

LOSSES ON THE DISPOSAL OF SHARES ON REVENUE ACCOUNT

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OPPORTUNITIES FOR LOSS UTILISATION IN THE CURRENT ENVIRONMENT?

The recent Full Federal Court decision in *Greig v Commissioner of Taxation* [2020] FCAFC 25 (Greig) has highlighted the difficulty in distinguishing whether profits received from an isolated transaction in relation to shares are taxable on revenue or capital account.

A majority of the Full Federal Court has held that AUD11.85 million in share losses, as well as legal fees incurred, in respect of the compulsory transfer of shares for nil consideration in a company which went into voluntary administration were deductible under section 8-1 of the *Income Tax Assessment Act 1997*.

FACTS

The taxpayer made regular investments in listed shares, on the advice of financial advisers and stockbrokers, between January 2008 and April 2014. In 2011, the taxpayer had the goal of buying and selling shares in large volumes for the purpose of making a short term profit. This was referred to as the taxpayer's "profit target strategy". With the assistance of financial advisers and stockbrokers, the taxpayer concluded that Nexus Energy Limited (Nexus) shares were undervalued and fell within the taxpayer's "profit target strategy".

The taxpayer invested almost AUD12 million, in 64 discrete trades, between March 2012 and May 2014 buying shares in Nexus. His Nexus shares were subsequently compulsorily transferred and cancelled by the administrators of Nexus. The taxpayer challenged the actions of the administrators in court. Ultimately, the taxpayer suffered a total loss of AUD12,358,960 attributable to both the share loss and legal fees in connection with the administration process. During the relevant period, the taxpayer also purchased shares in other listed companies on 218 separate occasions.

Prior to 2015 the taxpayer treated the gains and losses on these transactions as capital amounts in his income tax returns, but in 2015 he sought a private ruling from the ATO that the loss of his stake in Nexus was on revenue account.

It was argued that, in contrast to the other share transactions, those relating to the Nexus shares were in accordance with a "profit target strategy" such that the losses were incurred in gaining or producing assessable income since they were incurred in a "business operation or commercial transaction" entered into for the purpose of making a profit within the principle in *Myer Emporium*. The taxpayer was not arguing that he was carrying on a business of share dealing.

FIRST FINDING: INTENTION OF PROFIT-MAKING

The Full Federal Court accepted that the taxpayer acquired the shares with a profit-making intention. His plan was to sell the shares at a profit in the short term, rather than to hold the shares as a long term investment and to receive dividends over time.

The fact it took a longer time to realise the profit (and no profit was in fact made) did not affect the taxpayer's original and ongoing profit-making intention.

Interestingly, the Court acknowledged the artificiality in distinguishing the Nexus share transactions from the other investments, implying that all the taxpayer's transactions should be treated as on revenue account.

SECOND FINDING: BUSINESS OPERATION OR COMMERCIAL TRANSACTION

The Primary Judge had earlier found that the shares were not acquired in a business operation and commercial transaction, but rather, they were acquired as an ordinary private investment. However, the majority in the Full Federal Court disagreed with the Primary Judge's finding, stating that the mere fact a transaction has been undertaken privately does not mean that any gain is necessarily on capital account.

Justice Steward, in the Federal Court, focused on the following factors as the basis for the decision:

- An intention existed at the time of the acquisition of each share of profit making from their sale.
- The taxpayer had a sophisticated plan to generate cash profits within 4 to 5 years.
- The taxpayer acquired the shares in a systematic way on 64 occasions.
- The taxpayer actively participated in the value generation from the share transactions.
- The taxpayer used his business knowledge and experience in determining whether to buy or sell shares.
- The taxpayer acted as a "business person" would have in acquiring shares to obtain a profit on sale.

For these reasons, the Court found that the *Myer Emporium* principle was satisfied and held that the loss was incurred on revenue account and not capital account.

CHARACTER OF GAINS MADE ON ISOLATED TRANSACTIONS

The Court also stated:

- The share losses could not really be characterised as arising from an isolated trade.
- There is no absolute rule that can be relied on to state that shares acquired by individuals or private investors are held on capital account. The actual position must be determined on a case by case basis.
- The way that a taxpayer characterises a transaction is irrelevant.
- If shares are acquired by an individual for their dividend yield and long-term growth they are likely to be held on capital account.

WHAT DOES THIS MEAN?

Greig is an important decision regarding the principles governing how gains or losses from share transactions are to be treated. Of course while the decision is heavily dependent on the facts, this decision has now established that the *Myer Emporium* principle can apply even where the taxpayer is not otherwise engaged in a business.

The significance of the finding for individuals or trusts is twofold:

- If gains from the sale or disposal of shares are treated as being on revenue rather than capital account they will be taxable at an individual's marginal rate of tax without the benefit of the CGT discount (if applicable).
- Losses from the sale or disposal of shares on revenue account can be applied against either income or capital gains. Capital losses, by contrast, can only be applied against capital gains, not against income.

Private investors should not assume proceeds from selling shares are on capital account. Although Justice Steward acknowledged that a private investor may not have the same knowledge and experience as the taxpayer in this case, less sophisticated taxpayers who acquire investments in a systematic and business-like manner may have gains from the investments taxed on revenue account.

The COVID-19 pandemic has resulted in considerable volatility in the stock market. This will necessarily increase focus by investors on the characterisation of losses from these types of transactions and the ability to utilise those losses against other income.

A cautionary note, however, is the statement of the Court that there was nothing to distinguish the profitable trades in relation to which the taxpayer claimed to be an investor from the loss-making ones held to be on revenue account. This could signal heightened interest by the ATO toward investors generally on the characterisation of profits from share transactions.

While the assets under consideration in *Greig* were shares, the same principles can be applied to other asset classes, including real estate.

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