TR 2008/5 - Income tax: tax consequences for a company of issuing shares for assets or for services

There is a Compendium for this document: **TR 2008/5EC** .

Taxation Ruling

Income tax: tax consequences for a company of issuing shares for assets or for services

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A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling is about the tax consequences for companies of issuing shares for assets or for services. In particular it is about:

- whether and in what circumstances there might be a loss or outgoing in acquiring the assets or the services for the purposes of section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997),[1] and the amount of that loss or outgoing;
- when and in what circumstances assets which were trading stock of the vendor might be taken to have been bought by the company and for what price, by reason of section 70-95;
- when and in what circumstances the assets might have a cost for the purposes of Division 40, and the amount of that cost; and
- when and in what circumstances the assets might have a cost base for the purposes of the capital gains tax provisions of Parts 3-1 and 3-3, and the amount of that cost base.

[1] All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

This Ruling does not consider the tax consequences for taxpayers of receiving shares for assets.

Ruling

Loss or outgoing

2. When a company issues shares as consideration for assets or for services, the issue of its shares is neither a loss nor an outgoing of the company and so not deductible under section 8-1, no matter what the character of the assets or services or their intended use. Nor are the shares issued as expenditure of the company.

3. This extends to all cases where tax treatment is based on what would otherwise be deductions under section 8-1 of the ITAA 1997. For instance, trading stock deductions are varied under Division 70 of the ITAA 1997 in some respects, but what is varied is what would otherwise be deducted under section 8-1. Therefore where shares are issued in circumstances such that no deduction would be available under section 8-1 no trading stock deductions will be available either (see subsection 70-15(1) of the ITAA 1997). Similarly, deductions under section 73B of the *Income Tax Assessment Act 1936* (ITAA 1936) generally relate to expenditure incurred (see for instance definitions ***certified expenditure***, ***contracted expenditure***, ***core technology expenditure***, ***feedstock expenditure***, ***research and development expenditure***, and ***salary expenditure***, subsection 73B(1) of the ITAA 1936), and so where shares are issued for those research and development (R&D) purposes there is no such expenditure incurred and no deductions under section 73B.

4. However, when a company which has incurred a loss or outgoing or expenditure, that is something other than an obligation to issue its shares, to acquire assets or services and sets off its obligation in satisfaction of an obligation of the vendor of the assets or provider of the services to subscribe for shares in the company, the fact that the loss or outgoing arising for the acquisition of the assets or services has been set-off against, and so is satisfied by, the loss or outgoing incurred to subscribe for the issue of shares does not affect any deductions under section 8-1 to which the company would otherwise be entitled. The two obligations, one to pay for assets or for services other than by issuing shares, the other to subscribe for shares, are then each paid by the set-off.

5. When the company is to acquire assets or services for shares issued to the vendor or provider, and no price or amount for the assets or services other than the shares is identified or nominated, the company does not incur a loss or outgoing or expenditure for the assets or services.

6. When the company is to acquire assets or services for a nominated price and the company is to issue fully paid shares to the vendor or provider for a nominated sum, under the same contract or arrangement, the nomination of a price does not necessarily create an obligation on the part of the company to pay that price or on the vendor or provider to subscribe that sum (so far as the amounts match). The contract or arrangement may be characterised as only giving rise to an obligation on the part of the company to issue shares for the assets or services, or it may be characterised as giving rise to two obligations, one to pay for assets or services other than by issuing shares and the other to subscribe for shares. This will depend on the facts and circumstances, and can only be determined on a case by case basis. However if, as a matter of fact and law, the contract or arrangement does not give rise to two existing cross obligations there can be no payment by set-off. Consequently there would be no loss or outgoing, or expenditure, of the company.

7. Under section 21 of the ITAA 1936, where consideration is given in kind it is taken to be given to the money value of the consideration in kind. However, if consideration is given that is not a loss or outgoing, or expenditure, of the company (or in satisfaction of such a loss or outgoing or expenditure) then section 21 has no effect of converting the consideration into a loss or outgoing or expenditure incurred by the company. All section 21 does is fix the money value amount for tax purposes. The observations of Hill J in *Federal Commissioner of Taxation v. Energy Resources of Australia Ltd* (1994) 54 FCR 25; (1994) 126 ALR 161; 94 ATC 4923; (1994) 29 ATR 553 show that the Full Court of the Federal Court of Australia rejected the claim by the Commissioner that the section provided an independent basis of assessment. That authority precludes any claim that section 21 converts the issue of shares for consideration in kind into a loss or outgoing or expenditure of the issuing company.

Vendor's trading stock

8. Where a company acquires what was trading stock of the vendor for shares in the acquiring company, but the disposal of the trading stock was outside the ordinary course of the vendor's business, the company is treated as having bought the assets for the amount included in the vendor's assessable income for the assets (under section 70-95), and therefore as having incurred expenditure of that amount. In that case the company has a corresponding cost for the assets. For trading stock deductions in other circumstances, no trading stock deductions are available (as noted at paragraph 3 of this Ruling, and see subsection 70-15(1)).

Cost for purposes of capital allowances

9. When a company issues shares for depreciating assets, the provision of shares is not the payment of an amount and does not involve a liability to pay an amount. The issue of shares (or the promise to issue them) is the provision of a non-cash benefit and may involve the satisfaction of a liability or an increase in a liability to provide such a benefit, or the termination of an entitlement to be provided with some other benefit. The shares issued for the assets are provided to the vendor and are provided by the company. So the market value of the shares at the relevant time is the cost of the assets to the company for the purposes of Division 40 (see section 40-185 as applied in working out both the first element and the second element of cost for the purposes of the Division). Capital allowances under Division 40 for the cost of a depreciating asset will be based on the cost so worked out.

10. The amount or value at which the shares are recorded in the accounts of the company is not as such the market value of the shares and is not evidence of that market value. The amount or value at which the shares are recorded in the accounts of the company is not as such the cost of the depreciating assets acquired for the shares for the purposes of Division 40 and is not evidence of that cost.

Cost for purposes of capital gains tax

11. When a company issues shares as consideration for assets, the provision of shares is not money paid, or required to be paid, for the assets and does not involve a liability to pay money. However, the provision of shares is the provision of property given, or required to be given, in respect of acquiring the assets. Therefore, the market value of the shares, that is the property given, is a component of the cost base of the assets so acquired for the purposes of the capital gains tax provisions.

12. The amount or value at which the shares are recorded in the accounts of the company is not as such the market value of the shares and is not evidence of that market value. The amount or value at which the shares are recorded in the accounts of the company is not as such the cost of the assets acquired for the shares, for the purposes of the capital gains tax provisions of Parts 3-1 and 3-3, and is not evidence of that cost.

Examples

Example 1 – no obligation (other than to issue shares) paid by set-off

13. Purchaser Ltd agrees to acquire business assets, including both revenue assets and assets dealt with only under the CGT provisions, trading stock, and some depreciating assets, from A & B Coolrooms. The revenue assets are of a kind that will be realised by Purchaser Ltd in the ordinary course of business. The agreement also specifies that A & B Coolrooms will be paid by (and only by) issue of a number of fully-paid shares in Purchaser Ltd, credited as fully paid. Under the agreement the only obligation on Purchaser Ltd is to issue shares, and the only entitlement of A & B Coolrooms is to be issued those shares.

14. The parties are dealing with each other at arm's length.

15. Overall A & B Coolrooms is concerned to receive consideration of economic value to it after tax no less than the after tax value of the assets as a whole, while Purchaser Ltd is concerned to provide consideration of economic value after tax no more than the after tax value to it of the assets as a whole.

16. Purchaser Ltd has no loss, outgoing or expenditure on any revenue assets, including the trading stock of A & B Coolrooms. Purchaser Ltd has issued some of the shares for the depreciating assets, and so its cost for those assets includes the market value of the shares that relate to the assets at the time the agreement is made (under Item 4 of paragraph 40-185(1)(b)). Purchaser Ltd has provided some of the shares for the CGT assets, and so its cost base for those assets includes the market value of the shares that relate to the assets at the time the agreement is made. As the trading stock of A & B Coolrooms is being disposed of by that firm outside the ordinary course of its business, Purchaser Ltd is treated as having bought those assets for their market value.

17. The apportionment of the shares between the different things acquired by Purchaser Ltd under the agreement must be carried out on a reasonable basis. That basis will not take account of the different tax position of Purchaser Ltd in relation to some things as compared to others. If Purchaser Ltd is treated as buying A & B Coolrooms' trading stock for market value, this does not affect the apportionment required to work out how much of the market value of the shares is attributable to each other asset. The allocation of the actual amount of the consideration between assets must be carried out on a reasonable basis.

Example 2 – payment of an obligation by set-off against an obligation to subscribe for shares

18. Growth Ltd has agreed to acquire D E Foodsupply's Australian business, including assets dealt with only under the CGT provisions, depreciating assets, and trading stock. The price has been agreed as the money value of the assets according to the opinion of an agreed valuer on a set day, adjusted according to a formula, and the price is to be paid three weeks after that day. Under the agreement D E Foodsupply is entitled to the price in money.

19. The parties are dealing with each other at arm's length.

20. Valuation day has passed, the valuer has given the required opinion, and Growth Ltd knows the price in money. However cash flow issues for Growth Ltd make payment in money unattractive to it. On the day for payment of the price, Growth Ltd offers to issue Growth Ltd shares to D E Foodsupply for a total issue price equal to the price due for the D E Foodsupply business. D E Foodsupply accepts and agrees to set-off its obligation to subscribe for the shares against Growth Ltd's obligation to pay the purchase price.

21. Growth Ltd acquires the business for the price in money. That price is apportioned appropriately among the trading stock, CGT assets and depreciating assets. The apportionment shows the cost of the trading stock, being the loss, outgoing or expenditure for the purposes of section 8-1; the cost of the depreciating assets, under Division 40 (in this case, Item 2 of paragraph 40-185(1)(b)); and the cost base of the CGT assets, under Part 3-1. If D E Foodsupply is selling its trading stock outside the normal course of its business, then Growth Ltd is treated under section 70-95 as having bought the stock for market value, the amount included in D E Foodsupply's income. In this case this is likely to be the same amount as the apportioned share of the price in money, because the parties are dealing at arm's length in relation to the price.

22. D E Foodsupply sells the business, including the various assets, for the same price in money and likewise apportioned appropriately. The market value of the shares in Growth Ltd when D E Foodsupply agrees to subscribe for them is not the measure either of what Growth Ltd pays or what D E Foodsupply receives.

Date of effect

23. This Ruling applies both before and after its date of issue. However, the Ruling will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

24. There are no other current Rulings on the subject of this Ruling. This Ruling does not contain a change in Tax Office view on the subject, and the Commissioner did not have a general administrative practice contrary to the position taken in the Ruling.

Commissioner of Taxation
27 August 2008

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

No loss or outgoing, or expenditure, by company

25. Issuing shares as fully paid for consideration in kind involves no outgoing of, or expenditure by, the company issuing the shares. Nor does issuing shares as fully paid, but for inadequate or for no consideration, involve any loss by the company issuing the shares. This is the case even if the acceptance that there has been a value-for-value exchange might be taken to preclude a loss where adequate consideration *is* given for the shares. This is important because income tax deductions under section 8-1 of the ITAA 1997 and its predecessor, section 51 of the ITAA 1936 are only available in relation to losses or outgoings; and deductions under a range of provisions, such as section 73B of the ITAA 1936, are only available in relation to expenditure. It is noted that whether particular provisions give tax deductions when a loss, outgoing or expenditure is incurred, rather than when it is realised or paid, is essentially a timing point rather than something relevant to whether there is a loss, outgoing or expenditure.

26. The House of Lords explained the principles in *Lowry (Inspector of Taxes) v. Consolidated African Selection Trust Ltd* (1940) 23 TC 259 (*Lowry*), where shares to some employees were issued at par, a substantial discount to the value of the shares. To quote the view of the majority, as expressed by Viscount Maugham at page 284:

> Indeed the issue of shares by a trading company is not a trading transaction at all. The corporate entity becomes *pro tanto* larger; but the receipts of the trade on the one hand and the amount of the costs and expenditure necessary for earning those receipts on the other remain unaltered, and it is the difference between those two sums which is taxable…

The issue of its shares is not a cost or expenditure of the company, and so cannot be a loss or outgoing of the company either. Viscount Maugham further notes at page 285:

> The issue of shares by a company, whether at par or over, does not affect the profits or gains of the company for the purposes of Income Tax.

Comparably, to quote Viscount Caldecote LC at page 281:

> I ask whether the issue of these shares in the manner adopted involved the Respondent Company in any 'disbursements or expenses….wholly and exclusively laid out or expended for the purposes of' its trade. Its capital was intact after the issue of the shares: not a penny was in fact disbursed or expended. Its trading receipts were not diminished, nor do I think it is a right view of the facts to say that the Respondent Company gave away money's worth to its own pecuniary detriment.

The commitment to issue its shares is no pecuniary detriment to a company, and so cannot be a loss, outgoing or expenditure either.

27. The High Court had to consider what a company does in issuing its shares in deciding *Ord Forrest Pty Ltd v. Federal Commissioner of Taxation* (1973-74) 130 CLR 124 (*Ord Forrest*). The question was whether a company issuing high-value shares for a nominal subscription made a gift for the purposes of the gift duty provisions. In disagreeing over whether it did, both Gibbs J (Mason J concurring) and Barwick CJ (McTiernan J concurring) considered it beyond doubt that the allotment of shares does not involve any loss of value by, or outgoing or expenditure of resources of, the company. Stephen J approved *Lowry* at first instance (at page 131). Barwick CJ held that a company 'in allotting a share in its capital does not sell or transfer the share. … The company does not part with any property…' (at page 142), and so in committing to issue the share does not enter upon any obligation to part with property. Gibbs J similarly held that 'When a share is allotted, nothing is transferred or conveyed from the company to the shareholder' (at page 148), so committing to make the allotment is not entering upon an obligation involving a transfer or conveyance of any part of the company's resources. Mason J held that the 'allotment of shares in a company is certainly not a disposition of the company's property' (at page 155).

28. Where the judges disagreed was in relation to the operation of an extended definition of 'disposition of property' for gift duty purposes. The deciding view was that allotment of the shares was a disposition of property because of that definition even if there was otherwise no disposition of the company's property. And to the extent that the allotment was for inadequate consideration there was a dutiable gift by the company.

29. More recently the High Court has held that a company makes no loss in issuing or allotting shares for inadequate consideration. Initially this was the only issue in the High Court appeal in *Pilmer v. Duke Group Ltd (in liq)* (2001) 207 CLR 165, [2001] HCA 31 (*Kia Ora*) though subsequently equitable issues were added as a separate head in the appeal. McHugh, Gummow, Hayne and Callinan JJ held in their majority joint judgment, at paragraphs 63 to 64:

> … The relevant hypothesis is that the company could and would have made *no* takeover and the inquiry is about what it gave up or lost because it did.
>
> 64. The answer to that inquiry must be that Kia Ora outlaid cash and whatever may have been the administrative costs of issuing the shares. If a claim had been made, it may well be that some allowance would be made for the consequential effect on its capacity to raise other equity or debt finance. Otherwise, however, it gave up, or lost nothing by the issue of its shares.

So the only outlay or thing lost by a company issuing its shares is the administrative cost of the issue. Kia Ora also gave cash as part consideration for the assets, that is scrip, it acquired. Any consequential effect on capacity to raise money is no more than a damages claim.

30. Based on the High Court's authority a company committing to issue its shares is thereby not committing to any sale, transfer, conveyance or disposition of any of its property (*Ord Forrest*), and is thereby not committed to give up or lose any outlay beyond the administrative costs of the issue (*Kia Ora*). The Commissioner considers therefore that a commitment by a company to issue its shares is not itself a commitment to any loss, outgoing or expenditure by the company.

31. A company is in the same position when it issues its shares for non-monetary consideration, that is for assets or for services which it wishes to acquire, as when it issues its shares for cash. The issue of the shares involves no loss, outgoing or expenditure of the company; the consideration the company receives, and the purpose to which the company wishes to apply that consideration is irrelevant. What a loss, outgoing or expenditure is incurred for is important to its deductibility; but it must first be a loss, outgoing or expenditure.

32. However, when a company issues its shares for non-monetary consideration, there is a valid contract, as the company is providing consideration, that is the shares themselves, at their actual value. That consideration is provided without any loss, outgoing or expenditure by the company, but it is certainly provided and contractually required to be so. It is matched by the consideration in kind to be provided by the shareholder. The actual value of what the shareholder has provided is the value of the consideration in kind given for the shares, not the value of the shares nominated in the company's accounts.

33. In *Federal Commissioner of Taxation v. Becker* (1952) 87 CLR 456 (*Becker*), a landowner sold his land to a shelf company for shares: in doing so, he made no gain, as the shares were worth the same as the only asset of the company, the land. The landowner then sold the shares. But the cost to him of the shares was the full value of the land he gave to get them. That the shares had a paid-up value in the company of £8,000, that amount being nominated in the contract for the sale of the land to the company as the price of the land to be paid for in shares, while the land itself, and the market value of the shares, was worth £12,000, produced no gain to the landowner when he then sold the shares at that market value: what he had given for his shares was the full value of the land, not the nominal amount shown as paid up or nominated as the price of the land in the agreement under which the company was only obliged to issue shares. Per Kitto J, at 467:

> The question then is, what really was the cost to the respondent of the shares which he sold for £12,000? The plain fact of the matter is that the cost was the land which he transferred to the company. It simply is not true to say that the cost was only £8,000. That was the sum which the sale agreement named as the price of the land, and it was the sum which was credited as paid up on the respondent's shares. But the respondent did not sell his land for £8,000 payable in money, and he did not receive or become entitled to receive the 8,000 shares upon paying £8,000 in money. The sale agreement provided for only one method of completion: it bound the respondent to transfer his land to the company and it bound the company to issue fully-paid shares to him.

The Full Court of the High Court rejected the view that there is a general principle that:

> where there is a sale of property for a money sum to be satisfied by an issue of fully-paid shares, there are two separable and substantive transactions, a sale of the property for a cash price and an issue of fully-paid shares, so that if the shares are subsequently sold any excess over the amount paid up on them constitutes a profit.

as stated by Kitto J at page 467.

34. *J C Williamson's Tivoli Vaudeville Pty Ltd v. Federal Commissioner of Taxation* (1929) 42 CLR 452 (*Tivoli Vaudeville*) was High Court authority for the view that a company which acquired a lease for an amount to be provided by the issue of its shares fully paid to that amount was entitled to write off the paid up amount over the lease term, under paragraph 25(i) of the *Income Tax Assessment Act 1922* (ITAA 1922).

35. However, that case, *R v. Bullfinch Proprietary (WA) Ltd* (1912) 15 CLR 443 (*Bullfinch*) (holding that under then WA stamp duty provisions the dutiable consideration for leases acquired for an amount to be provided only in shares issued as paid was the amount and not the value of the shares), and *Messer v. Deputy Federal Commissioner of Taxation* (1934) 51 CLR 472 (*Messer*) (holding, conversely, that under paragraph 16(d) of the ITAA 1922 the consideration for the assignment of a lease was the value of the shares given by the company acquiring the lease although a money amount had been stated and a cheque tendered) were each distinguished in *Becker* as cases of no general application and depending on their particular statutory provisions. *Becker* itself concerned a provision which 'unlike the provisions with which the court was concerned in the cases cited, uses the language of everyday affairs without artificial restriction or enlargement', per Kitto J at page 467, and is therefore general in its implications. As payment of an obligation other than to issue shares by set-off is being considered here in the context of the general provisions of the income tax law, provisions which also 'use the language of everyday affairs', *Becker* is the more readily applicable authority.

36. Section 21 of the ITAA 1936 applies where any consideration on a transaction is given or paid other than in cash. It deems the money value of that consideration to have been paid or given. (It is related to the former section 20 of the ITAA 1936 and is subject to section 21A of the ITAA 1936, which applies specifically to non-cash business benefits.) Under section 21, where consideration is given in kind it is taken to be given to the money value of the consideration in kind. However, if consideration is given that is not a loss or outgoing, or expenditure (or in satisfaction of such a loss or outgoing or expenditure), then section 21 has no effect of converting the consideration into a loss or outgoing or expenditure incurred. All section 21 does is fix the money value amount for tax purposes. The observations of Hill J in *Federal Commissioner of Taxation v. Energy Resources of Australia Ltd* (1994) 54 FCR 25; (1994) 126 ALR 161; 94 ATC 4923; (1994) 29 ATR 553 show that the

Full Federal Court of Australia rejected the claim by the Commissioner that the section provided an independent basis of assessment to general principles of loss or outgoing or expenditure incurred. That authority precludes any claim that section 21 converts the issue of shares for consideration in kind into a loss or outgoing or expenditure of the issuing company.

Company's loss, outgoing or expenditure for assets or services paid by set-off against consideration due to it for issue of shares

37. The fact that a company pays or discharges a loss, outgoing or expenditure by set-off against the consideration due to it for the issue of its shares does not change the tax treatment of the loss, outgoing or expenditure it has incurred. That will depend on the original character of the loss, outgoing or expenditure. A loss, outgoing or expenditure that is deductible is no less so if it is paid or discharged by set-off rather than in some other way. That is illustrated clearly by *Lowry* itself. Viscount Maugham illustrated the case where the consideration for the issue of shares is set-off against an independent liability of the company to the allottee at page 285:

> If in this case the employees were paying the par value of the shares and also releasing to the Company some amounts of salary due to them the case would be very different from what it is.

And, for payment by set-off more generally, at page 290:

> It is of course clear that if a company owing, say, £500 to an employee for his contractual salary agrees to deliver to him so many tons of coal or any other marketable commodity in discharge of the £500, the company would then be entitled to deduct the £500 as an expense.

38. The principles of payment by set-off have been applied consistently since their statement in *Re Harmony and Montague Tin and Copper Mining Co Ltd (Spargo)* (1873) LR 8 Ch App 407. The authoritative statements are those of James LJ at pages 412 to 413:

> If it came to this, that there was a debt in money payable immediately by the company to the shareholders, and an equal debt payable immediately by the shareholders to the company, and that each was accepted in full payment of the other, the company could have pleaded payment in an action brought against them, and the shareholder could have pleaded payment in cash in a corresponding action brought by the company against him for calls. Supposing the transaction to be an honest transaction, it would in a court of law be sufficient evidence in support of a plea of payment in cash, and it appears to me that it is sufficient for this Court sitting in a winding-up matter. … any suggestion of sham, or fraud, or deceit, seems to be entirely out of question in this case, because everybody knew what was done; every shareholder of the company was present, and was a party to the resolution…

Mellish LJ's much-cited words at page 414 are that:

> Nothing is clearer than that if parties account with each other, and sums are stated to be due on one side, and sums to an equal amount due on the other side on that account, and those accounts are settled by both parties, it is exactly the same thing as if the sums due on both sides had been paid. Indeed, it is a general rule of law, that in every case where a transaction resolves itself into paying money by A to B, and then handing it back again by B to A, if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing the money backwards and forwards.

39. *Spargo* is itself an example distinguishing a company's issue of shares from its acquisition of property, for in that case Mr Spargo bought the lease of a mine for a company to be formed, subscribed for shares in the company, and in general meeting he, the company and the other members resolved to set off the liability of the company to pay for the lease bought for it against Spargo's liability to pay for his shares.

40. However, obligations can be set-off in this way only where they actually arise. The requirement that obligations payable immediately must have arisen is illustrated in the New Zealand tax case of *Northern Roller Milling Co Ltd v. Commissioner of Taxes* [1953] NZLR 517. Here the question was whether the deductible rent was the balance remaining after setting off capital instalments due from lessor to lessee, or was the larger amount to be taken as partly paid by the set-off. It was the larger amount, but only because the capital instalments were due independently of the lease in which the set-off was given, and because those instalments were set off only as they fell due, against that quarter's rent. Had the obligation to pay the capital instalments been forgiven as consideration for a lease at lower rent, the rent would have been only the reduced amount (and no capital instalments would have been received) because there would not have been any obligation to pay the capital instalments and there would have been only a smaller obligation to pay rent. The set-off applied because there were separate obligations paid by set-off.

41. *PJ Underwood v. HM Revenue and Customs* [2008] EWHC 108 (Ch) is a recent illustration where there were not separate obligations discharged by set-off but only a single obligation. There, the taxpayer asserted the sale and the repurchase of his land, with the obligations under the sale and under the repurchase carried out in full by set-off. This treatment would have had CGT advantages for the taxpayer. Briggs J found that the land was neither sold nor repurchased, and that all that happened was the settlement of a difference as part of releasing any obligations for sale or repurchase of the land (at paragraph 34). This was because for obligations to be carried out by set-off they must exist as cross-demands for money that are 'immediately payable', applying (at paragraph 36) *Coren v. Keighley* (1972) 48 TC 370 at 375. The potential obligations which could have arisen under the uncompleted sale contract and option agreement were never performed or intended to be performed.

42. Australian courts similarly require obligations to arise so as to be payable immediately before they can be recognized and paid by an agreed set-off. So Dixon J, in deciding *Federal Commissioner of Taxation v. Steeves Agnew & Co (Vict) Pty Ltd* (1951) 82 CLR 408 (*Steeves Agnew*), explained at pages 420-421:

> If cross-liabilities in sums certain of equal amounts immediately payable are mutually extinguished by an agreed set-off, that amounts to payment for most common-law and statutory purposes…But for the application of these principles there must be cross-liabilities and agreement, express, tacit or implied, and the cross-liabilities must be equal. If they are not equal payment of the residue must be effected by other means.

In that case a company made no payment of the manager's profit share (subject to tax instalment deductions) by set-off against advance drawings, because the manager was not entitled to the profit share at the time of the advance drawings, and so the company had no liability to deduct tax instalments from those drawings taken by a manager in advance of the manager's profit share. As the manager had anticipated the profit share, no obligation to pay the profit share ever arose. The company was entitled to reduce what its obligation would otherwise have been by the amount of the advance drawings. Therefore no such obligation was discharged either.

43. Lend Lease's claims for deductions for the paid-up value in shares issued to its staff superannuation fund failed for the same reasons in *Lend Lease Corporation Ltd v. Federal Commissioner of Taxation* (1990) 95 ALR 427. The issue of the shares was itself no loss, outgoing or expenditure; only if there was an obligation to contribute in cash, then paid by set-off, could deductions have been allowed. As Hill J explained at page 434:

> …I doubt whether it is possible to apply the rule in *Spargo's* case where there are no mutual liabilities but rather a liability on one hand and a voluntary payment on the other. The intention to make a voluntary payment does not constitute a binding obligation. But whether that is correct or not, the present is not a case where there was any agreement at all that could be inferred between the applicant on the one hand and the trustees on the other. The situation is merely one where the matter lay in intention on the part of the applicant and was never considered at all in terms of the trust deed by the trustees.

Hill J's inclination to regard *Spargo* as unavailable to produce payment by set-off of a liability and a voluntary payment, even where the two are independent of each other, is supported by *Gardner v. Commissioner of Probate Duties* [1967] WAR 106, which involved an imperfected gift by a testator to the family company of part of the debt the company owed to him. There set-off of the gift against the debt (reducing probate duty) was not possible.

44. The words of Dixon J from *Steeves Agnew* guided Fullagar J in deciding *Pro-Image Studios v. CBA* (1991) 4 ACSR 586 (*Pro-Image Studios*). There, an insolvent company's debt to the banks was set-off against a later agreement by the banks to subscribe for shares, and the separate existence of the agreement to subscribe, and for set-off from the debt, was fundamental to accepting that there had been payment of both obligations set off against each other.

45. The requirement that the separate cross obligations be due immediately explains why a mortgagee who takes over from a mortgagor in possession can demand from the tenant, as it falls due, rent the tenant has already paid in advance to the mortgagor. Those advance payments were not for rent due at the time; so they are not set off then, or later, against the rent as it falls due. The tenant is entitled to credit from the mortgagor, but not a set-off against the mortgagee. See the Victorian Court of Appeal decision in *SEAA Enterprises Pty Ltd v. Figgins Holdings Pty Ltd* [1998] 2 VR 90. In contrast, a set-off could take effect in *Whim Creek Consolidated NL v. Federal Commissioner of Taxation* (1977) 31 FLR 146, because the loans made over the preceding 3½ years were payable on demand and so a subsequent agreement combining a subscription for shares and an agreement for set-off of the corresponding amount of loans allowed valid payment. The terms of the loans were therefore a significant issue. Had they not been on demand, and had a term for their payment still to come in, set-off could not have occurred.

46. The obligations must exist before they can be discharged by an agreement to set them off against each other by way of payment. This is why an agreement for set-off of present obligations against future obligations is not only ineffective when made, but is not self-executing when the contemplated future obligations arise. See, for instance, *R Harding and Co Ltd (in liquidation) v. Hamilton* [1929] NZLR 338; where the Court of Appeal spelt out that, although cross obligations had arisen as contemplated by an existing agreement for set-off, it required a further agreement, once the mutual obligations were all payable immediately, before the set-off would be carried into effect. *In re Richmond Hill Hotel Company (Pellatt's Case)* (1867) LR 2 Ch App 527 also shows that an agreement for future set-off is ineffective when made.

47. The fact that, as actual obligations, the matching present obligations could not actually have been met has been suggested as enough by itself to bar acceptance that the obligations have been paid by set-off. However, *Re LB Holliday & Co Ltd* [1986] 2 All ER 367 is better understood consistently with principle as a case where there were not really two obligations. The view that obligations could not have been independently entered into would certainly be arguable in relation to such cases as *Pro-Image Studios*, where actually paying the debts to the banks would have been an improper preference, as the company was already insolvent. The obligation of the Holliday subsidiary to pay unpaid dividends, and the obligation of the Holliday parent to lend the amount of the dividends paid, like the agreement to set the one off against the other, were all linked.

So much so, that there was no possibility of paying the dividends, or lending the money, except as part of such a set-off arrangement. The court there found that there was only a continuing obligation to pay unpaid dividends, and that the purported payment of the dividends by set-off against a loan back to the subsidiary never happened.

48. There is commonly no set-off, and there is no payment of a separate liability in money, where assets are given or services performed for consideration that must be accepted in shares and the shares are issued. Illustrations include *Re Government Security Fire Insurance Co (White's Case)* (1879) 12 Ch D 511, in which a newspaper placed advertisements at its usual rates but only to be paid by way of the issue of shares of equivalent paid-up value: so the shares were not paid up in money, as there was never an obligation to pay for the advertisements in money. *Commissioner of Stamp Duties (NSW) v. Perpetual Trustee Co Ltd (Saxton's Case)* (1929) 43 CLR 247 also illustrates the point. In that case a company's controller purported to pay up shares issued to family members by debiting the controller's loan account with the company, but the High Court held that there was payment only to the extent that the loan account was in credit, because only to that extent was there an amount payable to the controller in cash other than by reason of the arrangement to pay up the shares. As to the rest of the amount, the shares were not paid up then in money, and gift duty had to be assessed accordingly. Similarly, in *Joseph v. Campbell* (1933) 50 CLR 317 the High Court held that there had to be a liability before that liability could be set off against a shareholder's obligation to pay up shares in cash.

49. In most cases where obligations to pay for shares and to pay for an asset or for services were not in existence, so that the company could not be made to pay cash for the asset or services and the vendor could not get cash while the company could only be made to issue shares and the vendor could only get shares, there was no payment in money for the shares by set-off or otherwise. Therefore the shareholder remained liable to calls on the unpaid shares. Additional examples include *Re Goodman Brothers Auto and Service Co Ltd; ex parte FW Rose* [1927] SASR 571 and *Re Federal Traders Ltd* [1934] SASR 174.

Whether there is payment by set-off in the case where the contract or arrangement specifies a price for the assets or services and also requires the company to issue shares

50. As the above discussion explains, in order for there to be payment by set-off there must be two existing cross obligations between the parties, which they have agreed to discharge by set-off.

51. In the case when, as in Example 2, the company's obligation to pay for the assets or services has arisen prior to its arrangement to issue shares for a subscribed amount, or the company's obligation to pay for the assets or services and the vendor's or provider's obligation to pay for the issue of shares arise under separate arrangements, there is no issue that there exist debts on either side which the parties may agree to set-off. Conversely, in the case when, as in Example 1, the company's obligation to get the assets or services is to issue shares and the vendor or provider has the obligation to provide the assets or services for the shares, no price or amount for the assets or services other than the shares is identified or nominated. In that case there is no issue that the company does not incur a loss or outgoing or expenditure for the assets or services.

52. However, when under a single contract or arrangement a company is to acquire property or services, and a price in money is nominated but the company is obliged to issue fully paid shares to the vendor or provider as consideration, the contract or arrangement does not necessarily give rise to two existing cross obligations between the parties. The nomination of a price for the assets or services does not necessarily give rise to an obligation on the part of the company to pay money. The stipulation of an amount to be subscribed for the shares does not necessarily give rise to an obligation on the part of the vendor or provider to subscribe that amount: it may serve only to quantify the number of shares to be issued. The substance of the contract may be that the company only has an obligation to issue shares and the vendor or provider may only have an obligation to provide the property or services. As was held by the High Court in *Becker*, although considering there the position of the shareholder rather than the company, there is not necessarily any separate obligation to pay a price for the property (other than the issue of the shares) and any separate obligation of the shareholder to pay for the issue of shares, with the prices then agreed to be set off.

53. Comments made by the High Court in *Tivoli Vaudeville, Bullfinch* and *Messer* indicate that where the contract provides for the company to purchase the asset for a price expressed in money and contemporaneously for the vendor to be issued shares fully paid in payment or satisfaction of the company's liability, that the company may have paid for the asset on the basis that there are two cross obligations which are set-off. However, as discussed in paragraph 33 of this Ruling in *Becker* the High Court rejected the view that the authorities stood for a general principle that there were two separable and substantive transactions. Each of these cases was distinguished in *Becker* as cases of no general application and depending on their particular statutory provisions (per Kitto J at page 467).

54. This means that, in the case where there is only one agreement and amounts are stipulated as the price of the property or services and as the amount to be subscribed for the shares, whether cross obligations arise and can be discharged by set-off cannot be concluded without case-by-case examination. This will depend upon a construction of the contract and the substance of the transaction.

Trading stock and other deductions based on a loss, outgoing or expenditure

55. Many other deductions for income tax purposes depend on the taxpayer incurring a loss, outgoing or expenditure under, or on similar principles to, section 8-1 of the ITAA 1997 or section 51 of the ITAA 1936. For example, consider the bulk of the trading stock provisions of Part 2-25 of the ITAA 1997. Subsection 70-15(1) of the ITAA 1997 explains that the section 'tells you in which year to deduct under section 8-1' certain outgoings which 'must be deductible under that section'. Section 70-25 of the ITAA 1997 makes certain outgoings not capital, and so potentially deductible under section 8-1 of the ITAA 1997. However what is not a loss or outgoing or expenditure for the purposes of the underlying sections will not be deductible under these trading stock provisions.

56. This Ruling, in determining that a company incurs no loss, outgoing or expenditure in issuing its shares, therefore determines that deductions are unavailable to the company under every provision to which actual loss, outgoing or expenditure are a prerequisite. This is true, both of provisions where only losses, outgoings or expenditure discharged or paid are deductible, and of provisions under which it is sufficient for them to be incurred.

57. Under Division 43, deductions are a portion of construction expenditure; and so only expenditure can give rise to the deductions. A company issuing its shares in consideration of construction work done for the company incurs no construction expenditure by doing so or by agreeing to do so.

58. The principles of this Ruling are correspondingly applicable to all other provisions in which tax treatment depends on incurring, or on paying or discharging, a loss, outgoing or expenditure. The research and development deductions under section 73B of the ITAA 1936 are of this character.

Trading stock

59. There had been dicta of the High Court supporting the view that, even where there was no loss, outgoing or expenditure incurred to acquire what becomes the acquirer's trading stock, there should be a cost as a matter of correct keeping of a trading stock account. These views, expressed by Gibbs J in *Curran v. Federal Commissioner of Taxation* (1974) 131 CLR 409 (*Curran*), were not supported by either of the majority judges Barwick CJ and Menzies J and were opposed by Stephen J, who dissented from the result. However, *Curran* was overruled by the High Court in *John v. Federal Commissioner of Taxation* (1989) 166 CLR 417 (*John*). There the joint judgment of Mason CJ, Wilson, Dawson, Toohey and Gaudron JJ recognised that there can be a cost of trading stock for which there was no loss, outgoing or expenditure incurred only to the extent that there is a corresponding diminution in the cost of other stock.

Brennan J preferred the view that there can be no cost even by such corresponding diminution. Whichever view is preferred, *John* shows that there can be no cost of an acquirer's trading stock where there is no loss, outgoing or expenditure incurred and where there is no corresponding reduction in the cost of other stock. Trading stock acquired by issuing shares must therefore ordinarily have no cost for income tax purposes.

60. The problem is ameliorated where a company gives shares for assets that are trading stock of the vendor, and where the vendor is disposing of the trading stock outside the ordinary course of business. In that case, section 70-95 provides that the company is treated as having bought the vendor's trading stock for the amount included in the vendor's assessable income under section 70-90.

61. The amount included in the vendor's assessable income, and so the amount for which the company is taken to have bought the vendor's trading stock, is the market value of the trading stock on the day of its disposal: subsection 70-90(1). Gifts valued under section 30-212 may have that value used instead, under subsection 70-90(1A), but where a vendor's trading stock is given for shares issued by a company there can be no gift.

62. A common case in which a vendor's trading stock is given for shares issued by a company is as part of the sale of a business to the company for shares in the company. Section 70-95 treats the company as having bought the vendor's trading stock for its market value, and so, to that extent, gives the company a loss, outgoing or expenditure.

Cost of depreciating assets for capital allowances purposes

63. When a company issues shares for depreciating assets, the market value of the shares is generally the cost of the assets to the company for the purposes of Division 40.

64. The cost of a depreciating asset a taxpayer holds has two elements, the first being cost worked out as at the time the taxpayer begins to hold the asset (section 40-180), the second being cost adjustments from time to time thereafter (section 40-190). Each has some specific rules for special cases, and other rules also adjust the way cost is worked out (for example, the exclusion from cost of amounts not of a capital nature, under section 40-220, and the exclusion from cost of amounts otherwise deductible, under section 40-215). However the basic rule in working out both elements of cost is provided by section 40-185, under which various amounts listed in the table to subsection (1) are added up.

65. Items in the table of subsection 40-185(1) include Item 1, where you pay an amount for a depreciating asset; Item 2, where you incur or increase a liability to pay an amount for a depreciating asset; Item 4, where you provide a non-cash benefit for a depreciating asset; and Item 5, where you incur or increase a liability to provide a non-cash benefit for a depreciating asset. Under Items 1 and 2, the cost is the amount, as what you pay or incur is an amount. Under Items 4 and 5 the cost is the market value of the benefit, as what you provide or incur or increase a liability to provide is a non-cash benefit.

66. When a company issues shares for a depreciating asset, it does not pay an amount, therefore Item 1 will not apply. When a company gives a commitment to issue shares so as to get a depreciating asset, it does not incur or increase a liability to pay an amount, therefore Item 2 will not apply. As the Full Federal Court explained in *Burrill v. Federal Commissioner of Taxation* (1996) 67 FCR 519; 96 ATC 4629; (1996) 33 ATR 133 (*Burrill*) at 525, at 4634 and at 138:

> Shares are not, and do not involve, a promise to pay money: they do not find expression in cash or sound in money. When shares are the consideration for another's promise, they are as much a consideration in kind as a bag of wheat or a horse.

67. Similarly, *Becker* shows that the value provided for the shares may well be the full value of the asset, not what nominal value is shown as paid in the books of the company.

68. The company does provide a non-cash benefit when it issues shares for a depreciating asset and in that case Item 4 will apply. The company does incur or increase a liability to provide a non-cash benefit when it gives a commitment to issue shares for a depreciating asset and in that case Item 5 will apply. As per subsection 995-1(1) any property or services in any form other than money is a non-cash benefit by definition. For example, an option to be issued shares would be a non-cash benefit to be valued according to its market value as an option.

69. The non-cash benefit is provided, or is agreed to be provided, to the vendor. The terms of items 4 and 5 of the table to subsection 40-185(1) do not limit what is provided to what was formerly the company's. *The Australian Oxford Dictionary*, 1999 and *The Macquarie Dictionary*, 2001, revised 3rd edition define the word 'provide' as including 'to supply or furnish', but the range of meanings in the dictionary context does not suggest that what is so supplied or furnished must first belong to the provider. According to the dictionary meanings, it would be appropriate to describe the shares as supplied or furnished to the vendor by the company.

70. Under the items relating to the provision of a non-cash benefit, the element of cost will include the market value of the non-cash benefit the company provides. Where the benefit to which the item applies is a share, therefore, the cost of the depreciating asset for which it is provided will include the market value of the share at the relevant time. Where current accounting standards apply, the depreciating asset acquired is likely to be shown in the accounts at its fair market value rather than according to the value of the shares issued for it. This does not alter the cost of the depreciating asset, which remains the market value of the share, not the market value of the asset, should those market values differ.

71. Some English authority on whether shares have been issued at a discount supports the view that, within the limits of fraud, a company can issue shares for assets in kind and can show as paid in the books of the company what amount it chooses. The profits of the company on realising the assets, for the purposes of the English statutory provisions at the times of the cases, are measured against what was shown as paid in the company's books. *In re Theatrical Trust Ltd (Chapman)* [1895] 1 Ch 771 and *In re Wragg, Ltd* [1897] 1 Ch 796 established the paid-up principle, and the line of UK cases which was cited to the High Court in *Kia Ora* shows that a company's profit on selling the asset it got for its shares is to be calculated under the English law from the amount shown as paid for the shares issued for the asset by the company. These cases are *Osborne v. Steel Barrel Co Ltd* (1942) 24 TC 293 (*Osborne*); *Craddock v. Zevo Finance Co Ltd* (1946) 27 TC 267 (*Zevo Finance*); *Shearer (Inspector of Taxes) v. Bercain Ltd* (1980) 53 TC 697 (*Bercain*); and *Stanton (Inspector of Taxes) v. Drayton Commercial Investment Co Ltd* (1982) 55 TC 286 (*Drayton*).

72. The relevant English law at the time of each of these cases applied to calculate a profit on a realisation of an asset, allowing in that calculation specific offsets. One of those was 'the amount or value of the consideration, in money or money's worth, given by him or on his behalf' (using the words of paragraph 4(1)(a) of Schedule 6 to the *Finance Act 1965*; the applicable earlier legislation is to the same effect). These successive provisions are concerned with the amount of consideration given for the taxpayer's asset now realised, but not with who gave the consideration. They expressly recognise consideration not given by the taxpayer, and implicitly recognise value the taxpayer gives that is not at the taxpayer's cost. These are all things that are not costs of the taxpayer, outgoings of the taxpayer, or expenditure of the taxpayer. These cases treat the value of the consideration a company gives when it issues shares for an asset as the credit the company gives in its books as paid, that is not as the market value of the shares issued. In *Kia Ora,* at paragraphs 61 and 62, the High Court rejected this view. It considered those cases as confined to the English statutes and rejected the application of those cases to support any claimed loss or outgoing of the company. The Commissioner agrees that these cases are inapplicable to measures of expenditure, cost and cost base for the purposes of the income tax law in Australia.

73. In any case, the express requirements of the table in subsection 40-185(1) mean that cost is not a technical analysis of the consideration moving to the asset provider when the company issues or agrees to issue shares for the asset. It is specified as the market value of the non-cash benefit, in these cases the share.

74. As explained above, a company might issue shares for money payable immediately in circumstances where there really is a matching obligation on the company to pay money to the shareholder immediately for a depreciating asset. In that case, the parties can agree to pay the two obligations by set-off. If they do, this is payment in money of both obligations, not the provision of a non-cash benefit, the shares, for the depreciating asset.

75. When that is what happens, the cost base of the depreciating asset does not include the market value of the shares in the company. It includes the obligation to pay money for the asset, satisfied by set-off. So it will be Item 1 or Item 2 of the table in subsection 40-185(1) that applies as an element in cost, not Item 4 or Item 5. As the amount credited as paid for the shares will be the payment set off against the money to be paid for the asset, the cost of the depreciating asset is worked out on the basis of the money obligation.

76. However, the circumstances in which there is a separate obligation to issue shares for money, and a separate obligation to pay money for a depreciating asset, may well not arise from agreement to issue shares for assets. As *Becker* and the cases discussed at paragraphs 43 to 46 of this Ruling illustrate, an agreement to issue shares and get an asset might not give rise to obligations to pay for the asset or receive money for the shares even if the terms of that single agreement identify a price in money for the asset and an equivalent paid amount for the shares, a situation which must be considered on a case by case basis as it arises.

Cost base for CGT purposes

77. When a company issues shares for acquiring CGT assets, the market value of the shares is generally the cost base of the assets for the purposes of Part 3-1 (Capital gains and losses: general topics).

78. The cost base of a CGT asset has 5 elements, subject to various modifications and exclusions. The first element is the total of the money you paid or must pay for acquiring it, and the market value of any property you gave or must give for acquiring it (subsection 110-25(2)). The second element is incidental costs to acquire the asset, or in relation to a CGT event for the asset. These can include giving property (subsection 110-25(3)). The third element is non-capital costs of owning the asset if it was acquired after 20 August 1991. These also can include giving property (subsection 110-25(4)). The fourth element is capital expenditure to increase the asset's value, and reflected in its state at the time of a CGT event. This can also include giving property (subsection 110-25(5)). The fifth element is capital expenditure to maintain your title to or rights over the asset. This too can include giving property (subsection 110-25(6)).

79. Where a company issues its shares for a CGT asset, it gives property in respect of acquiring the asset; so the market value of the shares will form part of the first element of cost base. For the other elements of cost base, a company issuing its shares for incidental costs, ownership costs, increasing the asset's value, or maintaining title or rights in the asset, issuing the shares is the giving of property to the shareholder.

80. *Ord Forrest* establishes that issuing shares is the disposition of property by the company for the purposes of the former gift duties. Those duties gave an extended meaning to disposition in that context. The views of the Full Court of the High Court also provide judicial support for the view that issuing shares is not a gift, at least where no special provisions extend the meaning of gift. In reliance on the dicta of Barwick CJ, of Gibbs J and of Mason J, the Commissioner stated in TR 93/15 (at paragraph 27 inserted by TR 93/15E) that, in order for property to be 'given' for the purposes of subsection 160ZH(4) of the ITAA 1936, now section 110-25 of the ITAA 1997, that is, in order for it to form part of cost base for CGT purposes, the property must first be the property of the giver.

81. That statement, and that paragraph, are now withdrawn by the Commissioner. The Commissioner considers that the more correct view is that in the context of the CGT cost base provisions the issuing of shares is the giving of property. That is, the company issuing its shares is giving property to the shareholder, in the sense that it is ensuring that the vendor of the CGT asset is provided with something that becomes property of the vendor. This view is consistent with the conclusion of the High Court in *Chief Commissioner of State Revenue v. Dick Smith Electronics Holdings Pty Ltd* [2005] HCA 3. There the court concluded that 'consideration' moving a sale of shares included a dividend required to be funded by the purchaser and paid by the company in which shares were sold. Note however that the legislation there concerned the value of the consideration for the dutiable transaction, not the consideration 'given' for the dutiable property. This view is also consistent with the views of Stephen J in the High Court at first instance in *Ord Forrest* at page 128 that:

> The definition of 'gift' in s. 4 of the Act does not concern itself with detriment to the disponor but rather with whether or not the consideration passing to it from the disponee is 'fully adequate'.

and at page 131 that:

> I would conclude that there was here a gift by the company to each of the allottees.

82. Shares issued for a CGT asset are property given to the vendor of the asset. Where a company has to issue shares for an asset, it has to give shares to the vendor, even though it may not have to give away anything of its own. The contrary view has some support from aspects of the meaning of 'give', but that word has a range of meanings relevant to the meaning of giving property in respect of acquiring property. *The Australian Oxford Dictionary*, 1999, Oxford University Press, Melbourne illustrates the meanings related to transfer and exchange or payment with usages which certainly require the giver to be the mover of the gift but do not necessarily require the giver to own the subject of the gift. *The Macquarie Dictionary*, 2001, revised 3rd edition, The Macquarie Library Pty Ltd, NSW similarly includes relevant meanings that require the giver to deliver freely, bestow, or hand over and to deliver in exchange, but again does not necessarily require a giver to own the subject of the gift. When a company issues shares for assets, it is a reasonable use of language to say the company gives the shares for the assets.

83. When a cost of a CGT asset includes giving property, as it does in the second, third, fourth and fifth elements of cost base, for CGT purposes the market value of the property given is to be used in working out the amount of the payment, cost or expenditure constituted by giving the property (section 103-5). So costs under the second and third elements of cost base, and expenditure under the fourth and fifth elements, are the market value of the property given for those purposes, and if the property given is shares in the giver that means the market value of the shares. The market value rule is explicit in the first element of cost base, without reference to section 103-5. Where current accounting standards apply, the CGT asset acquired is likely to be shown in the accounts at its fair market value rather than according to the value of the shares issued for it. This does not alter the cost of the CGT asset, which remains the market value of the share, not the market value of the asset, should those market values differ.

84. As explained above, a company might issue shares for money payable immediately in circumstances where there is an independent matching obligation on the company to pay money to the shareholder immediately as a cost in relation to an asset. In that case, the parties can agree to set off the two payments, and this is payment in money of both obligations if they do.

85. When that is what happens, and the asset is taxable as a CGT asset, the cost base of the CGT asset does not include the market value of the share in the company. It includes the amount of money required to be paid for the asset, the requirement which was satisfied by the set-off. So in the first element of cost, it is the required payment which is the measure of cost. In the second element of cost, the incidental cost is the required payment, not the share. In the third element of cost, the ownership cost is the required payment, not the share. In the fourth element of cost, the capital expenditure is the money, not the share. Finally, in the fifth element of cost, the capital expenditure is the required payment, not the share.

86. When there is an agreement to issue shares for assets, it is unusual that there will be separate obligations of the company to issue shares for money, of the company to give money for a CGT asset, and with the requirement separately to pay money under each obligation. As *Becker* and the cases discussed at paragraphs 43 to 46 of this Ruling illustrate, an agreement to issue shares for an asset might not give rise to separate obligations of the company to pay for the asset and of the asset supplier to subscribe for the shares. This is so, even if the terms of that single agreement identify a price in money for the asset and an equivalent money amount to be paid for the shares, a situation which must be considered case by case as it arises.

87. In the typical case where there are not obligations to pay for shares and to pay for a CGT asset, which may well be the case where the company could not be made to pay cash for the asset and the vendor could not get cash while the company could only be made to issue shares and the vendor could only get shares, there is no payment of cash in discharge of such obligations by set-off.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

Cost is always the share value and never deductible

88. An alternative view *against* deductibility under section 8-1 is that in all cases where shares are issued for in-kind consideration there is no loss or outgoing and so no deduction is available, even if there was an independent obligation under which there would have been a loss or outgoing and the amount of which was set-off against a corresponding amount required to be paid for the issue of the shares. On this view, the decision to set-off what would otherwise have been a loss or outgoing arising from the independent obligation of the company to pay for the in-kind consideration against the creditor's obligation to subscribe value for the shares means that the company has never really committed itself to any loss of value for the in-kind consideration.

89. This view would mean that the cost base for CGT purposes, and cost for the purposes of the capital allowance rules, would always and only be based on the market value of the shares and not on the amount paid on the shares. This is so even if there were independent money obligations to pay for the shares and to pay for the CGT or depreciating assets satisfied by set-off.

90. The Commissioner does not accept this alternative view. Where an independent obligation requires a company to pay an amount to a creditor, and the creditor and the company independently agree to set-off the company's obligation against an obligation of the creditor to give value for the issue of shares in the company, the Tax Office considers that the better view is that any loss or outgoing under each obligation will be characterised for tax purposes in the same way as if it had been paid by a separate cash payment. Where an obligation is paid by set-off, this produces no different tax consequences to any other method of payment. It is the character of the obligation so paid that matters for tax purposes.

Cost is never the share value and always deductible

91. An alternative view *for* deductibility under section 8-1 is that in all cases where shares are issued for in-kind consideration the value at which the shares are brought to account in the books of the company is a loss or outgoing because it represents an amount forgone by the company. On this view, deductions based on section 8-1, cost for the purposes of Division 40 and cost base for the purposes of Part 3-1 would all arise from an agreement to provide shares for consideration in kind, as appropriate to the consideration; and they would each be the same amount, the paid credit for the shares in the books of the company, never the market value of the shares.

92. This view has some wider economic attractions. It would move this aspect of the income tax law towards economic equivalence, although there could be a marked difference depending on the value at which shares were brought to account compared to the provision of other consideration of the same economic value to the recipient of the consideration. However the income tax law distinguishes between capital and revenue outgoings; and it distinguishes between losses, outgoings and expenditure and consideration of other kinds. The Commissioner does not accept the view. Where shares are issued for assets, there is no loss, outgoing or expenditure incurred and so there are no deductions based on section 8-1; and the cost for the purposes of Division 40 and the cost base for the purposes of Part 3-1 alike are represented by the market value of the shares given, not the amount taken to be paid on the shares (whether that is more or less than the market value of the shares). Where shares are provided for cash, and in-kind consideration is acquired for cash, whether paid by setting off the two cash obligations or not, the in-kind consideration is acquired for cash and there is a loss, outgoing or expenditure incurred accordingly. Therefore the cost for the purposes of Division 40 and the cost base for the purposes of Part 3-1 are worked out on the basis of the cash acquisition (and so without regard to any difference between the cash obligation in relation to the shares and the actual value of the shares given).

93. Moreover, the use of the paid credit in the books of the company could allow considerable difference between the value of the shares and the expenditure, cost or cost base used in calculating income tax obligations. The English cases of *Osborne*, *Zevo Finance, Bercain* and *Drayton* all illustrate aspects of this potential disparity. For instance, in *Zevo Finance*, an investment company was formed from the reconstruction of another company into two parts; the investment company holding speculative stocks, and a capital-secure company holding long term investments. The investment company gave consideration by issue of fully-paid shares for the stocks it bought from the former company at book value. The former company had acquired the stocks before the Great Depression, and the reconstruction occurred during it, so the actual value of the stocks acquired was considerably less than the book value.

94. The Court of Appeal held that the consideration given for the stocks was the credit shown as paid in the company's books. In the House of Lords, the decision of the Court of Appeal was upheld by all judgments. At pages 287-8 Viscount Simon noted that this meant that:

> it is possible to attribute a different figure of cost to the same stock, according to the form which the reconstruction takes. In the present instance, for example, a different figure of profit or loss would be reached if the fully paid shares allotted under the agreement were halved, or doubled. But that is only because the cost of the investments would correspondingly vary.

95. The relevant English law at the time of each of these cases applied to calculate a profit on a realisation of assets such as those acquired by issuing shares, allowing in that calculation specific offsets. One of those was 'the amount or value of the consideration, in money or money's worth, given by him or on his behalf' (using the words of paragraph 4(1)(a) of Schedule 6 to the *Finance Act 1965*; the applicable earlier legislation is to the same effect). These successive provisions are concerned with the amount of consideration given 'by him or on his behalf' for the taxpayer's asset now realised. *Kia Ora* shows that the cases on those provisions are not applicable to the determination of loss, outgoing or expenditure, or of cost of a depreciating asset, or of cost base of a CGT asset, under Australian income tax law.

96. Even if the English view were to be applied under Australian law, it could not override the express provisions of Division 40 or of Part 3-1, which explicitly require reference to market value. So treating the English cases on consideration as applicable would not remove inconsistency between section 8-1 (which would then apply, but would give deductions on the basis of the book value of the shares) and Division 40 and Part 3-1 (which would still apply according to the market value of the shares).

97. Correspondingly, the treatment of a company with a payment in money set off against the proceeds of a share issue (in which deduction, cost and cost base provisions would apply on the basis of the amount required for the shares) would remain inconsistent with the treatment of a company issuing shares as consideration (in which cost base and cost provisions would apply on the basis of the value of the shares).

98. For these reasons, in addition to the explanation already given, the Commissioner rejects the alternative view.

Separate obligations in money generally arise in the one agreement

99. An alternative view for payment in money, by set-off, would make it more practically likely that payment in money would occur in cases where shares are given for in-kind consideration and money amounts are specified in relation to the shares and the in-kind consideration.

100. *Tivoli Vaudeville* was High Court authority for the view that a company which acquired a lease for an amount to be provided by the issue of its shares fully paid to that amount was entitled to write off the amount over the lease term, under paragraph 25(i) of the ITAA 1922. (The relevant provisions then allowed a deduction over the lease term of what was paid for the lease.) It has been argued that this case is therefore authority for the view that, by nominating a price for assets and a price for shares to be provided and taken for the assets, an agreement will generally be providing for consideration in money.

101. However, that case, *R v. Bullfinch Proprietary (WA) Ltd* (1912) 15 CLR 443 (holding that under then WA stamp duty provisions the dutiable consideration for leases acquired for an amount to be provided only in shares issued as paid was the amount and not the value of the shares), and *Messer v. Deputy Federal Commissioner of Taxation* (1934) 51 CLR 472 (holding, conversely, that under paragraph 16(d) of the ITAA 1922 the consideration for the assignment of a lease was the shares given by the company acquiring the lease although a money amount had been stated and a cheque tendered) were each distinguished in *Becker* as cases of no general application and depending on their particular statutory provisions. *Becker* itself concerned a provision which 'unlike the provisions with which the court was concerned in the cases cited, uses the language of everyday affairs without artificial restriction or enlargement', per Kitto J at page 467, and is therefore general in its implications. As payment by set-off is being considered here in the context of the general provisions of the income tax law, provisions which also 'use the language of everyday affairs', *Becker* is the more readily applicable authority.

102. Accordingly the Commissioner does not accept the argument that *Tivoli Vaudeville* is authority for every agreement in which consideration in kind is given for shares to be treated as creating separate sales and purchases for money of the shares and of the assets, if only a money amount is nominated. The Commissioner considers that *Becker* is the more generally persuasive authority, and that the circumstances and terms of each arrangement where both a money amount is nominated and under which consideration in kind is given for shares must be considered case by case in working out whether in-kind consideration has been acquired for shares or for money. The Commissioner prefers *Becker* to the earlier cases distinguished by it.

Appendix 3 – Detailed contents list

103. The following is a detailed contents list for this Ruling:

References

Previous draft:

Previously issued as TR 2008/D1

Related Rulings/Determinations:

TR 93/15; TR 93/15E;
TR 2006/10

Subject references:

- acquisition of trading stock
- acquisition of a CGT assets
- CGT cost base
- cost of a depreciating asset
- deductions & expenses
- trading stock
- trading stock valuation

Legislative references:

- ITAA 1936 20
- ITAA 1936 21
- ITAA 1936 21A
- ITAA 1936 51
- ITAA 1936 73B
- ITAA 1936 73B(1)
- ITAA 1936 160ZH(4)
- ITAA 1997
- ITAA 1997 8-1
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- ITAA 1997 Div 40
- ITAA 1997 40-180
- ITAA 1997 40-185
- ITAA 1997 40-185(1)
- ITAA 1997 40-185(1)(b)
- ITAA 1997 40-190
- ITAA 1997 40-215
- ITAA 1997 40-220
- ITAA 1997 Div 43
- ITAA 1997 Pt 2-25
- ITAA 1997 Div 70
- ITAA 1997 70-15(1)
- ITAA 1997 70-25
- ITAA 1997 70-90
- ITAA 1997 70-90(1)
- ITAA 1997 70-90(1A)
- ITAA 1997 70-95
- ITAA 1997 Pt 3-1
- ITAA 1997 103-5
- ITAA 1997 110-25
- ITAA 1997 110-25(2)
- ITAA 1997 110-25(3)
- ITAA 1997 110-25(4)
- ITAA 1997 110-25(5)
- ITAA 1997 110-25(6)
- ITAA 1997 Pt 3-3
- ITAA 1997 995-1(1)
- ITAA 1922 16(d)
- ITAA 1922 25(i)
- Finance Act 1965 Sch 6 4(1)(a)
- TAA 1953

Case references:

- Burrill v. Federal Commissioner of Taxation (1996) 67 FCR 519; 96 ATC 4629; (1996) 33 ATR 133
- Chief Commissioner of State Revenue v. Dick Smith Electronics Holdings Pty Ltd (2005) 221 CLR 496; [2005] HCA 3; 2005 ATC 4052; (2005) 58 ATR 241
- Commissioner of Stamp Duties (NSW) v. Perpetual Trustee Co Ltd (Saxton's Case) (1929) 43 CLR 247
- Coren v. Keighley (1972) 48 TC 370
- Craddock v. Zevo Finance Co Ltd (1946) 27 TC 267; [1944] 1 All ER 566; (1946) 174 LT 385
- Curran v. Federal Commissioner of Taxation (1974) 131 CLR 409; 74 ATC 4296; (1974) 5 ATR 61
- Federal Commissioner of Taxation v. Becker (1952) 87 CLR 456; [1952] ALR 1018; (1952) 10 ATD 77
- Federal Commissioner of Taxation v. Energy Resources of Australia Ltd (1994) 54 FCR 25; (1994) 126 ALR 161; 94 ATC 4923; (1994) 29 ATR 553
- Federal Commissioner of Taxation v. Steeves Agnew & Co (Vict) Pty Ltd (1951) 82 CLR 408; [1952] ALR 29; (1951) 9 ATD 259
- Gardner v. Commissioner of Probate Duties [1967] WAR 106
- J C Williamson's Tivoli Vaudeville Pty Ltd v. Federal Commissioner of Taxation (1929) 42 CLR 452
- John v. Federal Commissioner of Taxation (1989) 166 CLR 417; 89 ATC 4101; (1989) 20 ATR 1

- Joseph v. Campbell (1933) 50 CLR 317; [1933] ALR 390
- Lend Lease Corporation Ltd v. Federal Commissioner of Taxation (1990) 95 ALR 427; 90 ATC 4401; (1990) 21 ATR 402
- Lowry v. Consolidated African Selection Trust Ltd (1940) 23 TC 259; [1940] AC 648; [1940] 2 All ER 545
- Messer v. Deputy Federal Commissioner of Taxation (1934) 51 CLR 472; [1934] ALR 364
- Northern Roller Milling Co Ltd v. Commissioner of Taxes [1953] NZLR 517
- Ord Forrest Pty Ltd v. Federal Commissioner of Taxation (1974) 130 CLR 124; 74 ATC 4034; (1974) 4 ATR 230
- Osborne v. Steel Barrel Co Ltd (1942) 24 TC 293; [1942] 1 All ER 634
- Pilmer v. Duke Group Ltd (in liq) (2001) 207 CLR 165; [2001] HCA 31; (2001) 49 ATR 324
- PJ Underwood v. HM Revenue and Customs [2008] EWHC 108 (Ch)
- Pro-Image Studios v. CBA (1991) 4 ACSR 586
- R Harding and Co Ltd v. Hamilton [1929] NZLR 338
- R v. Bullfinch Proprietary (WA) Ltd (1912) 15 CLR 443; [1912] HCA 71; (1912) 18 ALR 567
- Re Federal Traders Ltd [1934] SASR 174
- Re Goodman Brothers Auto and Service Co Ltd; ex parte FW Rose [1927] SASR 571
- Re Government Security Fire Insurance Co (White's Case) (1879) 12 Ch D 511
- Re Harmony and Montague Tin and Copper Mining Co Ltd (Spargo's Case) (1873) LR 8 Ch App 407; (1873) 28 LT 153; [1861-73] All ER Rep 261
- Re LB Holliday & Co Ltd [1986] 2 All ER 367
- In re Richmond Hill Hotel Company (Pellatt's Case) (1867) LR 2 Ch App 527
- SEAA Enterprises Pty Ltd v. Figgins Holdings Pty Ltd [1998] 2 VR 90
- Shearer (Inspector of Taxes) v. Bercain Ltd (1980) 53 TC 697; [1980] 3 All ER 295
- Stanton (Inspector of Taxes) v. Drayton Commercial Investment Co Ltd (1982) 55 TC 286; [1982] 2 All ER 942; [1983] 1 AC 501
- In re Theatrical Trust Ltd (Chapman) [1895] 1 Ch 771
- Whim Creek Consolidated NL v. Federal Commissioner of Taxation (1977) 31 FLR 146; (1977) 77 ATC 4503; (1977) 8 ATR 154
- In re Wragg, Ltd [1897] 1 Ch 796

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ATO references

NO:	2007/8720
ISSN:	1039-0731
ATOlaw topic:	Income Tax ~~ Capital allowances ~~ cost of depreciating assets Income Tax ~~ Capital Gains Tax ~~ cost base and reduced cost base Income Tax ~~ Trading stock and work in progress