The Institute of Chartered Accountants in Australia

7 July 2008

The Secretary
Senate Standing Committee on Economics
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir or Madam

Tax Laws Amendment (2008 Measures No. 3) Bill 2008

The Institute of Chartered Accountants welcomes the opportunity to make a submission to the Senate Standing Committee on Economics in relation to its inquiry into the following measures contained in the abovementioned Bill:

Schedule 1 – shareholder and unitholder rights
Schedule 2 – restriction on GST refunds and time limits for recovery and refund of indirect tax

The Institute is the leading professional accounting organisation in Australia, representing over 48,000 members in public practice, commerce, academia, government and the investment community. The Institute's members are advisers to businesses at all levels, from small and medium sized businesses to the largest global corporations operating in Australia and overseas.

Our comments on these Schedules are set out in Appendix A and Appendix B respectively.

Executive summary

Appendix A – shareholder and unitholder rights

The Institute strongly recommends that Schedule 1 of the Bill be passed expeditiously to provide certainty to companies and trustees of unit trusts seeking to raise capital through the issue of rights to existing shareholders or unitholders in respect of shares or units of a kind covered by the Bill. We would expect that rights issues of this kind would account for the vast majority of fund raisings involving rights issues. For those rights, the Bill reinstates the tax treatment which applied prior to the decision of the High Court in McNeil's case which was handed down on 22 February 2007.

However, in our view, there are a number of further issues arising from the decision in McNeil's case which could have been dealt with in the Bill to provide certainty to stakeholders. While some of these issues may, in time, be able to be dealt with satisfactorily through Taxation Office interpretative products, to the extent that they cannot and result in unintended tax consequences, further amendments may be required.

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The Institute has a number of concerns regarding the consultative process which occurred following the decision in McNeil's case and which spanned a change in government. The background to and reasons for those concerns are set out in more detail in Appendix A.

The Institute is alive to the fact that the Government is committed to improving the consultation process and, to this end, established the Tax Design Review Panel on 2 February 2008 to examine how tax design might be improved. The Institute lodged a submission with the Panel in which it made a number of recommendations based on its many years of experience in the consultation process, including the consultation following the McNeil decision.

We are hopeful that the Government's response to the Panel's report will recommend improvements to the consultation process to address the sort of concerns raised by stakeholders with the Panel, including the sort of concerns illustrated by the response to the decision in McNeil's case.

Appendix B - restriction on GST refunds and time limits for recovery and refund of indirect tax

For reasons set out in Appendix B, the Institute submits that Schedule 2 of the Bill and the Explanatory Memorandum accompanying the Bill should be amended to correct drafting errors and give a better contextual basis for the interpretation of these difficult provisions, in that:

> The proposed amendments to the law require alteration to accord with the stated policy intentions of the amendments; and

> The proposed amendments create unintended consequences and uncertainty.

At a minimum, the obvious drafting errors in the amendments contained in Schedule 2 of the Bill should be corrected prior to passage of the Bill. However, at some point attention must also be paid to the defects in the fundamental framework of the refund and time limitation provisions.

Should you wish to discuss any issues raised in our submission, please do not hesitate to contact Ali Noroozi on 02 9290 5623.

Yours faithfully

GRAHAM MEYER
Chief Executive Officer

Summary of Appendices and Attachments

Appendix/Attachment	Description
Appendix A	Schedule 1 – shareholder and unitholder rights
Appendix B	Schedule 2 - restriction on GST refunds and time limits for recovery and refund of indirect tax
Attachment A/1	Submission dated 24 April 2008 on draft legislation dealing with the taxation of rights
Attachment A/2	Addendum to NTLG Agenda item on McNeil's case following amendments proposed in *Tax Laws Amendment (2008 Measures No.3) Bill 2008*

Appendix A

Schedule 1 – shareholder and unitholder rights

The Institute welcomes the amendments proposed by Schedule 1 of the Bill to deal with the tax outcomes arising from the decision of the High Court in *McNeil v Commissioner of Taxation [2007] HCA 5* in relation to:

- certain rights issued to shareholders or unitholders to acquire further shares or units in the issuing company or unit trust (referred to as "call options")
- rights issued to shareholders to dispose of shares held in a company (referred to as "put options").

The amendments, when passed, will provide certainty for companies and trustees of unit trusts seeking to raise capital through the issue of call options in the more common situations by reinstating the tax treatment which applied prior to the decision of the High Court in McNeil's case.

While the amendments do not seek to restore the tax treatment of put options to that which was thought to apply prior to the decision in McNeil's case, which specifically dealt with put options, they do aim to ensure that any potential double tax issues are avoided. To date, no policy reason has been provided for retaining the treatment of put options which arises as a consequence of McNeil's case.

Given the short time to review the proposed changes for the purpose of this submission, the Institute has been unable to review the proposed amendments in detail to ensure that, in respect of the rights to which they apply, they achieve their stated objective and do not give rise to any unintended consequences.

In these circumstances, our comments are largely confined to issues which arise from McNeil's case which, in our view:

- are not adequately addressed in the amendments contained in the Bill and which may or may not be able to be adequately dealt with in Taxation Office interpretative products
- should be reconsidered as a matter of policy.

Notwithstanding that all of the issues arising from McNeil's case may not be adequately addressed in the amendments proposed in Schedule 1 of the Bill, we strongly recommend that Schedule 1 of the Bill be passed expeditiously to provide certainty in the circumstances covered by the Bill.

Unresolved issues

The Institute was involved in consultation with Treasury prior to the Bill being introduced into Parliament. During that consultation, we raised a number of issues arising from the decision in McNeil's case which, in our view, should be addressed in

any amending legislation. A copy of our submission on a confidential exposure draft of the Bill is attached as Attachment A/1.

We are pleased that a number of the issues raised in our submission have been dealt with in the Bill. In particular, the Bill includes certain rights issued to trust unitholders (issue 1B) and does not require that the issuing entity be an Australian resident (issue 2).

However, there are a number of issues which have not been addressed, some of which are more significant than others.

We understand that Treasury is of the view that issues which have not been addressed in the amendments should properly be resolved through interpretive or other products to be issued by the Taxation Office. A list of issues identified as requiring resolution or further guidance has been provided to the Taxation Office and is attached as Attachment A/2.

Preliminary discussions with the Taxation Office suggest that certain unresolved issues may be satisfactorily dealt with through interpretive products issued by the Taxation Office. However, the likelihood is that this will not be the case with all issues.

We therefore consider that there may be a possible need for further legislative amendments at a later date. These might include:

Call options issued in respect of converting interests

The effect of the amendments in respect of call options is to ensure that the tax treatment which applied prior to the decision in McNeil's case continues to apply *for shares or units to which the amendments apply.*

The amendments do this by ensuring that the market value of those rights at the time of issue is not included in assessable income (regardless of whether those rights are "renounceable" or "non-renounceable"). Any capital gain or loss will therefore arise only when the rights are disposed of (other than through exercising the rights) or the shares or units acquired on exercise of those rights are sold.

The problem which arises is that the amendments do not apply to *all* rights which are issued in respect of existing shares or units of a shareholder or unitholder. For example, even accepting that the decision in McNeil's case is limited to rights issued to shareholders or unitholders, the amendments do not apply to rights issued in respect of shares or units which are converting interests, e.g. convertible preference shares. In these circumstances, should the principles in McNeil's case apply to such rights, the value of the rights will be included in assessable income at the date of grant but, despite the amendments, there will remain no capital gains tax ("CGT") cost base for the rights thereby resulting in double taxation.

The Explanatory Memorandum ("EM") to the Bill indicates that the reason for excluding from the scope of the amendments rights issued to shareholders if the original interests are convertible is that "the principles in McNeil's case are not easily applied to convertible interests". Despite this, our preliminary discussion with the Taxation Office suggests that it should not be concluded that the principles in McNeil's case cannot apply to rights issued in respect of convertible interests.

In the event that the Taxation Office concludes that in its view the principles in McNeil's case do apply, with resulting double taxation, it is unfortunate that the opportunity was not taken to ensure that the amendments contained in the Bill put the position beyond doubt.

Call options issued in respect of shares or units held on revenue account or as trading stock

Where shareholders or unitholders hold their shares on revenue account or as trading stock, the amendments contained in the Bill do not apply. Instead:

- the shareholder or unitholder will be taxed on the market value of the rights at the time of issue, and
- the shareholder or unitholder will also be subject to tax on any profit on sale of those rights or the shares or units disposed of as a consequence of exercising those rights.

It is not clear how, at law, such shareholders or unitholders can treat the amount taxed on issue of the rights as part of the cost of the right in calculating any subsequent profit on sale of the right (or as part of the cost of shares or units acquired on exercise of the rights in calculating any profit on sale of those shares or units). In this respect we should add that there are no existing provisions in the taxation legislation which give shareholders or unitholders a deemed cost for the assessable rights. In the event that the Taxation Office is unable to resolve through an interpretive product the uncertainty regarding the tax cost of rights issued in respect of existing shareholdings or unitholdings then further legislative amendments may be required.

More fundamentally, we question the rationale for excluding from the amendments contained in the Bill rights issued to shareholders or unitholders whose shares or units are held on revenue account or as trading stock. One view is that this accords with their tax treatment pre-McNeil's case. On this point we submit that, until the McNeil decision, there was no authority of which we are aware to the effect that the value of rights granted to a shareholder or unitholder in respect of pre-existing shares or units held on revenue account or as trading stock was assessable as income. Indeed, the absence of a cost adjustment has no doubt been regarded by affected taxpayers as a basis for concluding (at least prior to McNeil's case) that the grant of rights was not a taxing event.

In these circumstances, we consider that where original shares or units are revenue assets or held as trading stock, then the shareholder should be taxed on any profit made on disposal of the rights at the time of disposal (or at the time of disposal of any shares or units acquired as a result of exercising those rights). Indeed, comments in paragraph 1.12 of the EM to the Bill could be read as suggesting that this is the legislative intent. To assess a shareholder or unitholder simply because the shareholder or unitholder has a right to invest more capital is in our view an undesirable outcome since such policy will create uncertainty and may adversely impact the capital raising alternatives available to Australian companies and unit trusts.

The consultation process

It should be apparent from the abovementioned comments that, in our view, the consultation process in relation to the issues which have arisen as a consequence of

the decision in McNeil's case has not been entirely satisfactory in a number of respects.

The High Court decision was handed down on 22 February 2007 and immediately provoked major concern in the business sector, which was raised with Treasury, the Taxation Office and Government. Little feedback was provided to the business sector about progress and the way forward. Thus, the policy development process took over 12 months from the High Court's decision.

After the Treasurer foreshadowed urgent action, the legislation was developed speedily. Unfortunately, the consultation process was very abbreviated and focused only on the most common scenario impacted by the McNeil decision and has resulted in a number of areas of uncertainty for stakeholders as noted above.

In our view the uncertainties could have been resolved more efficiently had the Taxation Office and Treasury processes proceeded more speedily and in a more transparent manner, with clearer indications of Taxation Office views leading to Treasury and Government policy development, and Treasury positions, before and after the 2007 election.

The Institute welcomed the fact that, on 8 February 2008, the Treasurer established the Tax Design Review Panel to examine how to reduce delays in the enactment of tax legislation and improve the quality of tax law changes. The Institute lodged a submission with the Panel in which it made a number of recommendations in relation to the consultation process based on our experience over many years, including our experience of the consultation process following the decision in McNeil's case. The Panel's findings and recommendations were submitted to the Government on 30 April 2008.

We are hopeful that the Government's response to the Panel's report will recommend improvements to the consultation process to address the sort of concerns raised by stakeholders with the Panel, including the sort of concerns illustrated by the response to the decision in McNeil's case.

Appendix B

Schedule 2 - restriction on GST refunds and time limits for recovery and refund of indirect tax

The Institute submits that Schedule 2 of the *Tax Laws Amendment (2008 Measures No. 3) Bill 2008* (the "Bill") and the Explanatory Memorandum ("EM") accompanying the Bill should be amended to correct drafting errors and give a better contextual basis for the interpretation of these difficult provisions, in that:

- The proposed amendments to the law require alteration to accord with the stated policy intentions of the amendments and
- The proposed amendments create unintended consequences and uncertainty.

At a minimum, the obvious drafting errors in the amendments contained in Schedule 2 should be corrected prior to passage of the Bill. However, at some point attention must also be paid to the defects in the fundamental framework of the refund and time limitation provisions.

Objectives of the proposed measures

The Press Release of the Treasurer, The Honourable Wayne Swan MP, of 6 May 2008 entitled "Indirect Tax: Refunds and Amendment Time Limits"[1] stated that:

- In relation to the "refunds" measures, the proposed measures were necessary because (following the decision in *KAP Motors Pty Ltd v Commissioner of Taxation*[2]),

  "These provisions seek to ensure that the benefit of the refund goes to the person who has borne the tax. Hence, a business that has overpaid GST must refund that amount to the customer that has borne the cost of GST before obtaining a refund. Similarly, the provision seeks to prevent refunds to businesses where their customer is registered for GST, as the customer is generally able to claim input tax credits which offset the incidence of GST on the transaction".

- In relation to the four year time limit measures,

  "The decision has also highlighted an anomaly in the operation of the four-year limit on the payment and refund of indirect taxes. This anomaly undermines certainty for taxpayers by preventing relevant indirect tax refunds and liabilities becoming final after four years.

  ... The Government will also seek to ensure a consistent four-year time limit applies to refunds and tax liabilities for indirect taxes."

The EM states that the proposed measures will amend the following flaws in existing law, contained in Schedule 1 of the *Taxation Administration Act 1953* ("TAA"), to ensure:

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[1] No 030 of 2008

[2] [2008] FCA 159

- that the restriction on refunds applies whether or not a transaction in respect of which goods and services tax (GST) has been paid is in fact a supply
- that the four-year time limit on recovery applies where a refund is overpaid to a taxpayer and
- that the four-year time limit applies where a refund is payable by the Commissioner of Taxation due to a reduction in the liability of a taxpayer.

Refund provisions – section 105-65 of Schedule 1 of TAA

The Proposed Amendments

Subsection 105-65(2)

The proposed new subsection 105-65(2) appears to contain a drafting error. The provision in the existing law[3] refers to "so much of any *net amount ***or amount of *indirect tax*** as you have overpaid" (emphasis added).

The proposed amendment refers to "so much of any *net amount ***or amount of *GST*** as you have overpaid". The subsection goes on to use the "amount of GST" terminology in subparagraph 105-65(2)(b)(i) instead of "amount of indirect tax".

We find it difficult to contemplate the reason for the change which seems to limit the application of the "passing on" provision from its current scope.

The discretion

We discuss the discretionary nature of section 105-65 below. Essentially, the section does not contain any statutory direction as to the matters to be taken into account by the Commissioner to deny a refund that is otherwise properly payable.

The Institute considers that it would assist better administration and promote certainty if the provision contained matters that would be taken into account in determining whether the discretion to disallow a refund ought be exercised. We consider that public administration would be assisted if the section provided specifically against unjust enrichment or windfall gains of either the supplier or recipient.

Exclusive code

The provision as presently drafted is a negating provision – that is, it applies only if the law would otherwise permit a refund. The Institute submits that the administration of the refund provisions would be served if the legislation provided for an exclusive code for refunds of overpaid GST and indirect tax. The clear inference of the decision in KAP Motors is that Subdivision 105-C does not represent an exclusive code and that common law rights of refunds persist to the extent that the legislation does not preclude that right.

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[3] In subparagraph 105-65(2)(a)(i)

The Explanatory Memorandum (EM)

The EM contains a number of statements that may give rise to some doubt as to the intended operation of section 105-65 that, in the Institute's view, might be better or more accurately expressed. We are concerned in this respect because of the courts' practice to refer to explanatory memoranda in seeking to discern the intended policy of legislation and amendments thereto.

In making these submissions we are concerned to ensure that the EM to the proposed measures contains sufficient accurate commentary as to the context of the refund provisions and time limitations to guide the Commissioner and the courts in the application of the provisions in future. Similar provisions have been the subject of litigation in the past and, in our view, a recitation of the context in which limitations on the revenue and taxpayers in claiming underpayments and refunds is important to limit uncertainty in the future.

In particular:

- at paragraphs 2.3 and 2.4 of the EM, it is stated that:

  "2.3 In the case of business-to-business transactions, the Commissioner is not required to refund overpaid GST because the purchasing business is potentially entitled to input tax credits to offset the GST included in the price of its acquisition.
  2.4 A discretion exists so that, for example, in business-to-business transactions, the Commissioner may refund overpaid amounts if the supplier can demonstrate that they have first reimbursed the registered recipient of a supply for the amount of GST included in the price and the Commissioner considers it reasonable in the circumstances.

  The Institute considers that this explanation is incorrect in that, whatever discretionary power the section might confer on the Commissioner, the section does not direct its exercise *"if the Commissioner considers it reasonable in the circumstances"*. Section 105-65 allows the Commissioner to refuse to pay a refund in either one of the following circumstances,

  - he is not satisfied that the claimant has reimbursed the overpayment of GST to the customer
  - the customer is *registered or *required to be registered.

  The legislation does not confer the limitation only in cases where he considers it reasonable in the circumstances.

  In this regard, we refer to the comments of Hill J in the Copperart case[4]. His Honour made specific reference to the direction of the legislature to "having regard to the circumstances it would be reasonable to do so" in a provision of the income tax law and the absence of those words in the sales tax law provision with which he was concerned. While we agree that the Commissioner's power to refuse to pay a refund is discretionary and, in exercising that discretion he must act reasonably, we do not consider that the EM should enhance the words contained in the legislation itself.

[4] *Copperart Pty Ltd v Federal Commissioner of Taxation* 93 ATC 4779

- The section allows the Commissioner to refuse a refund where the customer is registered or required to be registered, whether or not the customer has been reimbursed. The EM, in describing the effect of the KAP Motors decision and the role of the proposed measures, fails to give this second condition (allowing the Commissioner to refuse a refund) its full force. The EM fails, therefore, to emphasise the statement of intent contained in the Treasurer's Press Release that "the provision seeks to prevent refunds to businesses where their customer is registered for GST, as the customer is generally able to claim input tax credits which offset the incidence of GST on the transaction". As a result, it leads to the conclusion that, if the business customer is reimbursed, the discretion to pay the refund will be exercised. In this regard we refer to:

    - the recent High Court case of Avon Products[5]. Unlike the GST law, the relevant provision of the sales tax law, with which the High Court was concerned, required the taxpayer to have "passed on" the sales tax liability to the customer. The High Court decision contains a useful commentary on the character of an indirect tax and its intended incidence on customers that is, in our view, worthy of greater commentary in the EM to give a background to the reason for limitation of refunds where the incidence of the tax has been "passed on"

    - the decision of KAP Motors itself that confirmed the section was directed at ensuring that windfall gains did not arise from GST refunds[6] at the expense of the Revenue. The Institute submits that, given the absence of any direction or relevant matters for the Commissioner to take into account in refusing a refund under the section, the EM should provide a greater commentary of the purpose of the Commissioner's power.

- The Chippendale case[7] confirmed that the "regime contained in Pt 4 of [the Sales Tax Assessment Act] for reimbursement for sales tax overpaid represents a statutory code which provides relief against overpaid sales tax to the exclusion of what otherwise could be common law claims for money paid under mistake." The implication of the KAP Motors is that Subdivision 105-C will only operate to the exclusion of the common law where it imposes limitations on claims. The EM ought to express a view on whether the amendments to section 105-65 are intended to operate as an exclusive code under which refunds can be claimed. If it is concluded that the legislative scheme is not sufficient to achieve exclusion of the common law, consideration ought to be given to whether the legislation ought be amended to ensure that the Subdivision operates as intended.

- The inference contained in the EM is that the existing law is deficient where a payment is not consideration for a taxable supply. The finding in KAP Motors is, in the Institute's view, limited to the unique situation that was agreed as facts. In many cases (as the High Court decision in Reliance Carpets[8] illustrates) the existence of a supply may be satisfied in many circumstances, even though a payment that relates to the supply may not be "consideration" in connection with the supply so that there is a taxable supply. The question will most often be the nexus of the payment to a supply and not the existence of a supply *per se*. Accordingly, the limitation in section 105-65 applies only where the taxpayer has

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[5] *Avon Products Pty Limited v Commissioner of Taxation* [2006] HCA 29

[6] Whilst holding that the provision did not apply to "no supply" cases

[7] *Chippendale Printing Co Pty Ltd v Commissioner of Taxation* (1996) 62 FCR 347

[8] *Commissioner of Taxation v Reliance Carpet Co Pty Limited,* [2008] HCA 22

treated something that is not a supply as being sufficiently connected with the payment made in relation to it. The EM should emphasise the narrowness of the KAP Motors deficiency and give examples as to the nexus vs "no supply" propositions.

Time Limitation Provisions - sections 105-50 and 105-55 of Schedule 1 of TAA

The Proposed Amendments

Subsection 105-50(2)

The proposed subsection 105-50(2) proposes to treat as no longer recoverable, an amount paid to a taxpayer that exceeds the amount that the taxpayer was entitled to be paid, if it has not been subject to a relevant notice from the Commissioner 4 years "after [the excess] ***became payable by you***" (emphasis added).

Whereas subsection 105-50(1) applies to underpayment of positive net amounts, subsection 105-50(2) is directed at negative net amounts. Accordingly, the Institute considers that the reference to an amount "**payable by you**" should be a reference to 4 years after the excess "was paid to you or applied under Division 3 of Part IIB of this Act.".

In this regard, an "overpayment" made to a taxpayer (e.g. where the taxpayer lodges a BAS with a negative net amount), is recoverable under subsection 8AAZN(1) of the TAA. The amount is payable by the taxpayer 30 days after a notice is issued to the taxpayer in respect of the overpaid amount (subsection 8AAZN(2)). This position was confirmed by the South Australian District Court in *Deputy Commissioner of Taxation v De Angelis*.

While the outcome of that case is under appeal, the Institute submits that the 4 year time limit ought to expire 4 years after the overpayment – in this way, the 4 year limit for an overpayment of a refund will coincide with the underpayment of a positive net amount.

Subsection 105-50(3)

The subsection employs the same language as the existing provision in that it allows the 4 year time limit to be avoided if the Commissioner "has required payment of the amount ... by giving a notice to you". The previous sales tax law contained similar wording. In the Copperart case, Hill J rejected a submission that the Commissioner's notice requiring payment of an amount "should stipulate the precise figure of sales tax payable".

His Honour stated that to do so "when that information may well be known only to the taxpayer and not disclosed to the Commissioner by the taxpayer, imposes ... an unreasonable burden upon the Commissioner. It is also inconsistent with the explanatory memorandum to which I have already referred."

The Institute submits that, to achieve the stated policy of "certainty for taxpayers by preventing relevant indirect tax refunds and liabilities becoming final after four years", the requirement of the contents of the Commissioner's notice should be set out with particularity.

In this regard, the Institute submits that the law should require that the Commissioner specify the amount of the underpayment or overpayment, the tax periods and the particular of the items in question. In the absence of such a specification, the

Commissioner should be able to extend the 4 year period in a similar way to subsection 170(4) of the *Income Tax Assessment Act 1997,* by application to the Federal Court or with the consent of the taxpayer.

The Institute submits that the existing terminology without any clarification creates uncertainty as to when a taxpayer's affairs reach finality.

Equally, the taxpayer must not be prevented (through section 105-55) from seeking a reduction in a net amount or lodging an objection against an increase in liability made within the 4 year period as a result of an assessment authorised by a notice served within the 4 year period.

The uncertainty surrounding the contents of the Commissioner's notice also impacts on the application provision. The Institute submits that the commencement date is deserving of more certainty.

Subsection 105-55(2)

The existing law is uncertain as to whether the "refund" that is claimed is the overpayment of a positive net amount or any overpayment of GST on a supply. The policy requires that a taxpayer is only entitled to a refund if the "net amount" for a tax period is incorrect, that is, it must take account of all errors in the period in determining whether there ahs been an overpayment of the "net amount" for the tax period.

The proposed amendment to subsection 105-55(2) should read as follows (addition highlighted):

> "(2) Subsection(1) applies to:
> (a) a refund in relation to a *net amount or *net fuel amount in respect of a particular *tax period; or
> (aa) another payment that represents some or all of an amount
> (i) that you paid as ***a net amount or*** an amount of *indirect tax payable by you in respect of a particular tax period; and
> (ii) that exceeded the amount (if any) of such tax that you were liable to pay in respect of that tax period; or.."

Subsection 105-55(3)

In a similar way to subsection 105-50(3), the terminology "you notify the Commissioner that you are entitled to the refund, other payment or credit" is not, in the Institute's view sufficiently specific to provide certainty as to when a taxpayer's affairs reach finality. The Commissioner issued a ruling (SST 7) dealing with similar terminology contained in the previous sales tax law. The provision however, was discretionary and allowed the Commissioner to determine the sufficiency of evidence to be produced with the notice of entitlement.

The Institute submits that the limitations on the Commissioner and the taxpayer ought to be consistent in applying the 4 year finality rule. We agree with the Treasurer's statement of the policy intent of these amendments to "ensure a consistent four-year time limit applies to refunds and tax liabilities for indirect taxes."

Accordingly, the Institutes submits that the taxpayer ought to be required to specify the amount of the overpayment, the tax period and the particularity of the overpayment within the 4 year period.

As with the income tax law, nothing in section 105-50 or 105-55 should limit the making of a refund to give effect to a decision on objection, appeal or review.

Application – item 16

(a) Sub-item 16(2)

The commencement date refers to notifying "the Commissioner in writing... that you were entitled to the refund, other payment or credit". The Institute considers that this terminology is not sufficiently certain to ascertain whether or not a taxpayer is able to keep the 4 year period open. If the purpose of the proposal is to give certainty as to finality in the 4 year period, the Institute submits that the proposed provision is inadequate.

(b) Sub-item 16(3)

The last part of the application provisions suggest that the 4 year rule will "not prevent amendments made by this Schedule from applying to amounts that become payable, or entitlements that arise, on or after" 1 July 2008.

The EM does not clarify the meaning of this provision. Arguably, a taxpayer who obtains a refund after 1 July 2008 as a result of lodgement of a notice before 1 July 2008, will be subject to a fresh 4 year period without the limitation applied to the tax period in question under section 105-50.

The Institute considers that this is an inappropriate outcome.

The Explanatory Memorandum (EM)

For the reasons set out above, the EM, in the Institute's view fails to fully explain the impact and context of the time limitation in sections 105-50 and 105-55.

In this regard the Institute makes reference to the comments of Hill J in the Copperart case.

In particular:

- The EM does not explain or comment upon whether section 105-55 applies to an overpayment of a positive net amount or an overpayment of GST on a particular supply. The examples in the EM should explain the relevance of the provisions to the net amounts for a tax period and illustrate errors of under and overpayments of tax in the one tax period.
- The EM ought to explain what is required of a notification by the Commissioner or the taxpayer that is sufficient to keep the 4 year period open. It is essential, in the Institute's view, to give some policy or contextual basis for the strict or liberal interpretation of the requirements. The present position is contrary to the stated intention of certainty of finality.
- The EM ought to refer to the requirements of section 8AAZN of the TAA and its role in authorising the recovery of "administrative overpayments".

The Institute of Chartered Accountants in Australia

Attachment A/1

24 April 2008

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Submission on draft legislation dealing with the taxation of rights

The Institute of Chartered Accountants in Australia (the Institute) welcomes the opportunity to provide comments on the proposed amendments to the Income Tax Assessment Act (ITAA) 1997 to deal with the tax outcomes arising from the decision of the High Court in *McNeil v Commissioner of Taxation* [2007] HCA 5 (McNeil) in relation to 'share rights'.

Generally, our view of the proposed amendments is that they do not adequately deal with the issues arising from McNeil. In fact, the specific situation in McNeil is not addressed at all and no reason is provided for this omission.

We understand that you believe some of the issues arising from McNeil will be resolved through interpretive products to be issued by the ATO. However, the fact that the ATO has not dealt with these issues over a year after the case was handed down, may be an indication that they are not easily resolved without legislative change. In any event, it is unlikely that all the issues can be addressed by interpretive solutions and, indeed, it would be preferable to resolve almost all of them legislatively.

Our detailed comments are set out in the attached table, however, given the short time to review the proposed changes, the Institute cannot guarantee that unforeseen consequences or specific transactions that should ideally have been dealt with in these amendments have been identified. Thus the Institute reserves the right to bring specific matters to your attention in the future if the necessity arises.

In closing, we recommend that the issues raised in this submission be resolved expeditiously and that the resulting legislation be introduced into Parliament as a matter of high priority. Please do not hesitate to contact me on (02) 9290 5623 - we would be happy to assist you in any way possible.

Yours faithfully,

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Table of issues - draft legislation dealing with the taxation of rights

Item No	Issue
1	Subsection 59-40(1) proposes to treat rights to acquire shares as 'non assessable income' and 'non exempt income' (jointly referred to hereinafter as NANE) in the circumstances prescribed in subsection 59-40(2). The Institute raises four separate issues with respect to subsection 59-40(1): (A) The draft provision only covers rights to acquire shares issued to the taxpayer, and does not cover other rights that a shareholder may be issued such as the right to acquire a convertible note or other like security. Indeed, with a convertible note there would usually be an embedded right to acquire a share, but on one view, what is issued in this situation is a right to subscribe for a convertible note as opposed to a right to acquire a share. Before McNeil, it would generally be the case that the right of an existing shareholder to subscribe for a convertible note would not be regarded on revenue account, and if the proposed amendments are intended to restore the pre-McNeil position, subsection 59-40(1) needs to extend to rights to subscribe for convertible notes and other like securities. The further issue is that in view of the uncertainty arising from McNeil as to whether a 'right' is a different proprietary right to an 'option', the provision should clearly specify that a right is to be regarded as an option and vice versa. (B) The draft provision does not cover the issue of rights to beneficiaries of a trust to acquire further interests in the trust (including rights acquired as a result of being issued with a right to subscribe for convertible notes). Whilst it may well be the case that the McNeil decision cannot be 'extrapolated' to interests held in trusts, this position should ideally be encapsulated in the legislation itself to avoid the possibility that a different view is ultimately taken. In the event that section 59-40 is not extended to cover trusts, the reference to company in this section should incorporate Division 6B corporate unit trusts, Division 6C Public Trading Trusts and section 94J corporate limited partnerships. Additionally, extending section 59-40 to rights to acquire trust interests would, in conjunction with the recommendation in (C) below, overcome the uncertainty that may arise under McNeil with stapled securities whereby shares in a company are often 'stapled' to units in a trust in the sense that the holder of the security may only trade a 'stapled security' comprising a share and a unit. Since these securities are often listed, any 'rights issue' will generally require the issue of a right to acquire a stapled security. Without treating the issue of the right to acquire the stapled security as NANE, the question will clearly arise as to whether the various rights should be 'bifurcated' to determine whether in respect of the share held by the taxpayer, the taxpayer is issued with a right to acquire trust units. (C) The draft provision does not cover the issue of rights to acquire shares in an entity other than the company in which the taxpayer holds existing shares. The effect of this is that following McNeil, if a shareholder is issued with a right to subscribe for shares in another entity, the market value of that right will be assessable as ordinary income. This arrangement is of the type as occurred in *Allina Pty Limited v Commissioner 91 ATC 4195* where the issue before the Court was whether there was a cost base for capital gains tax (CGT) purposes of rights issued to the taxpayer to subscribe for shares in another company. That the Tax Office (ATO) treated this arrangement as solely under the CGT provisions of the tax law, is an indication that ATO has never considered the grant of 'call rights' to be on revenue account and that this position altered when the McNeil decision was handed down. To not extend subsection 59-

	40(1) to rights issued by a company to acquire shares in another company would mean that pre-McNeil transactions previously treated on capital account will now be treated on revenue account which is inconsistent with any notion that the amendments restore the pre-McNeil tax treatment of rights. Situations adversely affected if subsection 59-40(1) were not so extended include receipt of rights in relation to a demerged subsidiary. Therefore, it is the Institute's strong recommendation that the concession in section 59-40 should apply to all rights and trust interests issued to taxpayers in respect of existing holdings. (D) The concession in section 59-40 only applies where there is an 'issue' of rights. The word 'issued' is undefined, and without a broad definition, the question may arise as to whether a shareholder who acquires a right to acquire shares has been 'issued' with that right. For certainty the term 'issued' should be defined broadly. Consider, for example, section 139G of ITAA 1936 which sets out a number of different ways a person can "acquire" a share or a right.
2	Paragraph (a) of subsection 59-40(2) requires the company that issued the rights to be an 'Australian resident'. On this point it is our strong view that the provision must apply regardless of the resident status of the issuing entity. That residents of Australia are encouraged to invest overseas is reflected in many of the changes to the tax law that have been enacted in recent years. To restrict the concession in section 59-40 to rights to acquire shares in resident companies will mean that following McNeil, a different tax treatment of rights to acquire shares in non-resident companies will apply when compared to the tax treatment of rights to acquire shares in resident companies. This outcome will be in conflict with policy encouraging overseas investment, will result in confusion in the market place, and will require specific provisions in the CGT rules to ensure that the amount assessable on the issue of rights by non-resident companies is included in the CGT cost base of the rights held by the taxpayer. There is presently nothing in the proposed amendments which provides for this amount to be included in the CGT cost base of the rights issued by non-resident companies. The need to provide cost base to taxpayers who remain assessable on the receipt of rights is discussed in more detail at 9(E) below.
3	Paragraph (c) of subsection 59-40(2) is currently too restrictive and may exclude situations which should be covered by the amendments. An example is choices by shareholders to participate in a dividend reinvestment plan at a discount. As the shareholder may participate in the plan by choice, it is unclear whether the right to acquire shares is issued "because of" their ownership of the original shares. Arguably, it is not because of the ownership but is because of any or all of the following events: declaration of a dividend, the availability of a dividend reinvestment plan and their choice to participate in the plan. There are possibly other similarly affected examples. Accordingly, the Institute submits that the wording of paragraph (c) should be broadened to "in connection with" ownership of the original shares (or underlying asset).
4	Paragraph (d) of subsection 59-40(2) stipulates that the original shares <u>and</u> the rights must not be 'revenue assets' or 'trading stock' at the time of issue. There are three matters to raise with respect to this provision: (A) It is likely that where the original shares are 'revenue assets' or 'trading stock', the rights issued to the shareholder would be similarly classified. On this point, R W Parsons in Income Taxation in Australia (The Law Book Company Limited 1985) at 14.16 in discussing the application of trading stock accounting to the business operations of a share dealer states that: "*More difficult questions arise when bonus shares, rights or options are acquired by the taxpayer as the holder of shares in relation to which the bonus shares, rights or options are issued.* ***Curran (1974) 131 CLR 409 is authority that the bonus shares, rights or options are trading stock of a share trader***" On this basis, stipulating in paragraph (d) that the rights not be 'revenue assets' or

	'trading stock' will probably cause confusion to taxpayers, and could be avoided by simply providing that the original shares not be 'revenue assets' or 'trading stock'. However as discussed in (B) below, the Institute is of the view that the concession under section 59-40 should apply whether or not the shares are 'revenue assets' or 'trading stock'. (B) It is unclear why the exception in paragraph (d) is considered necessary, since the effect of paragraph (d) will be that a shareholder receiving rights in respect of shares (original shares) held as 'revenue assets' or as 'trading stock' will be assessed on the value of the rights under section 6-5 of the ITAA 1997, whereas if the original shares are held solely on capital account, section 59-40 will apply to treat the market value of the rights as NANE. On this point, the Institute submits that until the McNeil decision, there appears to be no authority to the effect that the value of rights granted to a shareholder in respect of original shares was assessable as income, and thus the fact that the original shares may have been held as 'revenue assets' or as 'trading stock' was historically of no consequence. This view was expressed by R W Parsons in Income Taxation in Australia (supra) where at 2.247 the author made the observation that: "*The question whether rights or options issued to a shareholder as shareholder are ordinary usage income of the shareholder as income derived from his shares has not been considered in any authority. There might be thought to be a detachment from his shares as the produce of his shares, though the notion of reframing of his interest is the more likely characterisation*". Whilst it is now clear following the decision in McNeil that the value of rights granted to a shareholder in respect of original shares will be income, the authority arising from McNeil should not in our view be applied selectively depending on the characteristics of the original shares in the hands of the shareholder. On the basis that the Government's announced intention (see Treasurer's Media release dated 8 April 2008) was to "*amend the income tax law to restore the long-standing taxation treatment of call options issued by companies.... by restoring the taxation treatment of call options issued by companies that existed before the decision of the High Court of Australia in Commissioner of Taxation v McNeil [2007] HCA 5*", paragraph (d) of subsection 59-40(2) is unwarranted. (C) If despite the view that we have expressed in (B) above, the amending law includes paragraph (d) such that section 59-40 could not be satisfied where the original shares are 'revenue assets' or 'trading stock', the amending law should provide that where upon the issue of rights to a taxpayer, section 59-40 cannot be satisfied because of paragraph (d), the taxpayer will be treated for the purposes of the tax law as having paid to acquire the rights an amount equal to the market value of the rights at the time of issue together with any amount actually paid to acquire the rights (for trading stock, it may even require a specific deduction for the market value of the right to be allowed as a deduction for acquisition of the right/trading stock). This amendment is clearly necessary to ensure that a subsequent disposal of the right, or a conversion of the right and subsequent disposal of the share, on revenue account (as well as the inclusion of the right or the share in the closing value of trading stock of an income year), does not result in double taxation.
5	Paragraph (e) of subsection 59-40(2) stipulates that the rights must not have been acquired within the meaning of section 139G of the *Income Tax Assessment Act 1936* (ITAA 1936) under an employee share scheme. It is unclear why the exception in paragraph (e) is considered necessary, since by operation of paragraph (b), the rights must be in respect of an existing shareholding. This requirement in paragraph (b) would seem to preclude the rights from being acquired under an employee share scheme i.e. because the rights are issued in respect of an existing shareholding and not in respect of employment. Inclusion of paragraph (e) in subsection 59-40(2) might by implication

	suggest that rights acquired because of an existing shareholding which was acquired under an employee share scheme are to be taken as rights acquired under an employee share scheme, and this implication would best be avoided by the removal of paragraph (e).
6	Paragraph (f) of subsection 50-40(2) stipulates that the original shares and the rights must not be 'traditional securities'. The definition of 'traditional securities' is in section 26BB of the ITAA 1936. There are three matters to arising with respect to this exception. (A) Firstly, it seems arguable that the exception in paragraph (d) would in any event apply to a shareholding that is a 'traditional security'. In this respect we note that the definition of 'revenue asset' in section 977-50 of the ITAA 1997 provides that a 'CGT asset' is a 'revenue asset' if and only if: a)the profit or loss on your disposing of the asset, ceasing to own it, or otherwise realising it, would be taken into account, in calculating your assessable income or 'tax loss', otherwise than as a 'capital gain' or 'capital loss'; and b) the asset is neither 'trading stock' (s70-10) nor a 'depreciating asset' (s40-30). Since under section 26BB of the ITAA 1936 the 'gain' on disposal of a 'traditional security' is included in assessable income, it is arguable that section 977-50 would be satisfied where the taxpayer acquired a share which is a 'traditional security'. That being the case, the share would satisfy paragraph (d) of subsection 59-40 and it is thus unclear why paragraph (f) is considered necessary. In any event we have expressed the view in 4(B) above that the exception in paragraph (d) should be removed and this view extends to paragraph (f). To reiterate our earlier point, the issue before the McNeil decision of rights to acquire shares was not treated on revenue account and to exclude 'revenue assets', 'trading stock' and 'traditional securities' from the concession in section 59-40 would not "restore the long-standing taxation treatment of call options issued by companies". (B) Secondly, if the exception in paragraph (f) is enacted, the amending law should provide that where upon the issue of rights to a taxpayer, section 59-40 cannot be satisfied because of paragraph (f), the taxpayer will be treated for the purposes of the tax law as having paid to acquire the rights an amount equal to the market value of the rights at the time of issue together with any amount actually paid to acquire the rights. (C) The ATO have provided a long standing view that shares are not intended to be considered traditional securities. This view is contained in the NTLG Finance and Investment subcommittee minutes of 11 August 2004 (refer to Agenda item 5), where the ATO stated: "We think that there are reasonable indications that a share in a company is not intended to be a security as defined at subsection 159GP(1) of the ITAA 1936. We note that this definition of security, as it appears in Division 16E, has been essentially adopted elsewhere in the ITAA 1936. For example, it has been precisely adopted in the traditional securities' provisions [sections 26BB and 70B of the ITAA 1936]. The Explanatory Memorandum to Taxation Laws Amendment Act (No 3) 1989 [which introduced the traditional securities' measures] explains that 'Shares in the issued capital of a company are outside the definition of securities." We note that these comments are consistent with the views contained in the recently released draft determination TD 2008/D4. Accordingly, we believe that paragraph (f) will cause uncertainty in relation to the question as to whether a share is considered to be a security for the purpose of the ITAA 1936 and 1997, and historical views provided by the ATO on this question.
7	Paragraph (g) of subsection 50-40(2) stipulates that the original shares must not be 'convertible

	interests'. The definition of 'convertible interests' is in section 995-1 of the ITAA 1997 and in relation to a company is "an interest of a kind referred to in item 4 of the table in subsection 974-75(1)". Since a share which has a right to convert into another share would satisfy item 4 of the table in subsection 974-75(4), the exception in paragraph (g) appears to have the effect that all shares which carry a right to convert into an 'equity interest' are excluded from the concession under section 59-40. If this is intended, the Institute fails to understand the reasoning for the position taken, since the amendment is intended to restore the position that applied with respect to rights before McNeil. On the assumption that the concession is to apply to rights issued in respect of shares generally ie without reference to classification as 'convertible' or 'not convertible', the exception in paragraph (g), needs to be removed. If the exception in paragraph (g) is however enacted, the amending law should provide that where upon the issue of rights to a taxpayer, section 59-40 cannot be satisfied because of paragraph (g), the taxpayer will be treated for the purposes of the tax law as having paid to acquire the rights an amount equal to the market value of the rights at the time of issue together with any amount actually paid to acquire the rights.
8	We are uncertain why an amendment is proposed at item 15 to subsection 104-135(1A) (CGT event G1). It is our understanding that the issue of a right is not a payment and therefore this section would not be triggered in respect of the 'original shares'. This view is supported in the public ATO class ruling on the St George Sell Back Rights CR 2001/75 at paragraph 38: "The grant of a Right is not a CGT Event G1 pursuant to Subdivision 104-G of the ITAA 1997." If Treasury is of the view that CGT event G1 could apply as the result of the issue of a right then the exemption in subsection 104-135(1A) must be expanded to also disregard a payment that is included in assessable income, other than as a dividend which is already excluded by paragraph 104-135(1)(b). This amendment is required to avoid double taxation of the assessable non-exempt rights issue amount as either an immediate or deferred capital gain (as a result of the reduction to the cost base of the share) in respect of the 'original shares'
9	It is implicit from the proposed amendment to section 112-20 and the insertion of section 112-37 that the receipt of 'put options' of the type considered by the High Court in McNeil will continue to be assessable as ordinary income, regardless of whether the shareholder holds the original shares solely on capital account. In this respect the Institute is of the view that: (A) where the original shares are neither 'revenue assets' nor 'trading stock', there should be no assessable income derived on issue of put options. The reason for this view is that to assess the shareholder on revenue account upon the receipt of a right to put shares to the issuing company, may result in unintended and adverse consequences. Specifically the effect of a rights issue where the right to put shares to the company has a market value at the time of issue is that unrealised capital gains (losses) on the original shares are reduced (increased) by the value shifted to the rights, the value shifted to the rights is assessable as income and the reduced value of the original shares represents a loss of capital. In an extreme case the loss of capital could result in a capital loss on disposal of the original shares with the shareholder being prevented from offsetting the loss against the gain on revenue account. In other cases the effect of the transaction may be to reduce the capital gain on realisation of the original shares with a resulting reduction in the amount that but for the transaction would attract the 50% CGT discount.

In addition, under conventional market practices, it is possible that the put rights/options lapse without the investor receiving any compensation or compensation that is greater than the market value of the right/option at the time it was issued. In such a case, under the proposed amendments, the only relief available is a capital loss on lapsing of the rights/options. This does not offset the impact of assessable income taxed under section 6-5 on issue of the right. The Institute submits that this is not an equitable outcome for investors and may impose an unreasonable burden (or tax driven motivation) on investors to exercise their rights – as if they fail to do so (including those investors who inadvertently fail to do so), they would suffer tax on a benefit they would not have received. Tax reasons should not be the reason why investors choose whether or not to exercise their rights/options.

(B) where the original shares are held solely on capital account and no amount is assessable on receipt of the rights, the rights issued to the shareholder should have no CGT cost base except to the extent that the shareholder paid an amount to acquire the rights.

The effect of this would be that if the shareholder disposed of the rights other than through exercising the rights, the consideration for the disposal would be the 'capital proceeds' for a CGT event, and unless the shareholder paid an amount to acquire the rights, the capital proceeds would be equal in amount to the capital gain realised.

(C) the positions outlined in (A) and (B) above should also apply where the original shares are 'revenue assets' or 'trading stock' since to do otherwise would not restore the position as applied before McNeil.

Additionally, the Institute is of the view that to assess a shareholder on receipt of a right prior to realisation is an inappropriate outcome when in general terms, the issue of a right to put shares to the company in an economic sense simply transfers value from the original shares to the right that is issued.

(D) In the event that put options remain assessable to the holder at the time of issue, proposed section 112-37 needs to be amended to provide that the first element of the CGT cost base is the sum of the amounts in paragraphs (a) and (b) and not the greater of those two amounts as is currently proposed.

Additionally, where the original shares are 'revenue assets' or 'trading stock' the amendments should provide the taxpayer will be treated for the purposes of the tax law as having paid to acquire the rights an amount equal to the market value of the rights at the time of issue together with any amount actually paid for issue of the rights.

(E) There is uncertainty as to how cost base is to be provided for rights and options not covered by 112-37, where they are also considered assessable in accordance with the McNeil decision. For example, a renounceable rights issue to shareholders of a company, to acquire 1 convertible note for every 10 shares held would be excluded from subsection 59-40(1). A further example would be a renounceable rights issue in relation to a non-resident company. Such rights would appear to be considered assessable income under McNeil. However, the proposed section 112-37 would not apply to such arrangements. If the position taken is that rights with respect to shares on revenue account are to remain assessable, it would be necessary to legislate for a cost base increase both for CGT and revenue purposes. If a CGT cost base is not provided for such rights, not withstanding a cost base uplift for revenue account purposes, there would still be assessable gains under the CGT provisions and this gain would not be reduced by the operation of section 118-20 except to the extent that the rights have increased in value from the date of issue.

10 We believe that the drafting mechanism used in section 112-37 is overly restrictive, and does

	not deal with any rights or options that are not covered by section 59-40, other than certain put options (see our comments in 9(E) above and elsewhere in this submission in relation to the need for cost base adjustments where section 59-40 does not apply).
11	It is unclear what the proposed amendment to subsection 118-20(4) is intended to achieve since even if the issue of rights is a CGT event, any subsequent dealing with the rights or shares acquired from exercise of the rights will be a separate CGT event. Clarification as to what the amendment is intended to achieve is required. Additionally, in McNeil, the question which the High Court did not answer was whether CGT event H2 applied upon the issue of the rights to the taxpayer. The question was not answered because of the way in which the questions being the subject of the appeal to the Court were framed. As a result, it seems fair to say that the Tax Office is still of the view that CGT event H2 applies to the issue of rights. On the basis that the Government proposes to restore the tax law to the position that applied before McNeil, it is our view that CGT event H2 needs to be amended to provide that the issue of rights to shareholders, whether they be call options or put options, will not result in CGT event H2 occurring. If this amendment is made there may well be no need for the amendment currently proposed to subsection 118-20(4).
12	The document provided by Treasury does not appear to specifically deal with all of the rights and options covered in the NTLG meetings, and reasons why such rights or options are excluded from the operation of the McNeil decision. We believe that it is imperative for both Treasury and ATO to provide a view as to whether (a) bonus shares, (b) dividend reinvestment plans, (c) private share placements, and (d) share purchase plans would be either covered by 59-40, or outside the decision in McNeil.

Attachment A/2

Addendum to NTLG Agenda item on McNeil's case following amendments proposed in Tax Laws Amendment (2008 Measures No.3) Bill 2008

Tax Laws Amendment (2008 Measures No.3) Bill 2008 (the Bill) has introduced amendments to deal with the assessability of options issued to shareholders following the McNeil[9] decision. It is evident that the amendments are limited and do not cover all scenarios. Given that we have been informed that a number of amendments were based on advice provided by the ATO, we would be grateful for a prompt response in relation to ATO views on the following arrangements that may be affected by the McNeil decision.

Question one – renounceable versus non renounceable rights

The ATO provided a 'considered but preliminary' view in the NTLG Meeting of 28 June 2007, that a 'right to subscribe for unissued shares that cannot be traded, assigned or otherwise dealt with as a commercial object in its own right, but only exercised or allowed to lapse, will not be derived as income' (item 5). Accordingly, we now request the ATO to formalise this view that rights issues will not be assessable where they cannot be traded, assigned or treated as commercial objects in their own right.

Question two – dividend reinvestment plans

There seem to be a conflicting view as to the application of the proposed section 59-40 to dividend reinvestment plans (DRP). The EM states (at para 1.11) that "rights issued to an existing shareholder or unit holder because they choose to participate in a dividend or distribution reinvestment plan in relation to existing interests will generally be taken to be issued because of their ownership of the original interests". However, this comment is in contrast with the view provided by the ATO in Taxation Determination TD 2000/3. In this document, the ATO states (at para 2) that "[s]hares acquired under a dividend reinvestment plan are not issued in relation to the shareholder's original shares." As DRPs have value (i.e. as shares are issued at a discount), we request the ATO to clarify whether the difference in interpretation has any implications for the additional value received by shareholders under a DRP.

Question three – subscribing for shares in another company

Proposed section 59-40 is limited to rights to acquire shares in the same company that has issued the shares. Accordingly, the amendment does not cover a right to acquire a share in a subsidiary of the entity. This type of rights issue was considered in the case of *Allina Pty Ltd v FCT*[10], where rights were issued to acquire shares in a subsidiary company. Could the ATO please indicate whether (in their view) the decision in McNeil changes the taxation consequences of an Allina type transaction, such that the right would be treated on ordinary income account rather than capital account?

Question four – revenue assets and trading stock

Section 59-40(2)(c) excludes rights that are issued in respect of original interests that are either revenue assets or trading stock. As a result, it would seem that under the McNeil decision, rights issued in respect of shares held on revenue account or as trading stock will be assessed as ordinary income at the time the rights are issued. We request the ATO to provide guidance as to how double taxation is avoided in the following four basic cases.

Case (4)(a) – Right disposed of subsequently for a gain

If a right is acquired on revenue account with a market value of $10 and subsequently sold for $12, how much would be included in assessable income? Is the $10 included at the time of issue under the principle in McNeil and the $12 included under section 6-5 as ordinary income? Can section 6-25 apply to prevent the $10 from being included on the subsequent sale? Does the reference to more than one rule in section 6-25 apply in this case?

Case (4)(b) – Right disposed of subsequently for a loss

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[9] *Commissioner of Taxation v McNeil* [2007] HCA 5

[10] *Allina Pty Ltd v Commissioner of Taxation* 91 ATC 4195

If a right is on revenue account and is acquired with a market value of $10 and subsequently sold for $8, how much would be included in assessable income? Would the $10 be included at the time of issue under the McNeil principle and the $8 under section 6-5? Is there a deduction available for the $2? We note that the correct "policy" result in this example would be a net assessable amount of $8.

Case (4)(c) – Right lapses for no value

If a "renounceable" right is on revenue account and is acquired with a market value of $10 and is subsequently allowed to lapse so that there is no benefit to the taxpayer, how much is included in assessable income? Is the $10 included at the time of issue under the McNeil principle? Is there a deduction available after the lapse of the rights? We note that the correct response would appear to be a net amount of $0.

Case (4)(d) – Right is exercised

If a right is on revenue account and is acquired with a market value of $10 and is subsequently converted into shares, would the taxpayer be able to recognise an amount relating to the market value of the right in the cost of the shares held on revenue account? We note that in the High Court case of *Bristowe*[11], Kitto J held that the value of the taxpayer's rights to acquire the shares must be recognised as part of the cost of acquiring those shares. Would Bristowe apply to ensure that the market value of the rights are included in the cost of the shares? What happens if there is a movement in the value between the time of issue and conversion?

Question five – convertible interests

Section 59-40(2)(f) excludes rights that are issued in respect of interests that are convertible interests. The EM suggests [at paras 1.13 and 1.14] that the reason for this exclusion is that the principles enunciated in McNeil's case are not easily applied to convertible interests. Can the ATO explain (in their view) how a renounceable rights issue in respect of a convertible bond would be different, and whether the market value of the rights would fall within the principles of McNeil?

Question six – preference shares

If a preference share is a convertible preference share (i.e. a preference share that has an option to convert into an ordinary share), it would appear to be excluded from the proposed amendment under section 59-40(2)(f). Where this is the case, can the ATO provide a view as to whether a rights issue in respect of a convertible preference share would be within the principles in McNeil? Are the ATO aware of any policy reasons why a convertible preference share should be treated differently to an ordinary preference share?

Question seven – cost of rights that are not subject to section 59-40

Where a right is issued to a shareholder, and it is neither within section 59-40 nor section 112-37 (e.g. a right in relation to a convertible preference share), can the ATO provide a view as to whether the capital gains tax rules will provide a cost base for the amount included in assessable income in relation to the option?

Question eight – interest deductibility

Section 59-40 treats the value of a call option as NANE income to the shareholder. If a shareholder has borrowed to acquire listed shares, and subsequently receives a valuable call option that is covered by section 59-40, does the ATO believe that this would result in a denial of an interest deduction to the extent of the NANE income (under section 8-1 and in accordance with the decision in Kidston Goldmines Ltd v FC of T 91 ATC 4538)?

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[11] *Executor Trustee and Agency Company of South Australia (executor of Robert Francis Bristowe) v Commissioner of Taxation* (1962) 11 ATD 520