

Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

TREASURY

Australian Taxation Office

(Budget Estimates 29 May 2007)

Question **BET 97**
Topic: **Rights issues**
Hansard Page: **E58-59**

Senator **Watson** asked:

My question is directed to the Taxation Commissioner. ATO are sanctioned in taxing corporate rights issues and from observation I note that the issuing share price generally falls following a rights issue. That reduction does not appear to have been recognised in the ruling and thereby the taxing of the rights may create an artificially high price. The second part of the question is: if shareholders allow the rights to lapse through ignorance or other reasons, given that by virtue of the fact that they have not accepted the offer, can you confirm that no tax will be levied on such situations?

Mr D'Ascenzo—Are you referring to share buy-backs or are you referring to rights issues?

Senator WATSON—Rights issues.

Mr D'Ascenzo—I am not sure about the question.

Senator WATSON—It is an ATO class action. It is tax and corporate rights issues.

Mr D'Ascenzo—We have been in consultation with the industry in relation to the outcome of the High Court's decision in the McNeil case. Out of that process there are some situations where if it is a nonrenounceable right you have a certain outcome and if it is a renounceable right you are likely to have another outcome. And those outcomes will vary depending on your circumstances and there will be circumstances where there seem to be anomalies in the treatment of rights, and that is a matter that we have raised and are discussing with Treasury in terms of possible legislative approaches. But at this stage we are in the course of consulting with people to see how it applies. One rule does not apply across all rights issues. It really does depend on the circumstances of those issues.

Senator WATSON—As it originally stood, would it give rise to a consequence of double taxation for capital gains purposes or would you get a deduction for tax paid on the rights issue?

Mr D'Ascenzo—The newspapers got it wrong in terms of supposing that there is one rule that applies in all of these circumstances. You have to find out what the situation is in terms of the nature of the rights issue, whether it is renounceable or non-renounceable, and also the position in terms of whether someone sells the right or does not sell the right, and then the position of the capital gains tax on top of that. So it does vary.

Senator WATSON—Could you give the committee a schedule of all of those options or situations?

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Senator WATSON—Could you also give the committee a summary of that High Court ruling that led to your class action? That might provide us with a bit more background as to what could be their personal liabilities for the future.

Mr D'Ascenzo—We will provide a summary of the impact in this area. As I said, we have been in consultation with the professional bodies. As far as the professional bodies and the advisers are concerned, there is no misunderstanding of how the law operates or could operate.

Senator WATSON—It does not seem to have been reported that way in the popular press.

Mr D'Ascenzo—That is right.

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Answer:

Summary of High Court decision in *McNeil*

- 1) In February 2001, St George Bank (SGL) issued to its shareholders, including Mrs McNeil, one sell-back right for every twenty shares they held. A trustee was created to hold the issued rights, and a buyer was arranged to buy them from the trustee in certain circumstances, and in those circumstances to sell them or exercise them.
- 2) In short, the shareholders could either exercise the right and sell back a share to SGL for a sum in excess of its market value, or sell the right on market, or do nothing in which case the right would be sold on their behalf for a designated price. Mrs McNeil chose to do nothing, so her sell back rights were sold and the money realised paid over to her. Clearly, the sell back right had a value when issued to the trustee for and on behalf of Mrs McNeil, which was agreed between the parties to the case to be \$1.89.
- 3) The Tax Office issued a class ruling stating that those shareholders who received sell back rights would be liable to pay income tax.
- 4) The High Court on 22 February 2007 allowed the Commissioner's appeal from the Full Federal Court that share sell back rights granted to St. George Bank shareholders in 2001 are considered income and therefore assessable.
- 5) In coming to their decision that the sell back rights were income in Mrs McNeil's hands, the majority relied on the established principles that determine the character of income. The first principle the Court relied on was that in determining whether a particular receipt has the character of the derivation of income, one must look to the quality in the hands of the recipient and not the character of the expenditure by the other party.
- 6) The second principle the Court relied on is that, as a general proposition, a gain derived from property has the character of income and this includes a gain to an owner who has waited passively for that return from property..
- 7) The question for the Court then became whether the sell-back rights enjoyed by Mrs McNeil represented a gain to her from property. In other words, whether they were severed from, and were a product of, her shareholding in SGL which she retained. If, on the other hand, the grant to her of the sell-back rights did not leave her shareholding intact and untouched but in some way represented merely a re-expression of the rights which constitute the share, the sell-back right would not constitute a gain from property in her hands but rather a receipt of capital.

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- 8) The majority of the Court did not see the receipt of the sell-back rights as altering the capital structure that was Mrs McNeil's shareholding in SGL. In other words, when the sell-back rights were constructively received by Mrs McNeil they were characterised as something of value which was the product of and severed from Mrs McNeil's shareholding in SGL and thus the sell-back rights constituted her income from property according to ordinary concepts. As an Australian resident, the sell-back rights were therefore included in Mrs McNeil's assessable income.
- 9) The Minister for Revenue and Assistant Treasurer issued a press release on 26 June 2007 foreshadowing legislation to reverse the effect of the *McNeil* decision on rights issues to shareholders. The Minister stated that: "shareholders issued with rights by companies seeking to raise capital will not have an income liability at the time of issue. Instead, the long-standing position to treat rights issues on capital account will be maintained." The Minister went on to state that "the amendments (to the law) will apply from 2001-02 year" and "this will prevent any adverse application of *McNeil*'s case to companies and their shareholders."