TD 2002/4 - Income tax: capital gains: what is the first element of the cost base and reduced cost base of a share in a company you acquire in exchange for a share in another company in a takeover or merger?

Taxation Determination

Income tax: capital gains: what is the first element of the cost base and reduced cost base of a share in a company you acquire in exchange for a share in another company in a takeover or merger?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 3, 5 to 11 and 13 to 15 of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the ***Taxation Administration Act 1953*** *and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

[Note: This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]

Date of effect

This Determination applies to shares acquired on or after its date of issue. For shares acquired in a 'target' company before the date of issue of this Determination, however, Taxation Determination 39 applies in relation to the time at which the market value of the shares are valued. This Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

General

1. If property other than money is given in respect of acquiring a CGT asset, the first element of the asset's cost base and reduced cost base (that is, broadly speaking, the asset's acquisition cost) is the market value of that property at the time of acquisition (paragraph 110-25(2)(b) of the *Income Tax Assessment Act 1997*).

2. If you acquire a share by issue or allotment, the time of acquisition is when you enter into the contract to acquire the share or, if you acquire it other than under a contract, when the share is issued or allotted (section 109-10 item 2).

Takeover offer

Unconditional takeover offer

3. If you accept an unconditional takeover offer from a 'bidder' company for your share in a 'target' company, and the capital proceeds for your 'target' company share is a share in the 'bidder' company, you are taken to have acquired the 'bidder' company share for the market value of your

'target' company share as at the time you enter into the contract to acquire the 'bidder' company share, that is, when you accept the offer.

Example

4. Aaron owns 100 shares in XYZ Ltd. ABC Ltd makes an unconditional takeover offer to acquire XYZ Ltd, exchanging 2 shares in XYZ Ltd for each share in ABC Ltd. Each share in XYZ Ltd is worth $4.50 at the time of the offer. Aaron accepts the offer. At the time Aaron accepts the offer the market value of an XYZ Ltd share is $4.40. The first element of the cost base and reduced cost base of each ABC Ltd share is $8.80 (that is 2 x $4.40). If the market value of an XYZ Ltd share was $4.60 at the time Aaron accepted the offer, the first element of the cost base and reduced cost base for each ABC Ltd share would have been $9.20.

Effect of a conditional offer

5. It is important to clearly understand the nature and effect of particular conditions of a contract. There is a clear difference between a condition which is precedent to the formation or existence of a contract (referred to in this Taxation Determination as a 'condition precedent to formation of a contract') and a condition which is precedent to the obligation of a party to perform their part of the contract (referred to in this Taxation Determination as a 'condition precedent to performance of a contract'). In the former case, non-fulfilment of the condition prevents a binding contract from coming into existence. No contractual rights enforceable by the parties are created unless and until the condition is fulfilled. In the latter case, a binding contract exists which creates rights capable of enforcement, though the obligation of a party to the contract (or perhaps of both parties) to perform their part of the contract depends on fulfilment of the condition. Non-fulfilment of the condition entitles one or both parties to terminate the contract.

6. The fact that a takeover offer is subject to a condition will not generally affect the time when the contract is entered into. Most conditions operate as conditions precedent to performance of a contract that is, they do not prevent the contract from coming into existence. In these cases, the contract exists and it is made when the offer is accepted and not when it becomes unconditional.

7. However, if an offer from a 'bidder' company for shares in a 'target' company is one which is subject to a condition precedent to the formation of a contract, the contract does not come into existence until the condition is satisfied. In this case, the date of acquisition of the 'bidder' company shares is the later of the date that the condition is met or the offer is accepted.

8. The status of a particular condition depends on the intention of the parties to the contract as expressed in their contract but will usually be described in the offer documents issued by a 'bidder' company. For example, the takeover offer that SingTel Australia Investment Ltd made in respect of C&W Optus Limited shares (see Class Ruling CR 2001/17) was subject to a condition precedent to formation of the contract that the Treasurer raise no objections to the takeover under foreign investment policy. The offer that Wesfarmers Retail Pty Ltd (Wesfarmers) made to Howard Smith Limited (Howard Smith) shareholders (see Class Ruling CR 2001/51) was subject to a condition precedent to performance of the contract that Wesfarmers acquire ownership of 90% of the shares in Howard Smith.

Scheme of arrangement

9. If a takeover or merger is effected by a court ordered scheme of arrangement, the bidder company shares are acquired otherwise than under a contract. Therefore, the first element of their cost base and reduced cost base is determined having regard to the market value of the target company shares:

- on the date the bidder company shares are allotted or issued; or
- in any other case, when they are acquired.

Special scrip for scrip roll-over rules

10. Special rules apply to the calculation of the cost base of a share acquired under a scrip for scrip roll-over if the provisions contained in Subdivision 124-M apply.

11. If a full roll-over is chosen, the first element of the cost base of each share in the 'bidder' company (referred to as 'the replacement entity' in those provisions) is determined by reasonably attributing to it the cost base of each share in the 'target' company (referred to as 'the original entity' in those provisions): subsection 124-785(2).

Example

12. Able exchanges 1 share in Small Co. with a cost base of $9 for a class X share and a class Y share in Big Co. An X class share in Big Co. has a market value of $5 and a Y class share has a market value of $10. The first element of the cost bases of the shares would be $3 and $6 respectively.

Target company share acquired before 20 September 1985

13. If a share in a 'target' company was acquired before 20 September 1985, a share in the 'bidder' company may be exchanged in consequence of an arrangement that satisfies the conditions in subsection 124-780(2). In this case, the first element of the cost base and reduced cost base of the share in the 'bidder' company will be its market value just after its acquisition (subsection 124-800(1)). It is not necessary that the arrangement be one for which a shareholder in the 'target' company actually chooses a roll-over.

14. If the share in the 'target' company were acquired before 20 September 1985, and the arrangement is not one that satisfies the conditions in subsection 124-780(2), the first element of cost base and reduced cost base of the share in the 'bidder' company will be the market value of the share in the 'target' company at the time of its acquisition. This is in line with the principles discussed in paragraph 1 of this Taxation Determination.

Note 1:

15. This Taxation Determination rewrites and replaces Taxation Determination TD 39.

Note 2:

16. This Taxation Determination does not consider how the first element of the cost base and reduced cost base would be calculated if the capital proceeds for a 'target' company share includes something other than a share in the 'bidder' company.

Commissioner of Taxation
23 January 2002

Previous draft:
Previously released in draft form as TD 2001/D9

Related Rulings/Determinations:
CR 2001/17; CR 2001/51

Subject references:
- acquisition
- acquisition cost
- capital gain

- contract
- cost base
- exchange
- first element
- merger
- reduced cost base
- roll-over
- share
- scheme of arrangement
- scrip
- scrip for scrip roll-over
- takeover
- time of acquisition

Legislative references:

- ITAA 1997 110-25(2)(b)
- ITAA 1997 109-10 item 2
- ITAA 1997 Subdiv 124-M
- ITAA 1997 124-780(2)
- ITAA 1997 124-785(2)
- ITAA 1997 124-800(1)

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