Condell* support the principle that the formal accounts of a company may not necessarily reflect from the company's perspective, the true source of a dividend or distribution. The reasoning in the *Consolidated Media* case supports the Commissioner's position regarding the ambit of the definition 'share capital account'. Emmett J's judgment in *Consolidated Media* supports the Commissioner's position that a company cannot deny that accounts (even if these are not called a share capital account) that contain its share capital are part of its share capital account. The illustrative reasoning in this case is discussed in paragraphs 59 to 69 of the Explanation section of the Ruling.
8.	**Retail Premiums are not a dividend deemed to be paid out of profits, because the elements of subsection 6(4) are not satisfied.** Subsection 6(4) does not apply because: • The amount representing the Retail Premium is never paid or credited to the company; • The Retail Premium is never credited to the company's share capital account; • The company doesn't pay the Retail Premium to the shareholder; and • The Retail Premium amount is never debited from the company's share capital account.	All the elements of subsection 6(4) of the ITAA 1936, to deem Retail Premiums dividends despite the exclusion in paragraph (d) of the definition of ***dividend*** in subsection 6(1) of the ITAA 1936, are explained in detail at paragraphs 13 to 75 of the Explanation section of the Ruling. Paragraphs 123 to 142 of the Alternative Views section of the Ruling also address these elements. Also, if a distribution is not debited from the company's share capital account, the distribution would be paid by the company to its shareholders as such and would still constitute a dividend in any event for the reasons explained in paragraphs 82 to 90 of the Explanation section of the Ruling and Issue 21 of this Compendium.

<table>
<tr><th>Issue No.</th><th>Issue raised</th><th>ATO Response/Action taken</th></tr>
<tr><td>9.</td><td> Subsection 6(4) only applies to arrangements entered into for the purpose of exploiting distributions from a share capital account.
Subsection 6(4) of the ITAA 1936 can only apply to arrangements where there was a purpose by the company to exploit the tax concessions on distributions made from a share capital account.
This view is supported by both the EM to the Income Tax Assessment Bill (No 4) 1967, which introduced the original provision of subsection 6(4) of the ITAA 1936 [which dealt with share premiums, when there was a concept of nominal capital for shares] and also the EM to Taxation Laws Amendment (Company Law Review) Act 1998 (‘CLR Act’) which amended subsection 6(4).
The EM in the 1967 Act stated:
<blockquote>Subsections (4) and (5) are designed as a safeguard against special arrangements that may be entered into for the purpose of exploiting the proposed exemption of distributions out of share premium accounts. Very broadly, the provision will apply where a share premium account is created as part of a scheme for making a tax free distribution of money or other property to shareholders.</blockquote>
The EM in the CLR Act amendments in 1998 also stated:
<blockquote>1.105 Subsection 6(4) of the Act, an anti-avoidance rule, provides that the exclusion to the definition of a dividend in subsection 6(1) does not apply where, pursuant to an agreement or an arrangement, a company issues shares at a premium and then distributes those premiums to shareholders in the company. The rule prevents companies substituting profit distributions with preferentially-taxed share premiums.</blockquote></td>
<td> The Commissioner takes the position that there is no ‘purpose requirement’ under subsection 6(4) of the ITAA 1936 beyond the terms of the subsection.
The subsection was intended as a safeguard against certain arrangements that raise share capital from some shareholders to pay it to other shareholders. Those arrangements are ones in which the exclusion of distributions from share capital from income would be exploited. The Retail Premium arrangements to which this Ruling applies are such arrangements.
The subsection protects against these arrangements without employing a separate test of the conscious purpose of the arrangements. It applies wherever the stated objective elements are satisfied.
When the EM for the 1998 amendments describes the rule as an anti-avoidance rule, this does not state or imply that there is a separate test of purpose in or to be implied as a condition of the rule. The conversion of the original rule from its ‘share premium account’ form to the ‘share capital account’ form required on the abolition of the nominal capital concept did not state or imply any different meaning for the rule.
The reasons why the Commissioner does not accept the alternative view are explained further in paragraphs 164 to 170 of the Alternative Views section of the Ruling.
The Commissioner accepts that the ‘arrangement’ in subsection 6(4) of the ITAA 1936 is one which contemplates the common elements required by the subsection. These contemplated elements do not include, expressly or implicitly, a separate purpose of exploiting those combined elements in some unstated way. </td></tr>
</table>

Issue No.	Issue raised	ATO Response/Action taken
	*1.106 As a result of the Corporations Law changes that abolish the concept of share premiums and associated terms**, the amendments introduce an equivalent rule** to subsection 6(4) that applies to the share capital account. The rule will prevent companies entering into arrangements where a company raises share capital from certain shareholders and then makes a tax-preferred capital distribution to other shareholders. [Item 7 of Schedule 3; amends subsection 6(4)]* (Emphasis added). The above EM statements support the view that subsection 6(4) of the ITAA 1936 is only to apply to arrangements with a clear anti-avoidance purpose. Retail Premium arrangements are designed to raise share capital - not as an anti-avoidance scheme to provide shareholders with a tax benefit. Indeed, many companies entering into such capital raising arrangements may not have any profits or may show accrued losses. It is highly unlikely that a company in such circumstances will be undertaking a rights issue as a method of making tax preferred capital distributions to its shareholders within the ambit of subsection 6(4) of the ITAA 1936. The clear policy intent of subsection 6(4) of the ITAA 1936 can be discerned by relying just on the words of the legislation. The word 'arrangement' contemplates a series of non-random steps that have occurred in the way they have as the result of a conscious decision on someone's part. Accordingly, it is submitted that history and terminology of subsection 6(4) of the ITAA 1936 supports that the provision should be interpreted as only intended to apply to 'special' arrangements designed to provide tax benefits in the form of the special treatment of payments out of share capital. It is contended that the Commissioner's interpretation is contrary to what Parliament intended.	

Issue No.	Issue raised	ATO Response/Action taken
10.	**TR 2010/D8 creates an incentive for companies to undertake a rights issue under which the rights are tradeable on the ASX (rather than non-tradeable).** Not all companies will be in a position to offer shareholders tradeable rights and it may not be appropriate or desirable for some companies to offer such rights. The Draft Ruling interferes with the way capital is raised.	The Commissioner of Taxation is responsible only for the interpretation and administration of tax laws. Treasury has primary responsibility for advising on tax policy and the design of tax laws. The Commissioner is unaware of any technical reason precluding the issue of tradeable rights, or precluding the exclusion of some non-resident shareholders from rights issues. Should there be any technical reasons of this kind, their character and the proper policy response to them would be matters for government. The Treasury is responsible for issues of tax policy and legislative design.
11.	**ASX Listing Rule 7.7.1 subparagraph (c) and subsection 9A(3) of the *Corporations Act 2001* in respect of renounceable pro-rata issues or assignable rights require a nominee of the entity to arrange for the 'sale of entitlements' and to provide the 'net proceeds' of the sale (if any) to the holder.** Paragraph 19 of TR 2010/D8 asserts that the Retail Premium is not paid as consideration for Entitlement Rights. This assertion is not consistent with the ASX Listing Rules. Where a *rights issue* under section 9A of the *Corporations Act 2001* is not offered to some non-resident equity holders, the issue may be required to sell equivalent rights and pay the proceeds to the non-residents who were not offered rights (under paragraph 9A(3)(c) of the *Corporations Act 2001*). Accordingly no Retail Premium arrangements to which the Ruling would apply are made. Where this appears to be the case, rights must really be sold and the proceeds paid to the Non Participating Shareholders, because of the definition of a rights issue in the *Corporations Act 2001*.	ASX Listing Rule 7.7.1(c) and subsection 9A(3) of the *Corporations Act 2001* apply to renounceable or assignable rights. However, the Entitlement rights described in the Scheme section of the Ruling are not renounceable or assignable rights within the meaning of the listing rule and subsection 9A(3). Also, it is the Commissioner's view that Retail Premium amounts as described in the Scheme section of the Ruling **are not** paid as consideration for Entitlement rights. Even if the listing rule applies, Retail Premium arrangements do not involve the sale of entitlements for any shareholder and the payment of the net proceeds to the shareholder. A rights issue under section 9A of the *Corporations Act 2001* that is not offered to some non-resident equity holders must sell rights and pay the proceeds to the non-resident equity holders only where the rights are able to be assigned (under subparagraph 9A(3)(c) of the *Corporations Act 2001*). Retail Premiums are paid only where the entitlements are rights which cannot be assigned by or for the Non Participating Shareholders. The Ruling applies to Retail Premium arrangements whether or not they qualify as a rights issue under the *Corporations Act 2001*. Where they do not do so, this is not a reason to treat the arrangement as being made differently so as to qualify as such a rights issue.

Issue No.	Issue raised	ATO Response/Action taken
		For the above reasons, ASX Listing Rule 7.7.1(c) and section 9A of the *Corporations Act 2001* have no relevance to this Ruling about Retail Premium amounts.
12.	**The Draft Ruling's view that Retail Premiums are unfranked dividends will create practical difficulties.** Many companies have a history of paying fully franked dividends. This means many shareholders are accustomed to receiving dividends free of any Withholding Tax (WHT). The Commissioner's position will force companies to apply WHT to non-resident shareholders who have not provided a TFN to the company (as WHT does not apply to fully franked dividends). This will often require the company to provide some form of written communication to shareholders in order to explain an outcome which will generally be entirely unexpected.	It is standard for companies to advise shareholders of the franking status of any dividend paid in its distribution statement. Any company can pay unfranked (and unfrankable) dividends, whatever its history of paying franked dividends. Whether and how to communicate with non-resident shareholders is a matter for companies with Retail Premium arrangements.
13.	**The Draft Ruling's conclusion, that Retail Premiums if not a dividend are ordinary income, is incorrect.** TR 2010/D8 fairly describes the result in *McNeil* - that the item of income was the right granted to the taxpayer. But this does not support the view that the Retail Premium is an item of ordinary income. If *McNeil* is relevant at all, it suggests that the item of income in this instance should be the Entitlement. On this view it is a corollary of *McNeil* that the Retail Premium could not be an item of income. This is supported by the principle in *Abbott* v. *Philbin* [1961] AC 352 - if the grant of the option is the item of income, the exercise of the option and the acquisition of the share is an independent event which requires independent analysis. The High Court specifically did not address whether the cash received from sale of the 'put' right was income in *McNeil.* This is	The alternative view submits that if *McNeil's* case has relevance to an item of income, the relevant item of income is the Entitlement right and not the Retail Premium. The Commissioner does not accept the above argument because it is his view that Retail Premium rights are **different and separate** rights to the Entitlement rights (as explained in paragraphs 20 of the Explanation and paragraphs 143 to 163 of the Alternative Views section of the Ruling). Therefore the principles of *McNeil* and *Montgomery* are applied to Retail Premiums separately to whatever treatment *McNeil* may apply to the Entitlement rights which must have expired unexercised for a Retail Premium to arise. The Retail Premium is not a price paid for (or for the loss of) the Non Participating Shareholder's entitlement. It is for this reason that the alternative view's analysis, regarding the scope of *McNeil* and the implications of *Abbott v Philbin* [1961] AC 352 in

Issue No.	Issue raised	ATO Response/Action taken
	evident in their statement in paragraph 51 in *McNeil*, that as the sell back right was income at time of receipt, *'that conclusion makes it unnecessary to consider the income nature of the receipt of the proceeds on 2 April 2001.'* Paragraphs 69 to 71 of TR 2010/D8 make much of the fact that the Court decided that the rights in *McNeil* were not something that affected the capital structure. While correct, this observation is beside the point. The High Court was addressing an argument made by counsel for the taxpayer in *McNeil* that rights represented a partial realisation of the shareholder's investment and so were capital in character. The Court rejected that argument. But saying the rights were not capital in character does not mean that it was this same reason which made them income. What made them income was that they emerged from the Deeds Poll. This is supported by the High Court's statement in *McNeil* that 'The scheme took its life from the deeds poll executed on the record date.' So what matters is the nature of the rights granted to the taxpayer (or a trustee for the shareholder) under the documents which create them. This is why the High Court devoted so much attention to the direct legal effect of the Deeds Poll to create an identifiable item of property in the taxpayer. Also if *McNeil* is relevant, the amount of income would be the market value of the relevant right - not the actual cash collected. This is supported by the High Court statement in McNeil that 'there was a derivation of income by her represented by the market value of her rights of $514' *[McNeil at* paragraph 51]. McNeil does not support the conclusion that the receipt of the Retail Premium is ordinary income. Rather, if it leads anywhere, it leads to (i) the Entitlement being income, and (ii) this just invokes section 59-40 of the ITAA 1997 which (iii) makes it non-assessable non-exempt (NANE) income. *McNeil* tells nothing about the actual cash received.	relation to Entitlement rights and in relation to consideration for the disposal or loss of those rights, has no relevance to Retail Premiums. The Commissioner's reasons why Retail Premium payments are ordinary income are explained in paragraphs 91 to 105 of the Explanation of the Ruling.

<table>
<tr><th>Issue No.</th><th>Issue raised</th><th>ATO Response/Action taken</th></tr>
<tr><td>14.</td><td> Analysis on FCT v Montgomery.
An alternative view also argues that the High Court case of FCT v Montgomery [1999] HCA 34; (1999) 198 CLR 639; 99 ATC 4749; (1999) 42 ATR 475 (Montgomery) does not support Retail Premiums being ordinary income.
The alternative view argues that the Draft Ruling's quote extracted from Montgomery [TR 2010/D8 at paragraph 73; Montgomery at paragraph 117] stops just before the relevant passage. What made the lease incentive income in Montgomery was that the firm was exploiting its commercial position to advantage. Montgomery is all about the deliberate exploitation of a business asset:
<blockquote> 'the firm used or exploited its capital (whether its capital is treated for this purpose as being the agreement to take premises or its goodwill) to obtain the inducement amounts ' … and
'The firm used or exploited its capital in the course of carrying on its business, albeit in a transaction properly regarded as singular or extraordinary... [Montgomery at paragraph 118].' </blockquote>
The alternative view contends that the High Court's reasoning was: Freehills had an asset - size, reputation, goodwill which made them a desirable tenant. They were a business; they had a business asset; they put it to its best advantage – that is, they used it to extract a cash payment from the landlord.
This is completely unlike the position of the shareholders who passively collect a Retail Premium. This is the non-sequitur in TR 2010/D8. It says Montgomery involved a gain from an item of property [at paragraph 78]. That i true, but it is irrelevant. The gain that Montgomery made was (i) actively pursued and (ii) arose from a </td>
<td> The High Court in Montgomery did not limit its ratio only to business taxpayers (as opposed to passive investors). The key principle that the High Court stressed in Montgomery was that the exploitation of capital normally produces income (regardless of whether the capital was a business asset or passive investment). This is evident in Montgomery, where the High Court after positively referring to Eisner v Macomber (1920) 252 US 189 (Eisner) stated at 67:
<blockquote> What can be seen from the passage of Eisner v Macomber is that income is often the product of exploitation of capital. But of course, that is not always so. </blockquote>
The alternative view's quotations show that the firm in Montgomery used or exploited its capital to obtain the inducement amount it received, but here the Court only states what occurred on those facts, and this was never meant to restrict the general principles of either Eisner or Montgomery.
That the High Court never meant to limit the ratio of Montgomery only to business assets as opposed to passive investors, is evident in the High Court analysis in McNeil. In McNeil at paragraph 21, the High Court clearly applied the principles of Montgomery and Eisner to owners of passive assets:
Secondly, as a general proposition, a gain derived from property has the character of income and this includes a gain to an <u>owner who has waited passively</u> for that return from property. The question then becomes one whether, as the Commissioner contends, the rights enjoyed by the taxpayer arose and were severed from, and were a product of, her shareholding in SGL, which she retained. The metaphor of severance and like expressions were used by Pitney J in Eisner v Macomber in a passage accepted in FCT v Montgomery as identifying the core meaning of 'income' where the character of a gain associated with property is at stake [emphasis added]. </td></tr>
</table>

Issue No.	Issue raised	ATO Response/Action taken
	business asset. *Montgomery* tells you nothing about (i) a passive receipt from (ii) an asset held as an investment outside the business context. It is contended that *Montgomery* is all about a business taxpayer who actively pursues an amount of cash by exploiting one of their business assets. It has nothing to say about a passive investor.	The above analysis demonstrates that the alternative view is clearly inconsistent with the High Court judgments in both *Montgomery* and *McNeil*. Accordingly, if Retail Premiums are not dividends, these amounts are ordinary income for the reasons stated in paragraphs 91 to 105 of the Explanation section of the Ruling.
15.	**If it is held that Retail Premiums are separate rights from Entitlement rights and ordinary income under *McNeil's case*, the market value of this right may be negligible at time of receipt.** Assuming the Retail Premium right was assignable (without the Entitlement), what would an arms length purchaser pay for a right to a Retail Premium which is only valuable in the event that the Entitlement is not exercised? It is submitted that any right to the Retail Premium only becomes valuable upon the lapsing of the Entitlement.	A right to a Retail Premium only arises when the Clearing Price, of the equivalent shares offered under the Bookbuild process, achieves a price higher than the Offer Price. If this occurs, the right arises and the market value of the Retail Premium right would accordingly be the same as the Retail Premium payment received.
16.	**In situations where Entitlements are tradeable, a taxpayer may obtain Entitlement rights without any underlying share ownership. In such situations the taxpayer may never become a shareholder.** It is submitted the above situation supports the conclusion that the Retail Premium is not the product of the shares but rather consideration for the disposal of the Entitlement rights, whether that be the shareholder to whom the Entitlements were issued or a purchaser of those Entitlements.	The Scheme in the Ruling does not cover arrangements involving transferable or tradeable Entitlement rights. The tax implications for such arrangements would be dependent on the specific facts of each case. When Entitlements are transferable or tradeable, by or on behalf of the shareholder, a Retail Premium will not be paid. The shareholder can access the value of the Entitlement by transfer. Where a Retail Premium arrangement depends on the total consideration provided for the issue of equivalent shares, those shares might be described as issued on exercise of an Entitlement, which is sold only where it is immediately exercised. No such cases have been identified to the Commissioner.

Issue No.	Issue raised	ATO Response/Action taken
17.	**Right to Retail Premium not a separate CGT asset** The CGT analysis in TR 2010/D8 depends entirely on the view that the relevant CGT asset is the right to the Retail Premium [paragraph 8]. So, a capital gain is said to be made when the right to the Retail Premium expires in exchange for a payment. It is submitted that under the Retail Premium arrangement described in the Ruling, there is no separate CGT asset owned by the Entitlement holder. In these transactions, the relevant contract is the agreement between the issuing company (the Company) and the underwriter, usually called the underwriting agreement. The underwriter gives a contractual undertaking **to the Company** that it will pay the excess of the Book Build Price over the Offer Price to the Non Participating Shareholders. But this does not create a contractual right in the shareholders to receive the Retail Premium. Because of privity of contract, there is no right *per se* that the Non-Participating Shareholders have against either the company or the underwriter. In the event of non-performance by the underwriter, the shareholders may have a claim against the Company in relation to the disclosure in the booklet given to shareholders. However, such a claim would not exist at the time the Entitlements are issued.	Under the Scheme to which this Ruling applies, Non Participating Shareholders are entitled to a Retail Premium only when, upon completion of the issue of equivalent shares (such as under a Retail Bookbuild), it is determined that the Clearing Price is greater than the Offer Price (or other applicable measure) and a Retail Premium is payable. This right is an intangible CGT asset under section 108-5 of the ITAA 1997. The right to receive the Retail Premium is satisfied upon payment.
18.	**Entitlements the most relevant asset for the purpose of analysing the CGT implications of Retail Premium arrangements** There may be Rights Issues involving a Retail Premium where the obligation to pay the Retail Premium arises under a Deed Poll (as in *McNeil*). However, even if this were the case it is submitted that it is appropriate in these circumstances to adopt the 'underlying asset' or a look through approach' explained in Taxation Ruling TR 95/35	It is the Commissioner's view that Retail Premium rights are different and separate rights to Entitlement rights for the reasons stated in paragraph 20 of the Explanation section and paragraphs 143 to 163 of the Alternative Views section of the Ruling. Therefore the arguments put forward in the Alternative view have no relevance. The Scheme in the Ruling does not involve non-resident shareholders who are ineligible to receive Entitlements having those Entitlements being sold on their behalf via a nominee entity. Under the Scheme in the Ruling,

Issue No.	Issue raised	ATO Response/Action taken
	(concerning treatment of compensation receipts). This alternative view contends that the main reason companies enter into Retail Premium arrangements is to 'look after' unsophisticated shareholders who might otherwise allow their Entitlements to lapse and be disadvantaged by the dilutory effect of the Entitlement offer. The essence of the Retail Premium is compensation for the disposal of the Non Participating Shareholders' Entitlements. It is submitted that there is a clear '*link*' (refer paragraph 82 of TR 95/35) between the receipt of the Retail Premium and the disposal of the Entitlements, thereby making the Entitlements (and not any right to the Retail Premium) the '*most relevant asset*' for the purpose of analysing the CGT implications of the Retail Premium arrangements. It is submitted that it is even clearer that this approach is appropriate in the case of non-resident shareholders who are ineligible to exercise Entitlements and the Entitlement offer is made under section 708AA of the *Corporations Act 2001* (this section deals with rights issues that do not need disclosure [i.e. a prospectus]). An Entitlement offer must comply with section 9A of the *Corporations Act 2001*. Subparagraph 9A(3)(c) of the *Corporations Act 2001* authorises assignable Entitlement rights to be sold on behalf of non-resident shareholders by a nominee entity. From the foregoing, it is evident that the Entitlements that would be offered to ineligible shareholders are required to be issued to the nominee and then sold on their behalf with any excess over the Offer price to be paid to the ineligible shareholders. Any cash emanates from the disposal of the Entitlements and no other asset.	no entitlements are given to ineligible non-resident shareholders that can be exercised by or for them or that can be sold by or for them. The Scheme in the Ruling does not involve a rights issue to which subparagraph 9A(3)(c) of the *Corporations Act 2001* applies, as it does not involve rights which can be transferred or assigned.

Issue No.	Issue raised	ATO Response/Action taken
19.	**The Ruling should explicitly state that it does not apply to Entitlement offers which are legally and commercially different to the arrangement described in the Ruling, including the following arrangements:** • where Entitlements for Non Participating Shareholders: - do not lapse but are sold on their behalf by the Lead Manager/underwriter via the Bookbuild; - the company issues a number of shares (equivalent to those that would have issued under the Unexercised Entitlements), to third parties who acquire the Unexercised Entitlements at the Offer Price; - the amount paid by the third parties (the Clearing Price) is paid for both the acquisition of the Unexercised Entitlements and the Offer Price for the issue of the equivalent shares; and - where the Clearing Price exceeds the Offer Price, a payment based on the excess is made by the Lead Manager/underwriter to the shareholders who had Unexercised Entitlements for which the equivalent shares were issued. • Entitlement offers undertaken by trusts and Stapled Groups.	The Scheme described in the Ruling does not cover Entitlements that are tradeable or Entitlement offers undertaken by trusts or Stapled Groups. The tax consequences for these or other arrangements (and whether the principles stated in the Ruling would apply to them) would be dependent on the specific facts of the actual arrangement. Advice on specific arrangements can be obtained by requesting either a class or private binding ruling. Retail Premiums are not paid where Entitlements which do not lapse are sold on behalf of the shareholder, to purchasers who may then exercise the Entitlements or not as they choose. Where third parties offer the Clearing Price as consideration for the issue to them of the equivalent shares, and the Retail Premium is payable depending on the amount of the Clearing Price, the Ruling applies whether the Retail Premium is paid directly by the company, is paid by the company's share registry service, or is paid by an underwriter/Lead Manager.
20.	**The Retail Premium received by the Non Participating Shareholders is not a gain, but compensation for the loss in underlying value of their asset - their shares in the company.** *McNeil's* case did not seek to overturn the previously accepted treatment of rights and bonus shares. It is contended that the Non Participating Shareholders existing shares is not unchanged - their rights to share in the future profits of the company have been	It is the Commissioner's view that the shares sold under the Bookbuild process are assessable dividends for the reasons stated in paragraphs 13 to 30 in the Explanation section of the Ruling. The Commissioner does not agree with the contention that the Non Participating Shareholders shares have been changed by the issue of the equivalent shares under the Bookbuild process (or that the shares of participating shareholders are changed by the issue of additional shares to them at their call). Nor does the Commissioner agree that the sale of

Issue No.	Issue raised	ATO Response/Action taken
	reduced. A rights issue that is taken up has the economic character of a bonus issue plus a (subsequent) issue for full value. An issue for full value cannot give rise to a gain or loss for existing shareholders, whereas a bonus issue is merely a rearrangement of the existing share capital and likewise does not give rise to a gain. A question only arises when part of the rights is sold to a third party - but in that case the amount received by the shareholder is effectively a partial sale of their shareholding since they have given up part of their rights to share in future profits of the company. It is agreed that when the Entitlement rights lapse (at the time the Entitlement offer closes), section 59-40 of the ITAA 1997 does not apply to the shares issued in substitution for the rights and sold in the Bookbuild (or in the market). However it is still the case that the shares issued to the underwriter or another nominee for the benefit of the excluded (or Non Participating) shareholders are issued in compensation for the loss in value of the original holding. Since the loss will eventually be brought to account for CGT on sale of the holding, it seems illogical to suggest that the corresponding gain on the shares issued in substitution for the rights should be taxed as income and not as a capital gain.	Entitlement rights is effectively a partial sale of their shareholding 'since they have given up part of their rights to share in future profits of the company.' The issue of shares to new shareholders, without any issue of Entitlements, does not change the shares of existing shareholders, however it may affect their value. *McNeil's* case made clear that there was no sound analogy between bonus shares and cases where shareholders receive gains severed and detached from their existing shareholding. A rights issue is not a bonus issue. Under the Scheme described in the Ruling, the Non Participating Shareholders receive a gain (the Retail Premium payment) which is severed and detached from their existing shareholding. Details of why the principles stated in *McNeil* and *Montgomery* apply to the Scheme described in the Ruling, is in paragraphs 91 to 105 in the Explanation section of the Ruling. Whether capital gains and losses should have the same tax consequences as economically equivalent revenue gains and losses involves difficult questions of tax policy. The tax law does not presently treat these gains and losses alike.
21.	**If a Retail Premium payment is a dividend, it is not paid out of profits.** This view asserts that the retained earnings of an issuing company are not affected in any way by the payment of the Retail Premium to the Non Participating Shareholders and therefore that no amount is debited to or against the profits of the company. Accordingly based on the above analysis, Retail Premiums cannot be assessable dividends under section 44 of the ITAA 1936.	For the reasons stated in paragraphs 13 to 75 of the Explanation section of the Ruling it is the Commissioner's view that Retail Premium payments are dividends debited against an amount standing to the credit of an issuing company's share capital account. Distributions (which are not Retail Premiums) from the company to its shareholders not debited from its share capital account, are dividends paid out of profits. Such dividends may be frankable. If distributions are not paid from an issuing company's share capital, or if they are paid out of share capital which has not been debited against an

Issue No.	Issue raised	ATO Response/Action taken
		amount standing to the credit of a company's share capital account, these payments would still be dividends under subsection 6(1) of the ITAA 1936 as these are: • distributions made by the company to any of its shareholders, whether in money or other property (subparagraph 6(1)(a) of the ITAA 1936); and • any amounts credited by a company to any of its shareholders as shareholders (subparagraph 6(1)(b) of the ITAA 1936). Distributions paid to shareholders out of share capital, but not from the company's share capital account, could **not** fall under the exemption in subparagraph 6(1)(d) of the definition of dividend in the ITAA 1936, as the share capital distributed would not be debited against the credit of the company's share capital account, a precondition of that exemption from being a dividend. **Company distributions to shareholders not debited from share capital account are dividends paid out of profits** Company distributions to shareholders not paid out of share capital or if paid out of share capital which has not been debited against a company's share capital account, are paid from profits derived by the company and therefore are assessable dividends under subsection 44(1) of the ITAA 1936. Taxation Ruling TR 2003/8 Income tax: distributions of property by companies to shareholders - amount to be included as an assessable dividend (TR 2003/8) and relevant case law explain why such distributions are dividends from the profits of the relevant company. Paragraph 4 of TR 2003/8 states: The amount of a dividend in respect of a distribution of property (including shares held by a company in another company) to a shareholder in their capacity as a shareholder will be the money value of the property at the time it is distributed, reduced by the

Issue No.	Issue raised	ATO Response/Action taken
		amount debited to a share capital account of the distributing company in respect of the distribution. Paragraphs 6 to 8 of TR 2003/8 then state: 6. In the case of a resident shareholder the amount by which the money value of the property exceeds the amount debited to the share capital account will be included in the shareholder's assessable income to the extent that the dividend is paid (or taken to be paid) out of profits derived by the company. 7. In the case of a non-resident shareholder the amount by which the money value of the property exceeds the amount debited to the share capital account will be included in the shareholder's assessable income to the extent that the dividend is paid (or taken to be paid) out of profits derived by the company from an Australian source, unless a double tax treaty provides for a different result in the circumstances of the taxpayer. (Usually such treaties substitute a different test based on effective connection with a permanent establishment in Australia.) 8. For the purposes of paragraphs 6 and 7, the dividend is paid out of profits derived by the company if, immediately after the distribution of property, **the market value of the assets of the company exceeds the total amount (as shown in the company's books of account) of its liabilities and share capital. In addition, if the dividend described in paragraphs 6 and 7 is a repayment by a company of an amount paid-up on the share, the dividend is taken to be paid out of profits derived by the company** (emphasis added)**.** TR 2003/8 supports the view that company distributions to shareholders that are not paid out of share capital, or that are paid out of share capital which has not been debited from a company's share capital account, are

Issue No.	Issue raised	ATO Response/Action taken
		assessable dividends paid out of profits derived by the company under subsections 6(1) and 44(1) of the ITAA 1936. If a dividend is not debited against a company's share capital account it can only derive from net assets of the company other than the share capital. If a company makes a distribution to its shareholders from its net value, the distribution can only be from share capital or from profits. As paragraph 13 of TR 2003/8 states: In most cases a company which distributes property to its shareholders and debits part of the value of that property to its share capital account would debit the remaining part to another account or reserve. Where that account or reserve does not represent share capital, it would, for subsection 44(1) purposes, represent profits derived by the company so that the amount debited to it would be included in the shareholder's assessable income under that subsection. The term 'profits' has a wide meaning and scope, based on the definition provided by Fletcher Moulton LJ in *Re Spanish Prospecting Company* [1911] 1 Ch 92 (*Spanish Prospecting*) at 98: 'Profits' implies a comparison between the state of a business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates. The above definition of the term 'profits' from *Spanish Prospecting* was applied in the Full Federal Court case of *MacFarlane v. Federal Commissioner of Taxation* (1986) 13 FCR 356; 86 ATC 4477; (1986) 17 ATR 808 (*MacFarlane*). *MacFarlane* also affirmed that that the term 'profits' was not limited to the accounting or Corporations Law's concept of that term. To quote Fisher J in *MacFarlane* at ATC 4483: There are in my opinion a number of indications in the Act which

Issue No.	Issue raised	ATO Response/Action taken
		confirm my view that there is no justification for attributing a narrow or accounting meaning to the word 'profits'. Paragraph 14 of TR 2003/8 states: When determining a shareholder's liability to income tax it is not necessary that the company has met all of the relevant accounting formalities….However, for taxation purposes the existence of profits does not depend on their recognition in the books of the company: see Latham CJ in *Dickson v. FCT* (1940) 62 CLR 687 at 705 to 706. In determining whether there are profits, paragraph 15 of TR 2003/8 states: There does not need to be a formal debiting of an account of profit of the company. So long as the market value of the company assets exceeds the total amount (as shown in its books of account) of its liabilities and share capital what remains is profits. **If the distribution is not debited to share capital the distribution is one of profits** (emphasis added). Paragraph 18 of TR 2003/8 reiterates the above point for distributions not paid out of share capital or paid out of share capital and not debited against a company's share capital account: This approach, when applied to a company that distributes property whose value is greater than the amount debited to the share capital account, will have the following consequence. The excess (which is a dividend) will be paid out of profits for the purposes of subsection 44(1) provided that immediately after the distribution the market value of the assets of the company exceeds the total amount (as shown in its books of account) of its liabilities and share capital. In such a case the only source of the dividend will be the company's earnings or an increase in its assets (that is, profits).

Issue No.	Issue raised	ATO Response/Action taken
		If a company receives consideration such as under a Bookbuild process on the basis of which amounts will be paid, which is not share capital, then these amounts would be profits of the company (as these amounts would increase the market value of the company compared to its liabilities and share capital (that is credited to the company's share capital account). When a company distributes the consideration, these payments would be assessable dividends under subsections 6(1) and 44(1) of the ITAA 1936 as they would be paid out of those profits. The view that distributions which are not debited from a share capital account are of profits is also supported by the dissenting judgment of Kitto J in the High Court case *of Federal Commissioner of Taxation v. Uther* (1965) 112 CLR 630; (1965) 13 ATD 542 (*Uther*). *Uther's* case involved a company that did a capital reduction by cancelling some of its shares. As part of this capital reduction, the company paid the taxpayer shareholder £32,288 in respect of the cancellation of 2,244 shares (which had a paid up value of £2,244). The Commissioner included the difference between the amount received by the taxpayer for the cancellation of their shares (£32,288) and its paid up value (£2,244), namely £30,044 as an assessable dividend under subsection 44(1) of the ITAA 1936. The issue in *Uther* was whether the excess amount of £30,044, which was not debited from the company's share capital account, was an assessable dividend paid out of the company's profits to its shareholder under subsection 44(1) of the ITAA 1936. In *Uther*, Kitto J's view was that the excess amount clearly was from the company's profits and therefore was an assessable dividend under subsections 6(1) and 44(1) of the then *Income Tax and Social Services Contribution Assessment Act 1936-1962*. In his judgment Kitto J stated at CLR 637: Indeed it seems obvious that the moneys distributed on the reduction of capital, so far as they exceeded the amount paid up on the cancelled shares, consisted of profits which the company

Issue No.	Issue raised	ATO Response/Action taken
		had derived. Whether capital profits or trading profits it is not material to inquire. The fact that the excess was not distributed separately from the share capital returned does not seem to me a ground for saying there was not a distribution of the excess out of profits within the meaning of s44(1). Kitto J also stated that in determining whether an amount received by a shareholder is an assessable dividend, one had to examine whether the relevant amount had a profit character from the company's viewpoint. Kitto J explained this at CLR 639: The criterion for the inclusion of a shareholder's receipts from the company is no longer the 'dividend' character of the receipts, that is to say their income character when considered from the shareholder's point of view; it is the profit character – from the company's point of view – of the source from which distributions should be made. However, Kitto J's judgment was not accepted by the majority (Taylor J and Menzies J) in *Uther*. Taylor J stated that the facts in *Uther* were essentially 'indistinguishable' from the facts in the earlier High Court case of *Federal Commissioner of Taxation v. Blakely* (1951) 82 CLR 388; (1951) 9 ATD 239 (*Blakely*) and that he supported the views expressed by Fullagar J in that case. Blakely's case involved shareholders in a company who, without putting the company in liquidation, had paid off its external liabilities and appropriated the company's remaining assets without any company resolution or any other legal formality. After taking over the company's business under a new partnership structure, the shareholders later had the company dissolved. The issue in Blakely was whether the appropriation of the company' assets by the taxpayer shareholder and his wife was a distribution by the company which was an assessable dividend under subsection 44(1) of the ITAA 1936. Fullagar J in *Blakely* stated that even if the taxpayer's appropriation of the

Issue No.	Issue raised	ATO Response/Action taken
		company's assets was a dividend under subsection 6(1) of the ITAA 1936, it was not a dividend derived out of the company's profits (and therefore was not an assessable dividend under subsection 44(1) of the ITAA 1936). At CLR 406-407 Fullagar J stated: I would not be prepared to deny that there was a 'distribution' in this case. There was clearly a 'distribution' in Stevenson's Case. But the point in this case is, as it was in Stevenson's Case, as to the nature of the receipt. There was not a distribution of profits, or a distribution out of profits. There was no detachment or severance from the funds of the company of money or other assets as representing a profit made by the company. There was simply a realization of a share investment (per Starke J in Thornett's Case). ….There is, in my opinion, nothing in the Act which gives the character of income to this receipt, which was according to general principles a capital receipt. In *Uther*, Taylor J based his view largely on Fullagar's J judgment in *Blakely* and argued that even if the distribution in *Uther* was a dividend under subsection 6(1) of the ITAA 1936, it would not be a dividend paid out of profits derived by the company. On this basis the distribution was held not be an assessable dividend under subsection 44(1) of the ITAA 1936. At CLR 642 Taylor J stated: On the assumptions which I have made it is true that the respondent received from the company by way of dividend as defined the sum of £30,044 but, in my view, it is impossible to say that this amount was paid out of profits derived by the company. It was, to adopt the language of Dixon CJ in *Parke Davis & Co v. Commissioner of Taxation*, received in partial distribution of a mass of assets which, although in a colloquial sense they contained profits, was a distribution of capital. The point which *Blakely Case* made was that, although, in the case of distribution

Issue No.	Issue raised	ATO Response/Action taken
		by a liquidator, s47 carried the matter as far as deeming such distributions to a limited extent to be dividends paid out of profits derived by the company, in the case of distributions of the character now under consideration, no provision of the Act takes this final and essential step. Menzies J in *Uther* held that the entire distribution of £32,288 received by the shareholder (both the amount debited from the share capital account and the excess amount that was not) was a *'return of paid-up capital or payment off of share capital'* and therefore was not a dividend, as it fell within the exemption words of the definition of dividend in subsection 6(1) of the ITAA 1936 (as it was then defined). That exemption no longer applies. Although Kitto J's view in *Uther* was a dissenting judgment, his view found unanimous support in the later Full High Court case of *Slater*, where Gibbs J (whose judgment was supported by the other justices) stated at CLR 457: In *Federal Commissioner of Taxation v. Uther*, Kitto J, in his dissenting judgment, advanced a criticism of the judgment of Fullagar J, which, with all respect, I find compelling. Gibbs J in *Slater* later stated at CLR 458: There were two possible grounds for holding that the distributions in *Federal Commissioner of Taxation v. Blakely* and *Federal Commissioner of Taxation v. Uther* were not assessable income. The first, which appears to have been accepted by Fullagar J, in the earlier case, is that the receipt in the hands of the shareholder was capital in nature, representing as it did, the value of the shareholder's interest in the company. **However, as I have already said, Kitto J pointed out in *Federal Commissioner of Taxation v. Uther* that to take that view would be to disregard the words of the Act. The second possible ground was that**

Issue No.	Issue raised	ATO Response/Action taken
		> **the distribution was not made out of profits. The fact that a distribution is itself of a capital nature does not mean that it did not have its source in profits,** that proposition was recognised as correct by Lord Reid in Staffordshire *Coal and Iron Ltd v. Brogan* and is consistent with the language of Dixon CJ in *Park Davis & Co v. Commissioner of Taxation*, but in any case is not novel [emphasis added]. While Gibbs J in *Slater* stated at CLR 459 that it was 'unnecessary finally to decide whether the reasons given by the majority in *Federal Commissioner of Taxation v. Blakely* and *Federal Commissioner of Taxation v. Uther* were in all respects correct', his comments (endorsed by the rest of the High Court) casts doubt on whether the views expressed by the majority in *Uther* and Fullagar J in *Blakely* are now determinative of this issue (paragraph 14 of TR 2003/8). Gibbs J and the rest of the High Court also stated that the wide definition of profits by Fletcher Moulton LJ in *Spanish Prospecting* while 'not of universal application, and that each case must depend on its own circumstances' was a 'starting point' and 'guide' in relation to determining whether an amount was profits. Given the High Court's support (in *Slater's* case) for the dissenting judgment of Kitto J in *Uther* and the wide profit test enunciated by Moulton LJ in *Spanish Prospecting*, it is the Commissioner's view that dividends paid (whether or not debited from a company's share capital account) would be sourced from profits of the company and therefore would be assessable dividends paid out of profits under subsection 44(1) of the ITAA 1936. **Dividend from share capital is deemed to be paid out of profits by subsection 44(1B)** If a dividend from share capital that is not debited against a share capital account is not actually paid out of profits, it is the Commissioner's view

Issue No.	Issue raised	ATO Response/Action taken
		that paragraph 44(1B)(b) of the ITAA 1936 would also apply to deem the dividend to be paid out of profits. Paragraph 44(1B)(b) of the ITAA 1936 is a deeming provision which states Where: (b) a dividend paid by a company is a repayment by the company of an amount paid-up on a share; the dividend shall, for the purposes of this section, be deemed to have been paid by the company out of profits derived by it. Paragraph 44(1B)(b) was specifically inserted into the ITAA 1936 in 1967, to overcome the decision in Uther (before the majority decision in Uther was criticised by the later High Court case in *Slater*). This was explained in pages 6-7 of the Explanatory Memorandum to the Income Tax Assessment Bill (No. 4) 1967: Broadly stated, the present definition provides that a 'dividend' includes any amount paid, credited or distributed by a company to its shareholders but does not include a 'return of paid-up capital'. The definition was recently considered by the High Court in the case of the Commissioner of Taxation v. Uther. In that case a company reduced its capital by cancelling part of its paid-up capital and distributed to its shareholders amounts very much in excess of the amount by which the nominal paid-up capital was reduced. The Court decided that no part of the amount distributed to the shareholders was liable to tax. ….The proposed amendments are designed to overcome the anomaly in the law revealed by the Court's interpretation of it [in Uther]. Broadly, the effect of the new provisions will be to tax in the hands of shareholders of a company so much of any distribution made in consequence of a reduction of the nominal paid-up capital of the company as exceeds the amount by which that capital is actually reduced. The amount of the nominal

Issue No.	Issue raised	ATO Response/Action taken
		> paid-up capital returned to shareholders will not be taxed [insertion added]. Dividends paid by a company to its shareholders out of share capital which has not been debited against its share capital account would come within paragraph 44(1B)(b) of the ITAA 1936 as these payments: • would fall under the definition of dividend under subsection 6(1) of the ITAA 1936 – as a distribution or an amount credited by a company to its shareholders; and • would constitute a repayment by the company of an amount paid-up on a share. Uther's case made clear that the term 'repayment' by a company of an amount paid up on a share simply means a return of paid up capital by the company to its shareholders, not only a return to a particular shareholder of an amount actually paid up by that shareholder. This was supported by the judgment of Kitto J in Uther where he stated at CLR 635: > The expression 'a return of paid-up capital' has no special technical legal meaning, and as a matter of English it means a repayment of capital paid up. ….The expression in the Companies Act 1958 (Vict), s53(1)(b)(ii), is not 'return' but 'pay off'; but I see no difference between them. Nor, apparently, did Lord Radcliffe in Ex parte Westburn Sugar Refineries Ltd. Menzies J in *Uther* also confirmed that any payment of share capital by a company back to its shareholders, which is not debited from its share capital account, would still be considered a repayment or a return of capital by the company to its shareholders. This is evident in his judgment in *Uther* at CLR 643 when he said: > Indeed, it is common enough to refer to **all** that a shareholder receives in a reduction of capital as 'returned capital' **even in a case where what is received exceeds the nominal amount**

Issue No.	Issue raised	ATO Response/Action taken
		> **whereby his share are reduced:** *Ex parte Western Sugar Refineries Ltd*. See too *Archibald Howie Pty Ltd v. Commissioner of Stamp Duties (N.S.W.)* [emphasis added]. Later at CLR 644, Menzies reiterated his point when he said: > A return of paid-up capital or a payment off of share capital-whichever form of words used- is of course, a distribution by a company to its shareholders but, **whether or not what is distributed exceeds the nominal amount by which capital is reduced, there is always but a single distribution and all that is distributed has the one character, viz. a return of paid-up capital or a payment off of share capital** [emphasis added]. Kitto J in *Uther* also stated that the source of the excess payment was: > …so far as they exceeded the amount paid up on the cancelled shares, consisted of profits which the company had derived. Whether capital profits or trading profits it is not material to inquire. The fact that paragraph 44(1B)(b) of the ITAA 1936 is meant to capture returns of capital not debited from a share capital account, even if this capital is from a composite amount containing profits, is made clear in pages 16-17 of the Explanatory Memorandum to the Income Tax Assessment Bill (No. 4) 1967: > The proposed new subsection (1B) is designed to ensure that the new definition of dividend proposed by clause 4 is effective for the purposes of section 44(1) of the Principal Act. If, on a reduction of capital an amount of the distribution to shareholders is a dividend under the new definition, that amount will be deemed by subsection (1B) of section 44 to be paid out of profits of the company. **In the absence of this provision it might be argued that, although the amount was a dividend as defined,**

Issue No.	Issue raised	ATO Response/Action taken
		section 44(1) was not effective for the purpose of including the amount in the assessable income of the shareholder because, technically, it had been paid as a composite sum including the nominal paid-up capital returned to shareholders. Accordingly, it is the Commissioner's view that if a company distributes a dividend to its shareholders, from share capital that has not been debited from its share capital account, the dividend would be considered a repayment of an amount paid-up on a share (assuming the share has a paid-up amount). Such dividends will be deemed to be paid out of profits under subparagraph 44(1B)(b) of the ITAA 1936 and therefore would be assessable dividends under subsection 44(1) (see similar analysis in paragraph 19 of TR 2003/8). **Dividend deemed to be paid out of profits under subsection 44(1A) of the ITAAA 1936** If a dividend that is not debited against a share capital account, is not actually paid out of profits, it is the Commissioner's view that subsection 44(1A) of the ITAA 1936 would also apply to deem the dividend to be paid out of profits (and therefore be an assessable dividend under subsection 44(1) of the ITAA 1936). Subsection 44(1A) of the ITAA 1936 is a deeming provision which states: For the purposes of this Act, a dividend paid out of an amount other than profits is taken to be a dividend paid out of profits. Subsection 44(1A) was inserted into the ITAA 1936 by the *Corporations Amendment (Corporate Reporting Reform) Act 2010*, as a result of changes to the definition of dividend in the *Corporations Act 2001*. Subsection 44(1A) applies to dividends declared on or after 28 June 2010.

Issue No.	Issue raised	ATO Response/Action taken
22.	**Application date and penalties** This alternative view contends that the views of the Ruling are novel, controversial and unanticipated by most corporates and their advisers. In particular, the ATO view on the application of subsection 6(4) of the ITAA 1936 was unexpected and inconsistent with past practice. Until the issue of Taxpayer Alert 2009/11 in May 2009, most corporations and tax professionals were of the view that Retail Premium payments were on capital account. Based on the above, it is therefore submitted that: • The Ruling should only apply to share entitlement offers that were completed after the May 2009 Taxpayer Alert. Alternatively, if the Ruling is to apply to share entitlement offers before the issue date of the Final Ruling, it is submitted that: • There should be full penalty remissions. In particular shareholders who choose to amend their tax returns to comply with the Final Ruling should be able to do so without penalties; and • Companies which did not withhold tax from payments to non-residents should not be subject to penalty under section 16-30 of the *Taxation Administration Act 1953* (TAA) or it should be remitted in full under section 298-20 of the TAA.	The views expressed in the Ruling are consistent with past practices of the Commissioner, including the long-standing interpretation of subsection 6(4) of the ITAA 1936. The Ruling will apply both before and after its date of issue. This is in accordance with the principles outlined in PSLA 2011/27 (Matters the Commissioner considers when determining whether the Australian Taxation Office (ATO) view of the law should only be applied prospectively). PS LA 2011/27 directs that where there is no evidence of previous ATO publications, products or conduct indicating a different view from that stated in the Ruling, then the ruling should normally apply both before and after its date of issue. In relation to Retail Premium arrangements, no ATO publication, product or conduct has issued conveying a different interpretation to that stated in the Ruling. The ATO has not contributed in any way identified in any submissions or otherwise to taxpayers taking and applying any different view to that stated in the Ruling. All previous publications the ATO has issued relevant to Retail Premium arrangements (Taxpayer Alert 2009/11, Fact Sheet on Retail Premiums, and DIS S56/2006 on *McNeil's* case) are entirely consistent with the view stated in the Ruling. The application or remission of penalties will be done in accordance with the legislation and taking due account of ATO policy.