- Buy-back or redemption of certain hybrid securities

The issues in this discussion paper were finalised in PCG 2021/1 *Application of market value substitution rules when there is a buy-back or redemption of hybrid securities - methodologies for determining market value for investors holding their securities on capital account*

Australian Government
Australian Taxation Office

Discussion Paper

Buy-back or redemption of certain hybrid securities

Methodologies for determining market value for investors holding their securities on capital account

Purpose and status of this discussion paper

The purpose of this paper is to facilitate consultation between the Australian Taxation Office (ATO) and the community as part of the process of developing advice on the application of the tax law.

This paper is prepared solely for the purpose of obtaining comments from interested parties. All views in this paper are therefore preliminary in nature and should not be taken as representing either an ATO view or that the ATO will take a particular view.

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Date of issue	12 February 2020
Contact officer *(for comments or further information)*	*Contact officer details have been removed as the comments period has ended.*
Final date for comments	11 March 2020

Table of Contents **Paragraph**

What this discussion paper is about

1. A common form of security in the market is a preference share or note generically known as a 'hybrid security'. The terms of such hybrid securities will generally permit (but not require) the issuer of the hybrid security to 'repay' investors at a particular time if certain conditions are satisfied (where the issuer does not elect to repay investors at that time, the hybrid security will usually convert into ordinary shares in the issuer or continue to remain on issue until another relevant date with the option to repay or convert). The actual form of repayment will depend on the legal form of the hybrid security. When the hybrid security is in the form of a preference share (**hybrid share**) the issuer may, among other mechanisms, repay the investor through an off-market buy-back of the share or, when the hybrid security is in the form of a note (**hybrid note**), through redemption of the note. Where this happens, the income tax law (as discussed at paragraphs 4 to 11 of this paper) will require the holder of the hybrid security to determine the market value of the hybrid security as a part of the process of determining their capital gain or capital loss.

2. The ATO has been made aware of some uncertainty and inconsistent tax treatment in relation to the redemption or buy-back of hybrid securities. In particular, there have been instances whereby taxpayers have either assumed it is not necessary to determine the market value of the security or the market value has been assumed to be the face value that is, the actual proceeds received) on redemption or buy-back of the security.

3. The ATO also recognises the practical problems for investors in determining the market value of the securities for the purposes of calculating their capital gain or capital loss on these transactions. This discussion paper is seeking feedback on a potential practical compliance approach for determining the market value of certain hybrid securities when they are bought back or redeemed (as relevant) from an investor holding their hybrid securities on capital account. A practical approach to determining market value may be published as a practical compliance guideline (and depending on the feedback received from this discussion paper, it may be published as a draft or final practical compliance guideline).

Requirement to determine market value on off-market buy-back or redemption

4. When a hybrid security, held by an investor on capital account, is subject to a buy-back or redemption, generally one of two CGT events will happen:

- CGT event A1 under subsection 104-10(1) of the *Income Tax Assessment Act 1997* (ITAA 1997), or
- CGT event C2 under subsection 104-25(1) of the ITAA 1997.

5. CGT event A1 under subsection 104-10(1) of the ITAA 1997 will happen when a security in the nature of a hybrid share is bought back off-market.

6. CGT event C2 under subsection 104-25(1) of the ITAA 1997 will happen when a security in the nature of a hybrid note is redeemed.

7. In both cases it will be necessary for the investor to determine the capital proceeds for the event happening, even if the capital proceeds are simultaneously reinvested into another product.

8. Where there has been a redemption of a hybrid security and CGT event C2 happens, in determining whether a capital gain or capital loss is made pursuant to subsection 104-25(3) of the ITAA 1997, regard must be had to the application of the market value substitution rule in subsection 116-30(2) of the ITAA 1997, taking note of subsection 116-30(3A) of the ITAA 1997.[1]

[1] The market value substitution rule exemption in subsection 116-30(2B) of the ITAA 1997 does not extend to non-share interests such as hybrid capital notes.

9. The relevant subsections in section 116-30 of the ITAA 1997 provide as follows*:*

> (2) The capital proceeds from a CGT event are replaced with the market value of the CGT asset that is the subject of the event if:
>
> (a) ...
>
> (b) those capital proceeds are more or less than the market value of the asset and:
>
> (i) ...
>
> (ii) the CGT event is CGT event C2 (about cancellation, surrender and similar endings).
>
> …
>
> (3A) If you need to work out the market value of a CGT asset that is the subject of CGT event C2, work it out as if the event had not occurred and was never proposed to occur.

10. Where there has been an off-market buy-back of a hybrid security and CGT event A1 happens, in determining whether a capital gain or capital loss is made pursuant to subsection 104-10(4) of the ITAA 1997, the consideration an investor is taken to receive may be modified by section 159GZZZQ of the *Income Tax Assessment Act 1936* (ITAA 1936). Relevantly, subsection 159GZZZQ(2) of the ITAA 1936 states:

> If apart from this section:
>
> (a) the purchase price in respect of the buy-back;
>
> is less than:
>
> (b) the amount that would have been the market value of the share at the time of the buy-back if the buy-back did not occur and was never proposed to occur;
>
> then … the amount of consideration that the seller is taken to have received or to be entitled to receive in respect of the sale of the share is equal to the market value …

11. Importantly this provision operates differently to the market value substitution rule for CGT event C2 as section 159GZZZQ only operates to increase the consideration where the purchase price is less than market value. As a consequence, where the purchase price is *more* than the market value, the capital proceeds will be the purchase price received for the hybrid shares.

Scope of this discussion paper

12. The ATO has undertaken research in this area, including obtaining advice and input from experts in capital markets and hybrid security valuation, to get a better understanding of the impact of the legislative requirements on investors and their advisers with the aim of developing an approach that will assist taxpayers to easily comply with the law. While the ATO has focused on hybrid securities designed to be recognised as Additional Tier 1 Capital for the purposes of the prudential standards, the proposed valuation methodologies have potential application to other hybrid securities. As a part of this process, the ATO is now seeking to consult with industry on the proposed methodologies and the hybrid securities that could be covered by those methodologies.

13. The proposed methodologies and this discussion paper are confined to the application of the market value substitution rules in the situations mentioned in paragraphs 4 to 11 of this paper (that is, redemption of a hybrid note or buy-back of a hybrid share). However, this paper does not consider the appropriateness or otherwise of different mechanisms to repay investors in hybrid securities (for example, the use of a nominated purchaser under a so-called 'resale').

Background to ATO proposed methodologies

Transaction structure

14. Our review of a sample of hybrid securities subject to buy-back or redemption has revealed that generally one of two approaches are adopted by the issuer of the hybrid security:

- *One date* – the issuer will announce to the market that all securities will be bought back or redeemed on a particular date specified in the terms of issue (which for the balance of this discussion paper will be referred to as the 'call date'[2]) and an investor may elect whether to receive cash for their security or reinvest the proceeds into another hybrid security issue on that date. Under this approach all hybrid securities on issue are bought back or redeemed on the same date.
- *Two dates*[3] – the issuer will announce to the market at some time close to the 'call date' that investors may elect to have their hybrid securities bought back or redeemed on a particular date before the 'call date' (usually referred to as the 'reinvestment date') and have the proceeds reinvested into another hybrid security issue. The balance of hybrid securities not bought back or redeemed on the reinvestment date will then be bought back or redeemed on the 'call date' for cash. Under this approach, the original hybrid securities will be bought back or redeemed on two different dates – the reinvestment date for investors receiving a new issue of securities and the call date for investors receiving cash.

15. As the second approach involves a buy-back or redemption of the relevant hybrid security on two different dates, the market value of the hybrid security will need to be determined separately for each date.

Valuation methodologies

Redemption/buy-back on call date

16. Subsection 116-30(3A) of the ITAA 1997 or paragraph 159GZZZQ(2)(b) of the ITAA 1936 (as relevant) require that the market value of a CGT asset (that is, the hybrid security) when it is redeemed or bought back must be worked out as if the redemption or buy-back 'had not occurred and was never proposed to occur'.

17. The valuation experts we have spoken with noted that, even though the terms of (some) hybrid securities do not mandate the redemption or buy-back of the hybrid security on the call date specified in the terms of issue, it is relevant to have regard to the market's expectation that all of the hybrid securities on issue will be redeemed or bought back at that time. Where there is a clear and unambiguous expectation by the market that there will be a redemption or buy-back at that time, such hybrid securities should have a market value that is similar to a 'vanilla' debt security when it is repaid or redeemed on the repayment date specified on its terms of issue. In these circumstances, there is consensus amongst the valuation experts that the ATO should accept that the market value of a hybrid security redeemed or bought back on its call date should be equal to its face value (that is, the proceeds received on redemption or buy-back).

18. The market's expectation about whether the hybrid security will be redeemed or bought back on the specified call date will depend on the facts and circumstances in each case. However, in the case of (Additional Tier 1) hybrid securities issued by entities in the financial sector, the valuation experts considered the market should generally have this expectation because historically such securities have generally been redeemed or bought back no later than their specified call date, the need to issue new hybrid securities on a regular basis and there would be

[2] The original prospectus (or other issuance document) would normally specify a date or include an indicative date for some or all of the securities to be redeemed at the option of the issuer (and may also be subject to approval from APRA if the hybrid security is intended to qualify as regulatory capital for the purposes of the prudential standards). We understand that this date may also be referred as the optional 'conversion', 'redemption', 'resale', 'transfer' or 'exchange' date.

[3] This generally only occurs where the hybrid security is listed on the Australian Securities Exchange (ASX).

significant commercial and reputational implications for an issuer that did not redeem or buy-back their securities.

Redemption/buy-back on reinvestment date prior to call date

19. However, where a hybrid security is redeemed or bought back on a reinvestment date, being a date prior to the call date specified in the terms of issue, the view of the valuation experts was that the market value of the hybrid security would generally not be equal to its face value. This is because, in taking into account the required assumption in either subsection 116-30(3A) of the ITAA 1997 or paragraph 159GZZZQ(2)(b) of the ITAA 1936 that the redemption or buy-back 'had not occurred and was never proposed to occur', the market value on the reinvestment date would need to take into account the fact that some of the securities will remain on issue post the reinvestment date until the specified call date and therefore reflect the present value of any potential future distributions that may be paid on the hybrid security between the reinvestment date and the call date. Feedback from the experienced experts revealed that there are many possible valuation methodologies and approaches that could be adopted to ascertain the market value of a hybrid security on a reinvestment date prior to the call date.

20. However, the experts confirmed that, similar to the valuation of any debt security, there is not a 'one size fits all' valuation methodology and it could be a laborious and costly exercise for investors in hybrid securities to establish a market value for their securities if the valuation is to take into account all the relevant factors influencing the valuation.

21. While investors must establish a market value for their hybrid securities, the ATO recognises that in establishing that value on a reinvestment date, investors are faced with a trade-off between having a simple methodology that can be applied to the redemption or buy-back and undertaking a detailed and complex valuation methodology that may need to be customised individually to each hybrid security issue.

22. In view of this, the ATO is considering whether to provide a practical compliance approach whereby the ATO will accept that the market value of a hybrid security on reinvestment date (for the purposes of subsection 116-30(2) of the ITAA 1997 or subsection 159GZZZQ(2) of the ITAA 1936 (as relevant)) may be calculated as the volume weighted average price (VWAP) over the last 5[4] trading days immediately prior to the **first** announcement date[5] adjusted for any accrued distributions.[6] However, unlike the method detailed in TD 2004/22, this method would not include a further adjustment for the percentage change in the S&P/ASX 200 Index between the announcement date and the redemption or buy-back date, as such an adjustment is not considered appropriate for these types of instruments.[7]

23. The reasons for considering a modified VWAP method include:

- it is a simple and cost-effective formula for investors to apply
- it traces back to the listed market price, which is a reflection of market value (albeit that the valuation experts have noted that the accuracy of the listed market price is affected by the liquidity of the market and that hybrid securities are generally thinly traded)
- it allows for a consistent approach to be applied to all buy-back/redemption events, and

[4] It will be open to consultation whether 5 days is appropriate or whether a longer sample period is considered more appropriate.

[5] As noted in Taxation Determination TD 2004/22 *Income tax: for Off-Market Share Buy-Backs of listed shares, whether the buy-back price is set by tender process or not, what is the market value of the share for the purposes of subsection 159GZZZQ(2) of the Income Tax Assessment Act 1936?,* the first announcement date will be taken to be the first time the company indicated to the market place that the buy-back was in serious contemplation.

[6] As detailed in TD 2004/22.

[7] An alternative index which may be appropriate in all circumstances has not been identified.

- sampling of a variety of instruments has revealed that the VWAP calculation produces a value substantially reflective of market fundamentals (see the Appendix to this paper).

24. The ATO appreciates that there may be some potential concerns with such a method, including:

- The method is, by its nature, crude and may not fully take into account the specific features of the hybrid security issuer, the instrument or the industry and therefore may not provide a perfect representation of market value.
- The VWAP methodology was developed for widely-traded shares which exist in perpetuity whereas hybrid securities (especially hybrid securities issued by entities in the financial sector) are usually thinly traded coupled with a market expectation that they will be bought back or redeemed by no later than their specified call date.

25. The ATO has attempted to take these concerns into account by providing flexibility to deal with instances where the modified VWAP methodology may not be the most appropriate valuation methodology.

Hybrid securities issued by financial sector entities compared with entities in other industries

26. From reviewing a sample of hybrid securities and undertaking discussions with relevant experts, the ATO understands that a strong expectation exists in the market that hybrid securities issued by financial sector entities will be bought back or redeemed on the specified call date rather than being converted. This expectation appears to be based on the fact that financial sector hybrid securities must comply with strict Australian Prudential Regulation Authority (APRA) prudential standards as well as commercial and reputational drivers for such securities being bought back or redeemed by no later than their call date. In other words, although the terms of the hybrid securities may contemplate other scenarios such as conversion into ordinary shares or even write-off, in practice those scenarios have never happened and are never expected to happen due to the actual and perceived economic strength of the Australian financial sector.

27. However, for hybrid securities issued by entities in other sectors, it will need to be determined whether a similar expectation exists in the market based on the facts and circumstances of the particular hybrid security and the issuer. For example, if the issuer has previously converted hybrid securities into ordinary shares (rather than repaying investors through a redemption or buy-back), it may be difficult to establish a clear market expectation that the current hybrid securities on issue will be redeemed or bought back on their specified call date. Perceptions about the financial strength of the issuer or the economic circumstances of the industry in which it operates may also be relevant.

28. Given the proposed valuation methodologies and compliance approach contemplated in this paper require the issuer to demonstrate a strong market expectation that the hybrid security will be repaid by its specified call date, feedback is sought on whether it is practical and feasible for the scope of the valuation methodologies and compliance approach suggested in this paper to extend beyond (Additional Tier 1) hybrid securities issued by entities in the financial sector.

ATO proposed methodologies

29. The ATO's proposed methodologies will apply to hybrid securities with the following features:

- the hybrid security is an equity interest under Division 974 of the ITAA 1997
- the issuer has an option (which may be subject to conditions), but is not required, to buy-back or redeem the hybrid security on a date specified in the terms of issue ('call date')

- where the issuer has an option to buy-back or redeem the hybrid security before the specified call date, the hybrid security will be listed on the ASX at all times while it is on issue
- the hybrid security will convert into ordinary shares in the issuer or a connected entity of the issuer if it is not bought back or redeemed on or before the specified call date
- the hybrid security carries a right to regular (at least annual) distributions calculated by reference to a fixed or floating market-based coupon rate, and
- there is a strong and demonstrated market expectation prior to the announcement of the redemption or buy-back that the hybrid securities will be redeemed or bought back on the specified call date.

30. The proposed practical compliance approach for hybrid securities satisfying the requirements at paragraph 29 of this paper is:

- The ATO will accept that the market value of a hybrid security on its specified call date for the purposes of subsection 116-30(2) of the ITAA 1997 or subsection 159GZZZQ(2) of the ITAA 1936 (as relevant) is equal to its face value.
- The ATO will accept that the market value of a hybrid security that is listed on the ASX on any reinvestment date before the specified call date (for the purposes of subsection 116-30(2) of the ITAA 1997 or subsection 159GZZZQ(2) of the ITAA 1936 (as relevant)) is equal to the amount calculated in accordance with the VWAP over the last (xx) trading days prior to the first announcement date adjusted for any accrued distributions, so long as the result is within a tolerance of (xx)% of the face value of the instrument (acceptable tolerance).
- Where the VWAP determined is outside of the acceptable tolerance range
  - the determined VWAP amount can still be applied where an independent valuation is sought by the issuer which justifies the VWAP result, or
  - alternatively, the issuer may obtain an independent market valuation using a methodology other than VWAP.

31. Including an acceptable tolerance factor in this valuation methodology is designed to cater for unusual conditions that may be present (for example, insufficient trading to determine a true market price) indicating that the VWAP valuation methodology is producing a result that is not within acceptable parameters.

32. Note: It is important to note that feedback from the experts indicated that a valuation methodology equal to face value for securities redeemed prior to call date was not appropriate as it would be highly unlikely, and possibly coincidental, that the market value would be equal to face value on an early redemption date.

33. The requirement in subsection 116-30(3A) of the ITAA 1997 and paragraph 159GZZZQ(2)(b) of the ITAA 1936 (which requires the market value of a hybrid security that is bought back or redeemed to be worked out as if the hybrid security had not been bought back or redeemed and was never proposed to be bought back or redeemed) is particularly relevant where the buy-back or redemption occurs before its specified call date. This is because other hybrid securities remain on issue and may continue to be traded.

34. However, it is considered that the requirement in subsection 116-30(3A) of the ITAA 1997 and paragraph 159GZZZQ(2)(b) of the ITAA 1936 (to assume that the redemption or buy-back 'had not occurred and was never proposed to occur') may have no practical effect where:

- there is a redemption or buy-back of **all** outstanding hybrid securities for their face value on their specified call date
- the issuer is solvent, and

- it can be established on reasonable evidence (including past issuances by the issuer) that the market would expect the hybrid securities to be bought back or redeemed on their specified call date (the ATO accepts that this will be the case where an APRA-regulated entity has issued the hybrid securities and there has been no non-viability trigger event for the purposes of the prudential standards on or before the specified call date).

35. This is because, even if the market value of the hybrid security were to be worked out as if the redemption or buy-back had not occurred and was not proposed to occur, the valuation experts engaged by the ATO consider that the market value of the hybrid security would still be equal to its face value because an investor would not expect any further distributions to be paid on the hybrid security beyond its call date and because none of the hybrid securities will remain on issue post that date.

36. Based on the ATO's consultation with the valuation experts, the ATO is satisfied that a buy-back or redemption of a hybrid security in the circumstances set out in paragraph 29 of this paper will not change the inherent value of the hybrid security as determined by its terms, market conditions and market expectations.

37. The ATO's view is that the requirement in subsection 116-30(3A) of the ITAA 1997 and paragraph 159GZZZQ(2)(b) of the ITAA 1936 is designed to ensure that the market value of a hybrid security can be arrived at, untainted by the fact that a buy-back or redemption has, or is expected to occur.[8] The ATO does not consider that the requirement in subsection 116-30(3A) of the ITAA 1997 and paragraph 159GZZZQ(2)(b) of the ITAA 1936 goes so far as to create a statutory fiction that the nature of the asset and its inherent value is to be ignored.[9]

Examples of the ATO's proposed methodologies in action

Scenario 1 – single redemption date

38. *Bank A issued subordinated convertible notes to the market with a face value of $100 per note, with a call date at the end of the fifth year after issue.*

39. *Bank A announced to the market one month prior to the call date that holders of the notes would have the option of reinvesting the proceeds of the notes into a new tranche of notes to be issued by the Bank on the call date. As part of the reinvestment process, Bank A will redeem the original notes and apply the proceeds to the issue of new notes on the call date.*

40. *For investors who choose to not participate in the reinvestment option, their notes are redeemed on the call date and they receive the face value of $100 per note.*

41. *In this scenario, for the purposes of determining an investor's capital gain or capital loss, the ATO accepts that the market value of each note equals $100 (that is, face value) at the time of redemption.*

Scenario 2 – two buy-back dates

42. *Bank B issued subordinated convertible preference shares to the market with a face value of $100 per preference share, with a call date at the end of the fifth year after issue.*

43. *Bank B announced to the market three months prior to the call date that holders of the preference shares have the option of reinvesting the proceeds of the preference shares into a new tranche of preference shares to be issued by the Bank two months prior to the call date of the*

[8] Refer to paragraph 2.13 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 1) 1996 and the discussion of section 18 of the *Taxation Laws Amendment Act 1990* in the Explanatory Memorandum to the Taxation Laws Amendment Bill 1990.

[9] Refer to the minutes of the National Tax Liaison Group Losses and CGT Sub-committee, 9 June 2004 (ATO response to item 10.1 'Capital gains implications of *Integrated Insurance Planning Pty Ltd v Commissioner of Taxation* [2004] FCA 35 – ICAA').

original preference shares (date X). As part of this reinvestment process, Bank B will buy back the original preference shares and apply the proceeds to the issue of new preference shares.

44. *The 5-day VWAP of each original preference share calculated at the time of the announcement is $100.80.*

45. *For investors who choose not to participate in the reinvestment option, their preference shares are bought back on the call date and they receive the face value of $100 per preference share.*

46. *In this scenario, for the purposes of determining an investor's capital gain or capital loss, the ATO accepts that:*

- *At date X, the market value of the preference share will equal the 5-day VWAP of $100.80, where the threshold tolerance is set at (xx)% of the face value of the instrument.*
- *At the final call date, the market value of each preference share equals $100 (that is, face value).*

Scenario 3 – single redemption date with resale mechanism

47. *Bank C issued subordinated convertible notes to the market with a face value of $100 per note, with a call date at the end of the fifth year after issue. An optional resale mechanism (exercisable at the option of Bank C) is included in the terms and conditions of the prospectus of the convertible notes whereby Bank C can may elect to engage a third party, usually an investment bank (the Purchaser), to acquire the original notes from the investors. Bank C can then redeem all (or a portion) of the notes from the Purchaser immediately after the acquisition. This option also provides Bank C with flexibility in managing its capital position as there is a possibility it may want to convert some securities to ordinary shares depending on its equity capital position at the time of redemption.*

48. *Bank C announced to the market one month prior to the call date that holders of the subordinated convertible notes have the option of reinvesting the notes into a new tranche of notes issued by the Bank on the call date. As part of the reinvestment and redemption process, Bank C has elected to engage the optional resale mechanism.*

49. *On the call date, the Purchaser acquires all of the notes from investors. For investors who chose not to participate in the reinvestment option, they received cash consideration from the Purchaser equal to the face value of $100 per note. For those investors who elected to participate in the reinvestment option, the proceeds are applied towards payment of the subscription price for the new tranche of Bank C notes.*

50. *Immediately after the Purchaser acquired the (old) notes from the investors, Bank C redeemed all (or a portion) of the notes from the Purchaser for $100 per note.*

51. *In this scenario:*

- *CGT event A1 happens to the investors when the Purchaser acquires their convertible notes regardless of whether the investor has chosen to be paid cash or to reinvest the proceeds in a new tranche of Bank C notes. The market value substitution rule will not apply to this event.*
- *CGT event C2 happens to the Purchaser when Bank C redeems the notes from it. The market value substitution rule will apply to this event. The ATO accepts that the market value of each note equals $100 (that is, face value) at the time of redemption for the purpose of determining the CGT implications for the Purchaser.*

Specific questions for consideration

52. The ATO welcomes feedback on the matters raised in this discussion paper. In particular the ATO is interested in receiving responses on the following questions:

- What hybrid securities should be covered by any practical compliance approach the ATO may adopt? Should it only cover hybrid securities that qualify as Additional Tier 1 capital and which are listed on the ASX? Should it extend to any ASX-listed hybrid security where the terms allow for redemption or buy-back on a specified date (including hybrid securities that are debt interests)? Should unlisted (for example, wholesale) hybrid securities be covered?
- If the scope of any practical compliance approach should extend beyond hybrid securities that qualify as Additional Tier 1 capital, is the requirement to establish that there is an expectation by the market (prior to an announcement) that a hybrid security will be redeemed or bought back (as relevant) on its specified call date practical and easy to establish?
- Is it otherwise clear what hybrid securities would be covered by any practical compliance guidelines?
- Overall, do you think the valuation methodologies proposed by the ATO are reasonable and practical to apply?
- Do you think the proposed modified VWAP methodology where ASX-listed hybrid securities are redeemed or bought back before their scheduled call date is reasonable and do you expect it would generally be applied?
- Do you have any views on
  - an acceptable tolerance threshold (percentage) for acceptance of the proposed modified VWAP methodology?
  - an acceptable number of trading days to be utilised in the calculation of the proposed modified VWAP methodology?
  - whether the proposed modified VWAP methodology would be an appropriate market value determinant based on the data extracted in the Appendix to this paper. In particular, do you have any views on
    - whether the data makes sense, and
    - any suggestions as to what idiosyncratic market features might cause the proposed method to produce a substantial variance in value (for example, a difference in trading margins on the securities due to a higher coupon rate; thinly-traded securities etc.)?

Appendix

53. As part of the research undertaken by the ATO for the purpose of determining an appropriate methodology for future hybrid securities that are bought back or redeemed, the proposed methodologies were applied to a random sample of hybrid securities which have been redeemed or bought back over the past 5 years. The sample contained both bank and non-bank securities and securities that were bought back or redeemed on one date or two dates. This should not be taken as the ATO expressing a view on the value of these securities for tax purposes. It should be noted that the data contained in this Appendix is sourced from publicly available material including Bloomberg (for the last price and volume) and ASX announcements (for the coupon payment rates and dates).

54. The process of applying the proposed modified VWAP methodology involved the following steps:

1. Identify the first date of the issuer's announcement of buy-back/redemption of the securities.
2. Identify the date of the last coupon payment and the amount payable on the next coupon date. Use this information to calculate the daily amount of accrued interest.
3. Obtain the last price of the security and volume traded for each of the five days prior to the announcement.
4. For each of the five days prior to the announcement, subtract the accrued interest from the last price paid for the security to produce the 'clean price' of the security for each of the five days.
5. Multiply the clean price by the volume traded for each of the five days.
6. Calculate total volume traded x clean price over the five days.
7. Calculate total volume traded over the five days.
8. Divide step 6 by step 7 to yield the final VWAP amount.

55. Below are the results of these calculations in respect hybrid securities that were redeemed or bought back on two dates. Feedback is sought on the appropriateness of the proposed methodology having regard to the resulting VWAP market value for each of the sample securities and/or whether there are any idiosyncratic features that might cause such a method to produce a substantial variance in value (for example, a difference in trading margins on the instrument due to a higher coupon rate; thinly-traded).

Table - Hybrid security 1

Hybrid security 1

Step 1: Reinvestment stage					
Announcement date	16/08/2016				
Last Coupon Payment date	15/06/2016				
Next Coupon Payment date	15/09/2016				
Coupon rate	3.8010%				
Days	365				
Rate per day	0.0104%				
Face value	100				
Date	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**
15/08/2016	101.3790	12,366	0.6352	100.7438	1,245,797
12/08/2016	101.3000	12,432	0.6040	100.6960	1,251,853
11/08/2016	101.2600	10,769	0.5936	100.6664	1,084,077
10/08/2016	101.3000	10,427	0.5832	100.7168	1,050,174
9/08/2016	101.2060	14,288	0.5728	100.6332	1,437,848
	Total:	**60,282**			**6,069,749**
VWAP	100.6892				

Step 2: Final redemption stage					
Announcement date	8/11/2016				
Last Coupon Payment date	15/09/2016				
Next Coupon Payment date	15/12/2016				
Coupon rate	3.3880%				
Days	365				
Rate per day	0.0093%				
Face value	100				
Date	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**
7/11/2016	100.0500	15,748	0.4920	99.5580	1,567,840
4/11/2016	99.9400	30,857	0.4641	99.4759	3,069,528
3/11/2016	99.9400	5,406	0.4548	99.4852	537,817
2/11/2016	99.9200	17,200	0.4455	99.4745	1,710,961
1/11/2016	100.0000	2,513	0.4363	99.5637	250,204
	Total:	**71,724**			**7,136,349**
VWAP	99.4974				

Table - Hybrid security 2

Hybrid security 2											
Step 1: Reinvestment stage						**Step 2: Final redemption stage**					
Announcement date	18/08/2014					Announcement date	26/08/2014				
Last Coupon Payment date	31/07/2014					Last Coupon Payment date	31/07/2014				
Next Coupon Payment date	31/10/2014					Next Coupon Payment date	31/10/2014				
Coupon rate	4.2385%					Coupon rate	4.2385%				
Days	365					Days	365				
Rate per day	0.0116%					Rate per day	0.0116%				
Face value	200					Face value	200				
Date	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**	**Date**	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**
15/08/2014	202.7000	6,331	0.3484	202.3516	1,281,088	25/08/2014	200.8000	13,564	0.5806	200.2194	2,715,776
14/08/2014	202.3800	5,003	0.3251	202.0549	1,010,880	22/08/2014	200.9300	8,662	0.5109	200.4191	1,736,030
13/08/2014	202.6500	8,547	0.3019	202.3481	1,729,469	21/08/2014	201.0000	6,114	0.4877	200.5123	1,225,932
12/08/2014	202.7000	7,289	0.2787	202.4213	1,475,449	20/08/2014	201.5000	27,016	0.4645	201.0355	5,431,175
11/08/2014	202.6900	5,704	0.2555	202.4345	1,154,687	19/08/2014	202.4100	25,941	0.4413	201.9687	5,239,271
	Total:	**32,874**			**6,651,573**		**Total:**	**81,297**			**16,348,184**
VWAP	202.3354					VWAP	201.0921				

Table - Hybrid security 3

Hybrid security 3											
Step 1: Reinvestment stage						**Step 2: Final redemption stage**					
Announcement date	23/10/2017					Announcement date	24/11/2017				
Last Coupon Payment date	18/09/2017					Last Coupon Payment date	18/09/2017				
Next Coupon Payment date	24/11/2017					Next Coupon Payment date	18/12/2017				
Coupon rate	4.4590%					Coupon rate	4.4590%				
Days	365					Days	365				
Rate per day	0.0122%					Rate per day	0.0122%				
Face value	100					Face value	100				
Date	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**	**Date**	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**
20/10/2017	101.7000	2,972	0.3909	101.3091	301,091	23/11/2017	101.1000	2,629	0.8063	100.2937	263,672
19/10/2017	101.7200	2,947	0.3787	101.3413	298,653	22/11/2017	101.1800	2,324	0.7941	100.3859	233,297
18/10/2017	101.7000	7,370	0.3665	101.3335	746,828	21/11/2017	101.1000	3,710	0.7819	100.3181	372,180
17/10/2017	101.5300	4,692	0.3543	101.1757	474,716	20/11/2017	101.1100	4,606	0.7696	100.3404	462,168
16/10/2017	101.5700	4,731	0.3421	101.2279	478,909	17/11/2017	101.1900	1,347	0.7330	100.4570	135,316
	Total:	**22,712**			**2,300,197**		**Total:**	**14,616**			**1,466,633**
VWAP	101.2767					VWAP	100.3443				

Table - Hybrid security 4

Hybrid security 4											
Step 1: Reinvestment stage						**Step 2: Final redemption stage**					
Announcement date	21/11/2016					Announcement date	22/02/2017				
Last Coupon Payment date	1/11/2016					Last Coupon Payment date	1/11/2016				
Next Coupon Payment date	1/05/2017					Next Coupon Payment date	1/05/2017				
Coupon rate	4.1860%					Coupon rate	4.1860%				
Days	365					Days	365				
Rate per day	0.0115%					Rate per day	0.0115%				
Face value	100					Face value	100				
Date	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**	**Date**	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**
18/11/2016	101.0000	2,016	0.1950	100.8050	203,223	21/02/2017	102.0510	4,645	1.2845	100.7665	468,061
17/11/2016	101.0000	2,934	0.1835	100.8165	295,796	20/02/2017	102.0500	6,795	1.2730	100.7770	684,780
16/11/2016	101.0000	4,269	0.1720	100.8280	430,435	17/02/2017	102.0500	1,550	1.2386	100.8114	156,258
15/11/2016	101.0000	9,238	0.1606	100.8394	931,555	16/02/2017	102.2500	1,120	1.2271	101.0229	113,146
14/11/2016	101.1500	1,343	0.1491	101.0009	135,644	15/02/2017	102.2000	522	1.2157	100.9843	52,714
	Total:	**19,800**			**1,996,652**		**Total:**	**14,632**			**1,474,957**
VWAP	100.8410					VWAP	100.8035				

Table – Hybrid security 5

Hybrid security 5											
Step 1: Reinvestment stage						**Step 2: Final redemption stage**					
Announcement date	22/11/2017					Announcement date	26/02/2018				
Last Coupon Payment date	16/10/2017					Last Coupon Payment date	16/10/2017				
Next Coupon Payment date	16/04/2018					Next Coupon Payment date	16/04/2018				
Coupon rate	4.9000%					Coupon rate	4.9000%				
Days	365					Days	365				
Rate per day	0.0134%					Rate per day	0.0134%				
Face value	100					Face value	100				
Date	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**	**Date**	**Last Price**	**Volume**	**Accrued interest**	**Clean price**	**Volume x Clean Price**
21/11/2017	102.5000	2,346	0.4833	102.0167	239,331	23/02/2018	101.5100	1,149	1.7452	99.7648	114,630
20/11/2017	102.5500	847	0.4699	102.0801	86,462	22/02/2018	101.5000	2,026	1.7318	99.7682	202,130
17/11/2017	102.7500	5,274	0.4296	102.3204	539,638	21/02/2018	101.4000	1,240	1.7184	99.6816	123,605
16/11/2017	102.5300	2,870	0.4162	102.1138	293,067	20/02/2018	101.6500	906	1.7049	99.9451	90,550
15/11/2017	102.4500	939	0.4027	102.0473	95,822	19/02/2018	101.7800	725	1.6915	100.0885	72,564
	Total:	**12,276**			**1,254,320**		**Total:**	**6,046**			**603,480**
VWAP	102.1766					VWAP	99.8147				

References

ATOlaw topic(s)	Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events - general Income tax ~~ Capital gains tax ~~ Capital proceeds Income tax ~~ Capital gains tax ~~ Valuation / market value issues Income tax ~~ Debt equity rules ~~ Equity rules
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Other references:	TD 2004/22 Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 1) 1996 Explanatory Memorandum to the Taxation Laws Amendment Bill 1990
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