

TD 1999/D49 - Income tax: capital gains: what are the CGT consequences for a shareholder if a company converts its shares into a larger or smaller number of shares?

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This document has been finalised by TD 2000/10.

Draft Taxation Determination

Income tax: capital gains: what are the CGT consequences for a shareholder if a company converts its shares into a larger or smaller number of shares?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered views of the Australian Taxation Office (ATO). DTDs should not be relied on; only final TDs represent authoritative statements by the ATO.

1. If a company converts its shares into a larger or smaller number of shares ('the converted shares') in accordance with section 254H of the *Corporations Law* ('C Law') in that:

- (a) the original shares are not cancelled or redeemed in terms of the C Law;
- (b) there is no change in the total amount allocated to the share capital account of the company; and
- (c) the proportion of equity owned by each shareholder in the share capital account is maintained;

no CGT event happens to the shareholder's original shares for capital gains purposes. While there is a change in the form of the original shares, there is no change in their beneficial ownership. The issue of roll-over relief under section 124-240 of the *Income Tax Assessment Act 1997* ('the 1997 Act') does not arise because no CGT event happens to the shares.

2. The converted shares have the same date of acquisition as the original shares to which they relate. For example, if the original shares were acquired before 20 September 1985 (pre-CGT shares), the converted shares have the same acquisition date.

3. In the case of original shares acquired on or after 20 September 1985 (post-CGT shares), section 112-25 of the 1997 Act applies to attribute a proportionate cost base to the converted shares.

4. Cancelling original share certificates and replacing them with new certificates as part of any conversion process does not change the result above, unless there is also a cancellation or redemption of the original shares in terms of the C Law. If the original shares are in fact cancelled or redeemed under the C Law, CGT event C2 in section 104-25 of the 1997 Act (about cancellations, surrenders and similar endings of intangible CGT assets) happens to them. In this case, roll-over relief is available under section 124-240 of the 1997 Act if the other requirements of the section are satisfied.

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Note 1:

5. This Taxation Determination does not consider whether, if a company converts shares into a larger or smaller number of shares, this results in a disposal of the original shares by their shareholders for the purposes of other provisions of the income tax law (e.g., sections 6-5 and 8-1 and Division 70 of the 1997 Act).

Note 2:

6. This Taxation Determination rewrites and replaces Taxation Determination TD 95/30. There is no material change in this Taxation Determination to the views expressed in TD 95/30 apart from updating it with the rewritten income tax law in the 1997 Act and with recent Corporations Law changes.

7. Sections 6-5, 8-1, 104-25, 112-25 and 124-240 of the 1997 Act, to which this Determination refers, express the same ideas, respectively, as, subsections 25(1), 51(1), 160ZH(12), 160ZH(13) and paragraph 160M(3)(c) and section 160ZZP of the *Income Tax Assessment Act 1936*.

Example 1:

8. *XYZ Ltd's share capital account of \$100,000 consists of 100,000 shares. In accordance with section 254H of the C Law, the company converts its share capital into 200,000 ordinary shares on 1 July 1992. The original shares are not cancelled or redeemed under the C Law. Further, the total amounts allocated to the share capital account are unaltered and there is no change in the proportion of equity owned by each shareholder in the share capital account.*

9. *John acquired 2,000 ordinary shares in XYZ Ltd in September 1984 and 3,000 ordinary shares in XYZ Ltd on 30 April 1988. Before the conversion, the shares John acquired in 1988 had a cost base of \$1.00 each.*

10. *On conversion of XYZ Ltd's share capital, no CGT event happens to any of John's original shares. John, however, now has 6,000 ordinary shares with a cost base of \$0.50 each with an acquisition date on 30 April 1988 and 4,000 ordinary shares with an acquisition date before 20 September 1985.*

Example 2:

11. *If XYZ Ltd in Example 1 decides instead to convert its original share capital into 50,000 ordinary shares, and all the other facts remain unchanged, no CGT event happens to John's original shares. In this case, John would now have 1,500 ordinary shares with a cost base of \$2.00 each with an acquisition date on 30 April 1988 and 1,000 ordinary shares with an acquisition date before 20 September 1985.*

Your comments

We invite you to comment on this Draft Taxation Determination. We are allowing 4 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by Date: 1 September 1999
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Previously released as:
TD 95/30

Related Rulings/Determinations:

Subject references:
cancellation; CGT event; conversion; cost base; redemption; roll-over; shares; share capital account; shareholder

Legislative references:
ITAA 1997 6-5, 8-1, 104-25, 112-25, 124-240
ITAA 1936 25(1), 51(1), 160M(3)(c), 160ZH(12), 160ZH(13), 160ZZP

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