HIGH COURT OF AUSTRALIA

GUMMOW ACJ
HAYNE, CALLINAN, HEYDON AND CRENNAN JJ

COMMISSIONER OF TAXATION APPELLANT

AND

HELEN MARY McNEIL RESPONDENT

Commissioner of Taxation v McNeil
[2007] HCA 5
22 February 2007
S56/2006

ORDER

1. *Appeal allowed.*

2. *Set aside order 1 of the Full Court of the Federal Court made on 8 August 2005 and in its place order that the appeal to that Court be allowed, the orders of Conti J made on 14 April 2004 be set aside, and the appeal by the taxpayer against the objection decision of the Commissioner made on 31 October 2002 be dismissed.*

3. *The appellant pay the costs of the respondent of this appeal.*

On appeal from the Federal Court of Australia

Representation

B J Shaw QC with G J Davies QC and S H Steward for the appellant (instructed by Australian Government Solicitor)

D H Bloom QC with W G Muddle and K J Deards for the respondent (instructed by Mallesons Stephen Jaques)

CATCHWORDS

Commissioner of Taxation v McNeil

Income tax – Derivation of income – Respondent acquired shares which were later the subject of a buy-back arrangement that gave the respondent "sell-back rights" – The sell-back rights were held on trust and sold for the absolute benefit of the respondent – The increase in value of the sell-back rights was subject to capital gains tax upon sale – Whether the remaining income from the sale was subject to either income tax or capital gains tax – Whether the remaining proceeds of sale amounted to a derivation of income according to ordinary concepts – Whether character of receipt as income to be determined according to its quality in the hands of the recipient or the character of the expenditure by the other party – Whether sell-back rights can be treated as being "severed" or "detached" from the respondent's shares for taxation purposes.

Income tax – Statutory interpretation – Whether subdiv D of Div 2 of Pt III of the *Income Tax Assessment Act* 1936 (Cth) formed a "code" regarding taxation of receipts by shareholders from companies.

Words and phrases – "for the absolute benefit of", "income", "in satisfaction", "code", "sell-back right".

Corporations Law, Ch 2J, ss 257A-257J.
Income Tax Assessment Act 1936 (Cth), Pt III, Div 2, subdiv D.
Income Tax Assessment Act 1997 (Cth), s 6-5.

1 GUMMOW ACJ, HAYNE, HEYDON AND CRENNAN JJ. The respondent ("the taxpayer") is a widow of advanced years who has lived all her life in Australia. The amount of income tax at stake in this appeal is less than $600. The year of income in question is that which ended on 30 June 2001. The litigation has been treated as a test case, in the circumstances which are more fully described later in these reasons, and is said by the appellant ("the Commissioner") to affect more than 80,000 taxpayers.

2 The taxpayer succeeded at first instance in the Federal Court (Conti J)[1] and an appeal by the Commissioner was dismissed by the Full Court (French and Dowsett JJ; Emmett J dissenting)[2]. No order for costs was made by Conti J. An agreement was made between the parties that there be no order as to costs in the Full Court. It was a condition of the grant to the Commissioner of special leave to appeal to this Court that the Commissioner pay the costs of the appeal in any event and not seek to disturb the position respecting costs in the Federal Court.

<u>The SGL buy-back scheme</u>

3 In 1987, the taxpayer acquired a parcel of shares in St George Building Society Ltd. In 1992, these were converted into ordinary shares in St George Bank Ltd ("SGL") upon its change from a building society to a corporation carrying on the business of banking. Since 1992, shares in SGL have been listed for quotation on the Australian Stock Exchange ("ASX"). In the years following 1992, the profitability of SGL increased. As a result of rights issues, share-rounding plans and other events, at the time of the critical announcement by SGL on 12 January 2001 ("the record date"), the taxpayer's shareholding comprised 5,450 ordinary shares.

4 On the record date, SGL announced an off-market buy-back of ordinary shares to the approximate value of $375 million; the buy-back was said to be designed to enhance returns to shareholders and to be the first step in proposals to convert existing preference shares to ordinary shares and issue new preference shares. The buy-back was to be funded by SGL from existing cash resources which, in turn, were to be replaced substantially by the issue of the new preference shares.

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1 *McNeil v Commissioner of Taxation* (2004) 206 ALR 44.

2 *Commissioner of Taxation v McNeil* (2005) 144 FCR 514.

5 The number of ordinary shares the subject of the announcement represented approximately 5 per cent of the then issued capital of SGL. For every 20 ordinary shares held at the record date and rounded down to the nearest whole number, SGL on 19 February 2001 ("the listing date") would issue to St George Custodial Pty Ltd ("Custodial") as trustee for the shareholder one "sell-back right". This would yield 272 sell-back rights for the taxpayer. The term "buy-back" was used from the perspective of SGL, while "sell-back" was used from the perspective of shareholders. Each sell-back right was to be a put option to oblige SGL to buy back one share for $16.50. Excluded from direct participation on the same terms as other ordinary shareholders were shareholders having a registered address outside Australia and New Zealand, and employees of SGL who held shares under certain employee share benefits schemes. More limited arrangements were made for these "excluded shareholders" to participate indirectly in the buy-back. The taxpayer was not an excluded shareholder.

6 Implementation of the proposed share buy-back was governed, as a matter of company law, by what was then Div 2 (ss 257A-257J) of Pt 2J-1 of Ch 2J of the Corporations Law[3]. Chapter 2J was headed "Transactions Affecting Share Capital" and in various respects replaced or qualified the previous law respecting reductions in share capital, in particular the prohibition upon the purchase by a company of its own shares[4]. An appreciation of this change in the underlying company law is important when considering various of the revenue decisions to which the Court was referred in argument in this case.

7 Section 257A of the Corporations Law permitted a company to buy back its own shares if the buy-back did not materially prejudice the ability of the company to pay creditors and the company followed the procedures laid down in Div 2. Section 257B(1) specified the procedures appurtenant to different types of buy-backs. In respect of what were classed as "selective buy-backs", s 257D stipulated special requirements for the obtaining of shareholder approval, beyond those requirements for "equal access schemes" (see s 257B(2)). No issue arises respecting compliance with Div 2. It is unnecessary to resolve apparent differences in submissions of the parties respecting the classification of the SGL buy-back scheme as a "selective" or "equal access" scheme.

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3 See now *Corporations Act* 2001 (Cth), Ch 2J, Pt 2J-1, Div 2.

4 *Trevor v Whitworth* (1887) 12 App Cas 409; *Thornett v Federal Commissioner of Taxation* (1938) 59 CLR 787 at 795-796.

8 The arrangements announced by SGL on the record date were implemented and controlled by a series of interconnected deeds poll, to which further reference will be made. Each of these documents was executed on the record date, 12 January 2001. On 10 January, ordinary shares in SGL had been traded at $13.88; the highest price at which shares had previously been traded was $14.10. On the listing date, 19 February, the share price was between $14.45 and $14.64 per share. The right to require SGL to purchase a share for $16.50 had a value represented by the amount by which that sum exceeded the market value. The parties agreed for the purposes of these proceedings that on that date the market value of one sell-back right was $1.89. Accordingly, the market value of the taxpayer's sell-back rights at the listing date was $514.

9 On the listing date, SGL granted to Custodial more than 22 million sell-back rights to be held on the terms of the arrangements made by the deeds poll.

10 The taxpayer and the other shareholders who had wished to obtain legal title to all or some of their sell-back rights so as to be able personally to sell their shares back to SGL or sell the sell-back rights on the market had been obliged to give a direction to Custodial before 5.00 pm on 16 February ("the election date"), that is to say, before the grant of those rights on 19 February. The taxpayer gave no such direction. The result of the controlling instruments in cases where no direction was given was that, on the grant by SGL on 19 February of 272 sell-back rights to be held for the taxpayer by Custodial as trustee, Custodial was obliged to sell those rights to a merchant bank, Credit Suisse First Boston Australia Equities Ltd ("CSFB"). CSFB was required to trade or exercise those rights and to account to Custodial as trustee for the taxpayer.

11 From the issue date, the sell-back rights were listed and traded on the ASX and this continued until 13 March 2001 ("the listing period"). In this way, there was created a market in the sell-back rights themselves. This was important for those shareholders who did not wish to exercise the legal title to some or all of their sell-back rights or who, like the taxpayer, stood by and took no steps before the election date to acquire that legal title. The existence of this market also would help facilitate attainment of SGL's announced intentions of effecting a buy-back to the extent of about 5 per cent of its issued capital.

12 The explanatory material sent by SGL to shareholders made it plain that shareholders not wishing to do so did not have to sell any shares to SGL. But the material also told shareholders that they could purchase additional sell-back rights on the ASX and thereby increase the number of shares they could oblige SGL to acquire. In this way, the sell-back rights are more readily seen to have been separate and detached from the shares in respect of which they had been granted by SGL; the rights were objects of commerce and by reason of

acquisition by another shareholder could be exercised in respect of shares of that shareholder.

13 The issue of the 272 sell-back rights for the taxpayer and what then ensued did not involve any return of capital paid up on her shares, nor any variation or re-expression of her rights as a shareholder. Shareholders, such as the taxpayer, who before the election date gave no directions in respect of their entitlements were to be paid the proceeds of trading activities in their rights which were to be conducted on their behalf by CSFB. But, unlike those shareholders who exercised their sell-back rights to require SGL to purchase their shares at the buy-back price of $16.50, or who purchased additional rights on the ASX and exercised them, these shareholders retained their shares.

<u>The issues on the appeal</u>

14 The taxpayer's 272 sell-back rights were included in more than 11 million sell-back rights sold by Custodial to CSFB on 20 February 2001. These then were sold by CSFB on the ASX during the listing period or exercised by CSFB itself in accordance with the CSFB Deed Poll. On 2 April 2001, the taxpayer received her portion of the proceeds, being $576.64, by direct deposit into her bank account with SGL. Of that sum, $62.64 represented the increase in the realisable value after the issue date. The taxpayer concedes that the sum of $62.64 was assessable income as a capital gain. The dispute turns upon the character of the balance of $514, representing market value at the issue date. The Commissioner seeks to bring this to tax either as income according to ordinary concepts, pursuant to s 6-5 of the *Income Tax Assessment Act* 1997 (Cth) ("the 1997 Act") or as a capital gain. However, if the Commissioner succeeds in his reliance upon s 6-5, then the anti-overlap provision of s 118-20 means that if the same event gives rise to both income and a capital gain, the capital gain is reduced to the extent that income was assessable.

15 As an Australian resident, the assessable income of the taxpayer included income according to ordinary concepts derived directly or indirectly from all sources; in determining the existence of a derivation and when it occurred, the taxpayer was taken by s 6-5(4) "to have received the amount as soon as it [was] applied or dealt with in any way on [her] behalf or as [she directed]".

16 Having allowed the taxpayer's objection, Conti J remitted the matter to the Commissioner for reassessment according to law. On appeal by the Commissioner, the Full Court divided. French and Dowsett JJ, in separate judgments, held that the appeal failed. There had been no derivation of income and no capital gain beyond the $62.64. Emmett J disagreed and concluded that there had been a derivation of income to which s 6-5 applied. Although that

conclusion made it unnecessary to do so, Emmett J went on to consider the issue respecting capital gains tax and decided this adversely to the Commissioner.

17 The majority of the Full Court erred in application of the principles respecting the derivation of income according to ordinary concepts. It follows that the appeal should be allowed on that ground. This renders it unnecessary to consider the operation of the capital gains provision.

18 The Commissioner primarily submits that the grant on 19 February 2001 of the 272 sell-back rights in respect of the taxpayer's shareholding and held by Custodial for her absolute benefit was the derivation of income by her in the amount of $514 and, alternatively, further submits that, in any event, the receipt of the proceeds on 2 April 2001 was income in her hands. It is the primary submission that should be accepted, so that the alternative submission need not be determined.

<u>General principles</u>

19 Before turning to explain why the appeal should have that outcome, and before looking more closely at the documents by which the share buy-back procedures were implemented, there are several preliminary points to be made.

20 First, whether a particular receipt has the character of the derivation of income depends upon its quality in the hands of the recipient, not the character of the expenditure by the other party[5]. It follows, despite indications to the contrary in the judgments of the majority in the Full Court[6], that the character of the sell-back rights held for the taxpayer is not determined by considerations that her entitlement arose out of the decision by SGL to effect the buy-back process and that this involved capital restructuring by SGL. The Commissioner correctly submits that, while the share buy-back scheme explains the involvement of SGL and the genesis of the conferral of the entitlement upon the taxpayer, for revenue purposes it does not explain the character of her sell-back rights.

21 Secondly, 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

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5 *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation* (1990) 170 CLR 124 at 136.

6 (2005) 144 FCR 514 at 529, 530, 568-569.

passively for that return from property[7]. The question then becomes one whether, as the Commissioner contends, the rights enjoyed by the taxpayer arose and were severed from, and were a product of, her shareholding in SGL, which she retained. The metaphor of severance and like expressions were used by Pitney J in *Eisner v Macomber*[8] in a passage accepted in *Federal Commissioner of Taxation v Montgomery*[9] as identifying the core meaning of "income" where the character of a gain associated with property is at stake.

22 It should be pointed out with respect to the application to this case of the reasoning in *Eisner* that, contrary to one approach in the Full Court[10], the taxpayer was not in a like position to a party who received payment to give up part of a profit-yielding structure or on the sale of new rights in the nature of a profit à prendre which were carved out of that structure. The taxpayer's shareholding in SGL remained untouched.

23 Further, the sell-back rights which the taxpayer enjoyed and which were turned to account on her behalf did not represent any portion of her rights as a shareholder under the constitution of SGL. The sell-back rights were generated by the execution, and subsequent performance, of covenants in the deeds poll, to which further reference now should be made.

<u>The deeds poll</u>

24 Three deeds poll, all made on 12 January 2001, the record date, established the scheme arrangements as they affected the taxpayer[11]. By the Sell Back Right Deed Poll executed by SGL in favour of parties including shareholders, such as the taxpayer, who were registered at the record date, and also Custodial and CSFB, SGL covenanted to grant the sell-back rights to Custodial "for the absolute benefit" of those shareholders (cl 2(a)). The

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7 Parsons, *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting*, (1985) at 87-89.

8 252 US 189 at 206-207 (1920).

9 (1999) 198 CLR 639 at 660-663 [62]-[69]. See also *Inland Revenue Commissioners v Blott*; *Inland Revenue Commissioners v Greenwood* [1921] 2 AC 171 at 195.

10 (2005) 144 FCR 514 at 569.

11 The Deed Poll (Excluded Shareholder) may be put to one side.

entitlements of those shareholders who did not take up their legal title to the rights were to be sold to CSFB, to be dealt with by CSFB under the CSFB Deed Poll (cl 2(c)).

25 The Deed Poll (Shareholders) was executed by SGL and Custodial. The latter as trustee, was obliged to hold absolutely for each "participating shareholder" the proceeds of the dealings by CSFB in those entitlements not taken up by shareholders (cl 2.2); Custodial appointed CSFB its paying agent to effectuate payment by SGL of those proceeds to shareholders (cl 3.2).

26 The CSFB Deed Poll was executed by CSFB in favour of parties including those "non-acceptance shareholders" such as the taxpayer, and also SGL and Custodial. CSFB was obliged to sell on the ASX or to exercise the sell-back rights relative to those shareholders and to deal with the proceeds as already described (cl 3).

27 In the events that happened, including the election of the taxpayer not to take the steps necessary to acquire legal title to her sell-back rights, she became, at the issue date, entitled at least to the observance and performance of the obligations owed to her under the deeds poll by Custodial and CSFB. Further, it may also be said that she acquired a beneficial interest in the covenants supporting the obligation assumed by SGL to honour the relevant put options it had created by deed poll. However the situation be treated from the viewpoint of the principles of equity[12], two relevant observations may be made. First, the taxpayer's rights were accrued, not merely executory, and were vested in her. Secondly, that result applied notwithstanding the apparent absence of any consideration moving from her; this result was a significant consequence in the law from the use of covenants in the deeds poll[13].

<u>Previous authorities in this Court</u>

28 Counsel for the taxpayer referred to various authorities in this Court in which issues arose respecting the revenue character of certain distributions to shareholders. The authorities began with *Commissioner of Taxation (NSW) v*

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12 cf *CPT Custodian Pty Ltd v Commissioner of State Revenue* (2005) 224 CLR 98; *Halloran v Minister Administering National Parks and Wildlife Act 1974* (2006) 80 ALJR 519; 224 ALR 79.

13 *Jones v Bartlett* (2000) 205 CLR 166 at 206-207 [141].

Stevenson[14]. The taxpayer had participated in an informal distribution of assets of a family company in advance of an attempted voluntary liquidation. The majority in this Court (Rich, Dixon, Evatt and McTiernan JJ) held that no part of the money received by the taxpayer was a dividend, profit or bonus paid by the company within the meaning of the New South Wales taxation legislation and that the legislation brought to tax distributions or detachments of profit by a company as a going concern but not "distributions in retirement or extinguishment of the shares"[15]. Rich, Dixon and McTiernan JJ stressed that the case turned upon the construction of the legislation and the definition of "dividend"[16].

29 *Stevenson* was applied, with respect to the *Income Tax Assessment Act* 1922 (Cth) ("the 1922 Act"), in *Thornett v Federal Commissioner of Taxation*[17]. At stake was the revenue nature of money and investments being part of the assets of a company which the taxpayer was paid out upon cancellation of certain issued shares in that company. The reduction of capital had received court confirmation under applicable companies legislation. This Court held that the distributions to the taxpayer were not a dividend, bonus or profit, credited, paid or distributed to a shareholder within the meaning of the 1922 Act. Latham CJ said that what the transaction "really amounted" to was "a surrender by a shareholder of all capital interest in the company in return for a lump sum payment"[18].

30 *Federal Commissioner of Taxation v Blakely*[19] concerned the revenue treatment under the *Income Tax Assessment Act* 1936 (Cth) ("the 1936 Act"), as it stood amended in 1942, of distributions to shareholders in an informal liquidation conducted without any action to put the company into liquidation or to appoint a liquidator. This Court held that, as s 44 of the 1936 Act then stood, there had been no distribution by way of dividend out of profits of the company as required to attract that provision. Section 47, as it then stood, did not apply

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14 (1937) 59 CLR 80.

15 (1937) 59 CLR 80 at 103.

16 (1937) 59 CLR 80 at 98-99, 103.

17 (1938) 59 CLR 787.

18 (1938) 59 CLR 787 at 796.

19 (1951) 82 CLR 388.

because there had been no distribution by a liquidator in the winding-up. Fullagar J (with whose reasons Dixon J agreed) considered that what had been received was of a capital rather than income nature; there had been "a realization" of a share investment but "no detachment or severance from the funds of the company of money or other assets as representing a profit made by the company", and nothing in the 1936 Act gave the character of income to what otherwise was a capital receipt[20]. The reasoning in *Stevenson* and *Thornett* was followed.

31 Thereafter, in *Federal Commissioner of Taxation v Uther*[21], it was decided (Taylor and Menzies JJ; Kitto J dissenting) that s 44 of the 1936 Act, read with the definition of "dividend" in s 6(1) as it then stood, did not bring into assessable income the excess of the amount received by a shareholder in respect of shares cancelled in consequence of a duly confirmed reduction of capital over the amount actually paid up on those shares. Later, in *Federal Commissioner of Taxation v Slater Holdings Ltd*, the reasoning of Kitto J was said by Gibbs CJ (with whom Mason, Brennan, Deane and Dawson JJ agreed) to be "compelling"[22]. Kitto J[23] took a view of the legislation which differed from that of Fullagar J in *Blakely*; the particular dividend provisions in question looked not to the nature of the receipt (as principle generally required) but to the nature of the source from which the distribution was made; here, that was profits. In *Slater Holdings*, Gibbs CJ summed the matter up as follows[24]:

> "Fullagar J was right in saying that the distribution made to the shareholders in *Federal Commissioner of Taxation v Blakely* was a capital receipt according to general principles, but he gave insufficient weight to the change that had been effected to the law by defining 'dividend' so as to include a distribution made by a company to any of its shareholders."

32 In the meantime, as a sequel particularly to the majority decision in *Uther*, the definition of "dividend" in the 1936 Act was replaced and amendments were made to s 44 by the *Income Tax Assessment Act (No 4)* 1967 (Cth). Section 44 is

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20 (1951) 82 CLR 388 at 407.

21 (1965) 112 CLR 630.

22 (1984) 156 CLR 447 at 457.

23 (1965) 112 CLR 630 at 640.

24 (1984) 156 CLR 447 at 457.

the central provision in subdiv D, headed "Dividends", of Div 2 of Pt III of the 1936 Act. Division 2, which begins with s 25, deals with "Income".

The first submission by the taxpayer

33 Counsel for the taxpayer referred to the above decisions of this Court and to the structure of Div 2 of Pt III of the 1936 Act to claim support for her case in two respects. First, the reasoning in these cases was said to indicate an error in the case put by the Commissioner, the error being in speaking of the sell-back rights as severed or detached from the taxpayer's shares. It was said that the Commissioner conflated two rights, the "general right" to returns of capital, this being "part of the variety of rights making up the share", on the one hand, and the grant by SGL of the sell-back rights in "effectuation" of the foregoing "general right".

34 In further support of this submission, counsel referred in particular to passages in *Ord Forrest Pty Ltd v Federal Commissioner of Taxation*[25]. There, Gibbs J and Mason J, in the course of dismissing an argument *in terrorem* by the taxpayer as to the consequences of holding that the *Gift Duty Assessment Act* 1941 (Cth) applied to the particular facts, denied the general proposition that there was an element of gift where a share was allotted for less than its true value[26]. Mason J said that "the allotment is made to a member in satisfaction of the rights which he enjoys as a shareholder ... under [the corporation's] memorandum and articles of association"[27]. Nor was there an element of gift in an offer made by a company to its shareholders of renounceable (ie, saleable) rights to take up new shares in proportion to then existing holdings[28]. From that standpoint, the taxpayer submitted that the issue of bonus shares and of renounceable rights does not give rise to the derivation by the shareholder of income according to ordinary concepts, because, for the reasons explained by Gibbs J and Mason J in *Ord Forrest*, there was not the requisite "detachment" or "severance" from the existing shareholding.

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25 (1974) 130 CLR 124.

26 (1974) 130 CLR 124 at 150-151, 155-157.

27 (1974) 130 CLR 124 at 156.

28 (1974) 130 CLR 124 at 151, 157.

35 The taxpayer also relied in this respect upon *Federal Commissioner of Taxation v Miranda*[29] and *Macmine Pty Ltd v Commissioner of Taxation (Cth)*[30]. However, the question there was whether the sale of rights made at a profit attracted s 26(a) of the 1936 Act and did not concern what may have been the revenue nature of those rights as they were issued.

36 Contrary to the taxpayer's submission, it is insufficient to say that SGL issued the sell-back rights to Custodial on behalf of shareholders "in partial satisfaction of the shareholders' right to participate in reductions of capital", this being "within the congeries of rights comprising the shares". It is the character of the grant of rights to the shareholders that, as already explained, is decisive. It is not the reduction of capital effected by SGL pursuant to the new statutory processes provided by the Corporations Law.

37 The gain made by the taxpayer upon grant of the sell-back rights and the subsequent receipt of the proceeds of sale on her behalf was not the receipt of a distribution of any form of the assets of SGL. Nor, as explained earlier in these reasons, was the sell-back scheme provided "in satisfaction" of the rights of shareholders under the constitution of SGL. The scheme took its life from the deeds poll executed on the record date.

38 Thus, there is no sound analogy between this case and the liquidation and informal distribution cases beginning with *Stevenson*[31], and the cases dealing with the dividend provisions of the 1936 Act. Nor is the receipt of bonus shares a sound analogy to the position of the taxpayer here. Bonus shareholders do not receive a gain severed and detached from their existing shareholding. Rather, their proportional interest in the business of the company is re-expressed in the sense explained in *Inland Revenue Commissioners v Blott*[32]. In that case, Viscount Finlay, with reference to *Eisner*[33], said[34]:

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29 (1976) 11 ALR 85.

30 (1979) 53 ALJR 362; 24 ALR 217.

31 (1937) 59 CLR 80.

32 [1921] 2 AC 171 at 192-196.

33 252 US 189 at 207 (1920).

34 [1921] 2 AC 171 at 195.

> "In the present case the bonus or so-called dividend was not severed from the capital; on the contrary, it was added to it. ... What might have been paid as income went to increase the capital of the company. The shareholder got his proportionate share in the business of the company as increased by the additional capital."

The first submission by the taxpayer should be rejected.

<u>The taxpayer's second submission</u>

39 The taxpayer also submitted what was said to be a "code" argument. This was that s 44 and companion sections in subdiv D of Div 2 of Pt III of the 1936 Act together constitute a complete code with respect to the taxation of receipts by shareholders from companies.

40 The term "code" ordinarily is used to describe the statutory replacement of the common law upon a particular subject[35]. However, taxes are imposed and levied by statutes and the term "code" has an awkward application in that setting[36]. Moreover, the practice for laws of the Commonwealth imposing taxation not to deal in the one Act both with imposition of taxation and the assessment, collection and recovery of the tax[37] indicates that the 1936 Act, when read with the 1997 Act, cannot be said to constitute a "code" in any real sense of the term.

41 It is to be recalled that the 1936 Act and the 1997 Act, for income years following that which ended on 30 June 1998, have concurrent operation; although the latter now contains the general provisions rendering income liable to taxation, the former still contains specific provisions governing the taxation of certain forms of income. Section 44 of the 1936 Act is one of those provisions (see s 10-5, 1997 Act). In essence, the submission by the taxpayer on this branch of the case is that the application of the generally expressed provision in s 6-5 of the 1997 Act is to be restricted by a process of construction giving an exhaustive operation to the dividends subdivision in the 1936 Act. That exhaustive

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35 See, for example, *Gamer's Motor Centre (Newcastle) Pty Ltd v Natwest Wholesale Australia Pty Ltd* (1987) 163 CLR 236 at 243-244; *Bellino v Australian Broadcasting Corporation* (1996) 185 CLR 183 at 220.

36 *Malika Holdings Pty Ltd v Stretton* (2001) 204 CLR 290 at 309 [63].

37 See *Permanent Trustee Australia Ltd v Commissioner of State Revenue (Vict)* (2004) 220 CLR 388.

operation of subdiv D of Div 2 of Pt III of the 1936 Act, for the submission to be accepted, must cover not only receipts by shareholders which are brought to tax as assessable income by the subdivision, but also receipts which are not dividends in the defined sense of the term and are not otherwise reached by the subdivision. Thus, the "exhaustive" operation of the subdivision gives it a negative effect which is found by implication and goes beyond the terms of the subdivision.

42 Both sides agree that the taxpayer's sell-back rights were not "dividends" in the statutory sense. It may be assumed for present purposes that the rights otherwise would give rise to income according to ordinary concepts. Nevertheless, if the "code" argument be correct, they cannot do so. It would be an heroic exercise, and certainly not one previously undertaken in the cases to which the taxpayer referred, to construe the dividend provisions, which bring in gains, some of which would otherwise be of a capital nature, as implicitly excluding from the general income provision what otherwise would fall within it.

43 The exercise must fail. The taxpayer gave many examples of the inclusion in the dividend provisions of measures to deem as assessable income that which would not be income according to ordinary concepts. But that does not support the implicit exclusion from s 6-5 of the 1997 Act of other items of income according to general concepts.

44 Counsel invoked the decision of this Court applying s 109 of the Constitution by reference to the "covering" of a "field". But it is agreed, as noted above, that the grant of the sell-back rights fell outside the dividend provisions which must mark out the field.

45 The general position respecting the relations between the general and specific provisions of the 1936 Act was indicated by Dixon CJ and Williams J in *Federal Commissioner of Taxation v Dixon*[38] as follows:

> "As a result of s 25 what is gross income derived directly or indirectly from all sources or all sources in Australia, as the case may be, depends upon what is income. ... [The 1936 Act] begins with the general conception of gross income and specifies in s 23 what is exempt and in s 26 and other sections particular classes of income that are to be included. Sometimes these classes of income appear to be specified simply for

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38 (1952) 86 CLR 540 at 555.

greater certainty, sometimes because they do not fall within the natural understanding of gross income".

The same is true of the relationship between the general provision of s 6-5 of the 1997 Act and the specific provisions contained, amongst other places, in subdiv D of Div 2 of Pt III of the 1936 Act.

46 In *Reseck v Federal Commissioner of Taxation*[39], differing views were expressed as to the relationship between s 26(d) of the 1936 Act, including in the assessable income 5 per cent of the capital sum of certain allowances and gratuities, and s 25(1).

47 Stephen J (who dissented as to the outcome in *Reseck*) asked whether any "conflict" arose between the two provisions and referred to authorities dealing with the relationship between an earlier and later statute, particularly where a specific provision was followed by a general provision[40]. However, whilst the 1936 Act was much amended, both s 25(1) and s 26(d) had not been materially changed. No question of implied repeal arose[41].

48 Gibbs J, who, with Jacobs J, formed the majority in *Reseck*, construed s 26(d) as having both a charging and liberating effect, to tax both a percentage of an amount otherwise not brought to tax at all and a percentage of an amount otherwise assessable in full[42]. Two points should be made here. First, this reasoning as to the relationship between s 25(1) and s 26(d) is an anticipation of the processes of construction of the one statute, now required by *Project Blue Sky Inc v Australian Broadcasting Authority*[43], whereby apparent conflict is alleviated. Secondly, there is no such conflict in the first place between s 25(1) and the dividend provisions which is presented by the circumstances of the present case.

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39 (1975) 133 CLR 45.

40 (1975) 133 CLR 45 at 53-54.

41 cf *Minister for Immigration and Multicultural and Indigenous Affairs v Nystrom* (2006) 81 ALJR 1; 230 ALR 370.

42 (1975) 133 CLR 45 at 50.

43 (1998) 194 CLR 355 at 381-382 [70]-[71]. See also *Peldan v Anderson* (2006) 80 ALJR 1588; 229 ALR 432.

49 Jacobs J, the remaining member of the Court in *Reseck*, began from the standpoint that, because s 26(d) brought in only 5 per cent of the sum received, only one of the two sections could be applicable[44]. His Honour concluded that as a "special provision" which, with s 26(e) "cover[ed] the whole subject matter of allowances, gratuities and compensation", s 26(d) must be given effect in preference to the general provision of s 25(1)[45]. The reference to the covering of the whole field does not assist the taxpayer in the present case. First, this is not a case of amounts brought into assessable income, wholly or in part, by two provisions. Secondly, the "special provision" has no operation in the present case and no legislative intention is disclosed to imply a negative which limits the general provision of s 25(1).

50 The taxpayer's second submission should be rejected.

Conclusions and orders

51 For the reasons stated earlier in these reasons, the Commissioner's submissions that the majority of the Full Court erred should be accepted. In particular, on the listing date, 19 February 2001, when the taxpayer's sell-back rights were granted by SGL to Custodial "for the absolute benefit" of the taxpayer, as stated in the Sell Back Right Deed Poll, there was a derivation of income by her represented by the market value of her rights of $514[46]. That conclusion makes it unnecessary to consider the income nature of the receipt of the proceeds on 2 April 2001.

52 The appeal should be allowed and order 1 of the orders of the Full Court set aside. In place thereof, the appeal to that Court should be allowed, the orders of Conti J made on 14 April 2004 set aside and the appeal by the taxpayer against the objection decision of the Commissioner made on 31 October 2002 dismissed. The Commissioner is to pay the costs of the taxpayer of the appeal to this Court.

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44 (1975) 133 CLR 45 at 57.

45 (1975) 133 CLR 45 at 57.

46 cf *Abbott v Philbin* [1961] AC 352.

53 CALLINAN J. The issues, the facts and the relevant statutory provisions are set out in the joint judgment. Because my opinion is a dissenting one, and I agree in substance with the reasoning of the majority in the Full Court of the Federal Court, it is not necessary for me to state in elaborate detail why I would decide the appeal differently from the majority in this Court.

54 The key to unlock the problem here is to be found in the observation of French J, that the money received by the respondent[47]:

> "… was not an entitlement derived from profits earned by the company. It arose out of the decision by the company to reduce its issued capital through a buy back process."

And that, inevitably was what happened when the transactions for which the documents provided were carried into full effect: the capital, including the value of the respondent's rights as a shareholder in respect of it, became less than it would otherwise have been, because St George Bank Limited ("SGL") had expended some of that capital in buying some of its own shares and reducing thereby the number of shares on issue.

55 In my view the character of a payment for the purposes of the statutory definition of income, that is, "income according to ordinary concepts", is not always to be, indeed cannot always be, determined simply and solely by reference to its quality in the hands of a recipient. I do not take *GP International Pipecoaters Pty Ltd v Federal Commissioner of Taxation*[48] and the other cases referred to in the reasons for decision there, to be denying reference to the full circumstances leading to the receipt in the hands of the taxpayer. It will usually only be by reference to a transaction as a whole that the quality of a receipt, otherwise perhaps even unintelligible, will begin to be able to be ascertained. In *GP International* this Court was dealing with an argument that a receipt was disbursable by the taxpayer and should not for that reason be treated as income, and was not enjoining courts in the future from examining the whole of a transaction to identify the quality of a receipt.

56 The fact that the capital of the company suffered a reduction is far from irrelevant. But even if it were, and it were possible, as realistically I do not think it is, to look only to what the respondent had in her hands, the result is the same. She was left with a sum of money, and, it may readily be accepted, the same notional pieces of property, her shares, intact, representing a contingent

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47 *Commissioner of Taxation v McNeil* (2005) 144 FCR 514 at 529 [44] per French J.

48 (1990) 170 CLR 124 at 136 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ.

entitlement to the capital of SGL reduced by reason of the expenditure of some of it to buy back its shares. The money that the respondent received was not "severed" from the shareholding in SGL. It was the result of a reorganisation of the capital of the company which effectively gave shareholders access to a component of it that they would not otherwise have had. It was not a dividend, nor was it analogous to one.

57 The appellant, in his determination (the subject of the appeal) said this:

> "Although the [sell back] Rights were granted for the benefit of shareholders for nil consideration, they had a value because possession of a Right entitled the holder to sell SGL shares back to SGL for a price which exceeded the market value of the SGL shares."

This statement wrongly assumes that the quoted price of the shares on the stock exchange from time to time was necessarily the correct and exclusive value of the shares. The fact that the sell back rights, available to shareholders, had an additional value shows that this is not so. In this case SGL's directors knew better than those in the usual marketplace, the stock exchange. Perhaps that value, coming to attach as it did specifically to shareholders' sell back rights, may have been a consequence wholly, or in part, of a perception, or the actuality, of the "tax-effectiveness" of the scheme, as three judges in the Courts below and I hold in effect it to be, but there is nothing unusual about that.

58 Of course, the likely incidence of tax may affect value. If an example be required, *Tait v Federal Commissioner of Taxation*[49] in which special provisions relating to the incidence of income tax upon graziers was held in this Court to affect the value of a deceased's estate for the purpose of federal estate duty, provides it. That the value of a species of property may be so affected does not change its character.

59 The quoted price on the stock exchange of the shares in SGL was not the full measure of the value of the shares to shareholders on the relevant date as the directors of SGL knew, and took steps to establish by setting in motion the arrangements that they did. I agree with these passages in the judgment of Dowsett J[50]:

> "The Commissioner's case assumes that in the latter case, the relevant shareholding would remain unchanged, that the proceeds of sale

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49 (1967) 116 CLR 620.

50 *Commissioner of Taxation v McNeil* (2005) 144 FCR 514 at 559 [178], 562-563 [186]-[187].

were produced by the Taxpayer's investment without any diminution in its value. This assumption is made superficially more attractive by the fact that sale of the Sell Back Rights led to the Taxpayer receiving money from a third party, not from SGL. However it is obvious that the only reason for purchasing Rights would be in order to exercise them by selling shares to SGL. That was an attractive opportunity because SGL was offering an amount which was well above the prevailing market price. A purchaser of Sell Back Rights would pay a price which reflected, to some extent at least, the gain to be made by selling shares to SGL, which gain was to be derived from the assets of SGL. By creating Sell Back Rights, SGL ensured that shareholders who chose not to sell their own shares would nonetheless participate indirectly in the distribution of SGL assets which was an essential element of the Scheme. The special sense in which I use the expression 'distribution of SGL assets' is obvious.

…

In examining the Scheme, one must keep in mind the legal context in which it was designed and implemented. Shareholders had contractual and statutory rights as against SGL and inter se. In buying back one of its shares, SGL was buying the relevant shareholder's right to participate in dividends and in any surplus of assets over liabilities in a winding up. In this case, it seems that those rights were worth more than the paid up value of the share. The market price reflected the market's assessment of that value, but SGL offered an even greater amount. One must proceed upon the basis that SGL's offer reflected the Board's assessment of the true value of the shares. It is unlikely that the Board decided to buy the shares at a price above the amount which it considered to be their true value. Presumably, the board considered that the market was under-valuing the shares. For this reason, the offer was attractive to some, perhaps many, shareholders to whom market price was more important than the possible return from a notional winding up.

What, then, was the purpose of the arrangement concerning the shareholders who did not accept the offer? It is conceivable that it was designed as a convenient mechanism for ensuring that the 5% target was achieved. However it is significant that those who designed the Scheme considered that there would be a worthwhile market for the Sell Back Rights, probably because the offer was well above the market price. Clearly, SGL considered that shareholders who chose not to sell should, nonetheless, be able to participate in the benefit of the Scheme. Given that such benefit cannot be characterised as a gift, one must ask why that view should have prevailed. The only likely answer is that as the Scheme involved the disbursement of company assets, there was at least a possibility that the outcome would be disadvantageous to such shareholders, either because the value of their shares on an asset-backing

> basis might be reduced (perhaps because the Board erred in assessing the value of the shares) or because the Scheme might have an adverse effect on the market price of the shares."

60 I am unable to accept that the sell back rights which the respondent enjoyed, and which were turned to account on her behalf, did not represent any portion of her rights as a shareholder under the constitution of SGL; or that anything turns upon the execution of the scheme for what was, clearly, a reduction of capital, by the performance of covenants in deeds poll. Indisputable rights that the respondent had as a shareholder included her right with other shareholders to insist upon the application of the capital of SGL diligently and honestly in pursuance of its objects, and, in the event that there was an excess of it which SGL's directors thought might prudently be returned to shareholders, that it be returned to them in the same proportions as their shareholdings bore to all of the shareholdings in the company.

61 It was not the deeds poll that breathed life into the scheme under which the respondent received the value of her sell back rights. The deeds poll recorded the scheme, and ensured that the respondent would receive her due under it, but the scheme itself had more to it than them. The availability of excess capital, SGL's directors' decision to return it to the shareholders, the selection and adoption of the means of doing so, the retention by shareholders, such as the respondent, of their shares intact, the actual reduction of capital that ensued, and the receipt of the value of the sell back rights by the shareholders, were the major elements of the scheme and constituted in totality its "life".

62 I would also regard the cases, as to which there is unanimity only in that they are not determinative, to the extent that they are illuminating, as tending to support the respondent's position rather than the appellant's. By reason of the careful analysis by Dowsett J of them, it is unnecessary for me to do more than say that I agree with it.

<u>Capital Gain</u>

63 I am also in agreement with Dowsett J in the Full Court of the Federal Court that the "event" upon which the appellant relied, the issue of the sell back rights, did not of itself result in the receipt by the respondent of money, or indeed an entitlement to receive money. What is taxable in a given case is the capital gain calculated by reference to the amount of the capital proceeds "because of the 'Capital Gains Event'". And "capital proceeds" includes money, "other consideration … received" or money that a taxpayer is "entitled to receive" "because of the … event"[51]. "Consideration" is a term which involves an element

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51 cf *Commissioner of Taxation v McNeil* (2005) 144 FCR 514 at 570 [218]-[220].

of exchange[52], something which is missing here in relation to the sell back rights[53].

64 I would dismiss the appeal with costs.

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52 *Commissioner of Taxation v Scully* (2000) 201 CLR 148 at 166 [25] per Gaudron ACJ, McHugh, Gummow and Callinan JJ.

53 cf *Commissioner of Taxation v McNeil* (2005) 144 FCR 514 at 570-571 [220].