

IT 2483 - Income tax : takeovers and company reconstructions - exchange of shares by life assurance companies and other financial institutions for shares or shares and cash - whether realization of profit - whether profit is assessable

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There is an Addendum notice for this document.

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TAXATION RULING NO. IT 2483

INCOME TAX : TAKEOVERS AND COMPANY RECONSTRUCTIONS -
EXCHANGE OF SHARES BY LIFE ASSURANCE COMPANIES AND
OTHER FINANCIAL INSTITUTIONS FOR SHARES OR SHARES AND
CASH - WHETHER REALIZATION OF PROFIT - WHETHER PROFIT
IS ASSESSABLE

F.O.I. EMBARGO: May be released

REF

N.O. REF: 85/6629-1

DATE OF EFFECT: Immediate

B.O. REF:

DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1103618	PROFIT ON EXCHANGE OF SHARES SHARE SWAPS TAKEOVERS CAPITAL GAINS TAX	25(1) 26AAA 51(1)

PREAMBLE This Ruling considers the income tax implications for a life assurance company of a takeover proposal whereby, as consideration for the shares it holds in the target company, the life assurance company has options of taking:

- (i) a cash settlement;
- (ii) a share swap with no cash element; or
- (iii) a mixture of shares and cash.

2. For many years courts have held that profits on the sale of investments by life assurance companies are income according to ordinary concepts and are included in assessable income under sub-section 25(1) of the Income Tax Assessment Act [C. of T. v The Commercial Banking Co. of Sydney (1927) 27 SR(NSW) 231; Colonial Mutual Life Assurance Society Ltd v Federal Commissioner of Taxation (1946) 73 CLR 604; London Australia Investment Company Ltd v FCT 77 ATC 4398, 7 ATR 757; Case T 39, (1967) 18 TBRD 166. Hence where investment shares are disposed of for a cash settlement the transaction is regarded as giving rise to an assessable profit or deductible loss at the time of disposal.

3. However, paragraph 5.35.37 of the Company Assessing Handbook states :

"Takeovers

5.35.37 Where a life assurance company receives shares as a result of a 'takeover' and the market value of the new shares exceeds the cost of the shares that were given in exchange, the amount of the excess is not included

as assessable income in the year in which the new shares are received. The new shares are brought to account at the same value as the shares for which they are exchanged. The full profit on the extended transaction is brought to account when the new shares are eventually sold. This policy is limited solely to life assurance companies."

4. This approach was developed as part of an overall settlement of objections lodged by a number of life assurance companies many years ago and has been followed ever since. However, if a life assurance company held shares which were exchanged for cash and shares in another company, any profit arising from the exchange would be included in assessable income in the year of exchange regardless of the fact that the shares received as part consideration may be retained by the life assurance company.

5. The income tax treatment outlined in paragraph 5.35.37 of the Company Assessing Handbook was never intended for other investors. Nor as a practical matter was there any need to extend it to share traders who are required to bring their shares on hand to account as trading stock.

6. The introduction of capital gains tax necessitates a review of the practices outlined to ensure consistency of treatment of life assurance companies assessable under subsection 25(1) and other taxpayers liable to tax on capital gains.

RULING

7. It has been decided that the administrative practice outlined in paragraph 5.35.37 of the Company Assessing Handbook should no longer apply to the exchange of shares in a takeover situation by a life assurance company. Nor should the practice be applied to similar transactions by general insurance companies, banks or other financial institutions where profits/losses by those parties on share transactions are accountable for income tax purposes under sub-section 25(1)/51(1).

8. In this context, where, in the course of a takeover, a shareholder in the target company receives cash, or shares either in the bidder company or some other company, or a combination of cash and shares, in exchange for its holdings in the target company, the exchange of shares constitutes a sale of property: *Californian Copper Syndicate v Harris* (1904) 5 TC 159, 167; *Royal Insurance Company Ltd v Stephen* (1928) 14 TC 22, 29; *Gold Coast Selection Trust Ltd v Humphrey* (1948) 2 All ER 379; *Case T39* (1967) 18 TBRD 166.

9. The relevant profit for this purpose is the amount by which the market value of the replacement shares at the time of the exchange plus the amount of cash, if any, received exceed the original cost to the taxpayer of the shares in the target company.

10. These principles apply irrespective of whether the shares are exchanged as a result of a formal takeover bid, through a court-sanctioned company reorganisation pursuant to the

Companies Code, or simply through a private treaty arrangement. The presence of an element of compulsion in a takeover situation does not affect the application of the principles: *Brettingham-Moore v FCT* 81 ATC 4658, 12 ATR 627; *Smith v FCT* (1932) 48 CLR 178; *Case P21* 82 ATC 90; *Case 84* 25 CTBR(NS); *C of T v Salenger* 88 ATC 4449.

11. Transitional arrangements are necessary for swaps of shares for shares or for shares and cash which have occurred prior to the date of this Ruling where the replacement shares are still on hand. Those transactions will continue to be treated in accordance with the previous administrative practice and the profits should be brought to account for tax purposes when the replacement shares on hand are sold or exchanged.

COMMISSIONER OF TAXATION
14 July 1988