TD 2002/2 - Income tax: capital gains: how is Division 19B of Part IIIA of the Income Tax Assessment Act 1936 applied to a share value shifting arrangement that is 'neutral' for each shareholder in a company?

This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

This document has changed over time. This is a consolidated version of the ruling which was published on *29 November 2006*

Taxation Determination

Income tax: capital gains: how is Division 19B of Part IIIA of the *Income Tax Assessment Act 1936* applied to a share value shifting arrangement that is 'neutral' for each shareholder in a company?

Preamble

The number, subject heading, date of effect and paragraphs 1 to 7 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.

Date of Effect

This Determination applies only for the 1997-98 income year and earlier income years.

1. A share value shifting arrangement is 'neutral' for each shareholder in a company if, and only if, under an arrangement value is shifted between shares of the *different* shareholders as well as within each shareholder's own shares and, for each shareholder, the total increase in market value of shares that increase in value (or the total discounts given) is equal to the total decrease in market value of post-CGT shares that decrease in value.

2. In the circumstances contemplated by this Taxation Determination, Division 19B of Part IIIA of the *Income Tax Assessment Act 1936* ('ITAA 1936') is applied to each shareholder as though value is shifted under an arrangement only involving the shares of that shareholder. This means that the shareholder does not make a capital gain from the share value shift, provided value is not shifted into pre-CGT shares. Adjustments to cost bases, indexed cost bases and reduced cost bases of shares may be required.

3. This result is now expressly afforded by section 140-50 of the *Income Tax Assessment Act 1997* ('ITAA 1997') for share value shifts which are 'neutral' for all shareholders in a company. This Determination only applies to assessments for the 1997-98 and earlier income years.

Explanation

4. A share value shift contemplated by this Determination occurs only if, for *each and every* shareholder in a company:

(a) there is a decrease in the market value of some of the shareholder's post-CGT shares in the company (decreased value shares); and

(b) there is either:

 (i) an increase in the market value of some of the shareholder's shares in the company; or

 (ii) the issue of shares at a discount to the shareholder (increased value shares); and

(c) the total decrease in market value of the shareholder's shares equals:

 (i) the total increase in market value of the shareholder's shares; or

 (ii) the total discounts given in relation to the shareholder's shares.

5. In these situations, the share value shifting arrangement shifts value between the shares of different shareholders as well as within the shares of the same shareholder but - for each shareholder - the effect is that the decrease in market value of their decreased value shares matches the increase in market value of their increased value shares.

6. In such cases, any value shifted from one shareholder's shares to another shareholder's shares (the value shift between different shareholders) is disregarded. The share value shift is treated as if it were a separate arrangement for each shareholder under which there is only a shift in value from the decreased value shares to the increased value shares held by each shareholder.

7. In this Determination, a reference to:

'post-CGT shares' means shares in a company acquired on or after 20 September 1985; and

'pre-CGT shares' means shares in a company acquired before 20 September 1985.

Example

8. *Debbie and Dave, the sole shareholders of a company, each holds one post-CGT share in the company. In 1997, the company issues, for less than market value consideration, a new share to each of Debbie and Dave. As a result, there is a share value shift from the original shares to the new shares (the relevant increase in value of the new shares being their market value less the amount paid - subparagraph 160ZZRM(1)(c)(ii) of the ITAA 1936).*

9. *Because the requirements in paragraph 4 above are satisfied (for Debbie and for Dave, the total decrease in market value of their decreased value shares equals the total increase in market value of their increased value shares), the value shift is regarded as comprising*:

- *a share value shift from Debbie's original share to Debbie's new share; and*
- *a share value shift from Dave's original share to Dave's new share.*

10. *On this characterisation, there are no different person shares in respect of which a capital gain may be triggered. Therefore, only adjustments to cost bases, indexed cost bases and reduced cost bases (relevant cost bases) are required to be made under subsection 160ZZRQ(3) of the ITAA 1936 for the original decreased value shares and under subsection 160ZZRQ(4) of the ITAA 1936 for the new increased value shares.*

11. *Continuing with the example above, assume that*:

(a) *Debbie and Dave each paid $12 for their original share;*

(b) *Each new share was issued for $10 consideration;*

(c) *The market value of each original share was $120 before the value shift and $65 after the value shift; and*

(d) *Each of the new shares also has a market value of $65.*

12. *Division 19B of Part IIIA of the 1936 Act is applied as follows in relation to each shareholder*:

- *The relevant cost base of their decreased value share is reduced under subsection 160ZZRQ(3). By paragraph 160ZZRQ(3)(b), the reduction in the relevant cost base of Debbie's and Dave's original decreased value share will be ($55/$55) x ($55/$120) x $12 = $5.50. The reduced amount for each share will therefore be $12.00 - $5.50 = $6.50;*

- *Under subsection 160ZZRQ(4), Debbie and Dave are taken to have incurred expenditure to which paragraph 160ZH(1)(c), (2)(c) or (3)(c) applies in respect of their increased value share and the increase under subsection 160ZZRQ(4) is the sum of the subsection 160ZZRQ(5) and 160ZZRQ(6) amounts. In the present case the subsection 160ZZRQ(5) amount is nil because, in a value shift within the shares of a shareholder, there is no 'different person share'. As to the subsection 160ZZRQ(6) amount, the smallest amount is that under paragraph 160ZZRQ(6)(c), namely, $5.50 being the amount of the reduction in the relevant cost base of the original share (as calculated above).*

13. *As a result of these adjustments, each of Debbie and Dave has two shares – the original with a relevant cost base of $6.50, and a new share with paragraph 160ZH(1)(c), (2)(c), or (3)(c) relevant cost base elements of $5.50. There has been no loss of that original relevant cost base of $12, but merely a rearrangement of that amount between the original and the new shares*.

Commissioner of Taxation
16 January 2002

Previous draft:

Previously released in draft form as TD 96/D4 and TD 2001/D3

Related rulings:

TR 92/1; TR 97/16

Subject references:

- arrangement
- capital gains
- cost base
- decreased value share
- increased value share
- neutral
- neutral share value shift
- shares
- share value shifting
- value shift

Legislative references:

- TAA 1953 Part IVAAA
- ITAA 1936 Pt IIIA Div 19B
- ITAA 1936 160ZH(1)(c)
- ITAA 1936 160ZH(2)(c)
- ITAA 1936 160ZH(3)(c)
- ITAA 1936 160ZZRM(1)(c)(ii)
- ITAA 1936 160ZZRQ(3)
- ITAA 1936 160ZZRQ(3)(b)
- ITAA 1936 160ZZRQ(4)
- ITAA 1936 160ZZRQ(5)
- ITAA 1936 160ZZRQ(6)
- ITAA 1936 160ZZRQ(6)(c)
- ITAA 1997 140-50

ATO references:
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