Reorganisation or reduction of share capital (S.584)

Part 19-04-06

This document should be read in conjunction with section 584 of the Taxes Consolidation Act 1997

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Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

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Introduction

Section 584 of the Taxes Consolidation Act 1997 ("TCA 1997") provides special rules to be applied on the reorganisation or reduction of share capital of a company as, for example, when persons are allotted shares in a company in proportion to their existing shareholdings or when rights attaching to different classes of shares are altered. In the absence of a provision to the contrary, the reorganisation or reduction would represent a disposal of the old shares and an acquisition of the new shares with a consequent liability to Capital Gains Tax ("CGT").

6.1 Reorganisation of share capital

In relation to reorganisations of the share capital of companies and the conversion of securities, the CGT Acts recognise the fact that the changes are more in the nature of form than of substance.

Where a company issues to its shareholders, in proportion to their shareholdings -

(a) bonus shares, or

(b) rights shares, i.e., where there is consideration for the issue, or

(c) shares in exchange for other shares or securities in the company (notwithstanding that, in general, an exchange is a disposal and acquisition),

there is neither a new acquisition nor a disposal. The new holding is deemed to be part of and acquired at the same time as the original holding at the combined cost of the old and (if any) of the new. On the disposal of any part of that holding, the part disposal rules apply.

Where, however, the shareholder received in the course of the reorganisation any consideration in money or money's worth, he or she is deemed to have disposed of part of his or her holding.

Section 584 TCA 1997 also applies where the new holding comprises debentures, loan stock or similar securities where these were allotted before 4 December 2002 or, if later, pursuant to a written binding agreement made before that date.

Section 584 TCA 1997 does not however, apply where the new holding comprises units in an investment undertaking, being a company. "Investment undertaking "and "unit" have the same meaning as in **section 739B TCA 1997.**

For conversions of securities into shares or securities see Tax and Duty Manual (TDM) Part 19-04-09.

6.2 Amalgamations

There are various methods by which companies may amalgamate by means of exchanges of shares or issues of shares of one company to shareholders of another in proportion to their holdings. Subject to certain conditions, the amalgamation does not create a chargeable occasion, a new holding being regarded as the same as the old holding unless the shareholders receive consideration in money or money's worth.

6.3 Transfer of a business to a company

There is another change of form (but not of substance) when an unincorporated business is transferred in its entirety to a company, wholly in exchange for shares of the company. In effect, the transfer is treated as if there is no disposal but the shares are treated as if they were the assets so transferred. This is dealt with in further detail in TDM Part 19-06-04.

If the consideration for a disposal is not wholly in the form of shares of the acquiring company, there is a part disposal.

There are detailed rules for the appropriation of the shares to the respective assets where the consideration does not consist wholly of shares of a single class.

6.4 Replacement of original shares

The reorganisation of a company's share capital most commonly takes the form of a bonus or rights issue of shares or a reduction of capital, as a result of which the original shares are replaced by a new "holding" which may or may not include the original shares. The general rule is that mere exchange of one block of shares or securities for shares on the occasion of a company’s capital reorganisation is not to be taken as a disposal of the original shares or securities; instead, the new holding is treated as having been acquired at the same time as the original holding. Consequently, any gain or loss on the original shares or the shares in the new holding will be charged or relieved only when the new holding (or part of it) is disposed of.

Where, on a subsequent reorganisation of share capital, additional bonus or rights shares are acquired in respect of the shares of that new holding, the additional shares augment the new holding and do not set up a separate new holding.

6.5 Consideration given for the new holding

Any consideration given for the new holding is deemed to be enhancement expenditure **(section 552(1)(b) TCA 1997)** given for the original shares. The consideration given for a rights issue of shares is deemed to be expenditure incurred on the date the consideration was given. Where shares are received on the exercise of a stock dividend option within **section 816 TCA 1997**, the amount to be added to the cost of the original shares is the net cash dividend the shareholder could have chosen. It should be noted that **section 816 TCA 1997** does not apply to shares received in lieu of dividends on quoted shares.

6.6 Rights issue

A “rights” issue usually involves an allotment of new shares to the existing shareholders in the same proportion to their existing holding in exchange for consideration. It is a way for companies to raise finance and the shares are often offered at a discounted value to offer an incentive to the existing shareholders to acquire them.

Where a person acquires shares as a result of a “rights” issue the consideration given for the new shares is, under **section 584(4)(a) TCA 1997**, to be treated as if it were a separate item of expenditure enhancing the value of the existing holding.

Example 1

In June 2000, an individual X bought 2,000 €1 Ordinary Shares for €2,000 (€1 per share).

In June 2010, there was a 1 for 4 rights issue at €2 per share costing €1,000.

In September 2021, X sold 500 shares at €3 per share, total €1,500.

The consideration for the rights issue is treated as expenditure within **section 552(1)(b) TCA 1997**. X has other chargeable gains against which the small gains exemption has been allowed.

Computation of CGT liability: -			€	€
Proceeds of sale: Sept 2021				1,500
Cost: June 2000 (€1/share)	$\frac{500}{2,500}$ x €2,000 =	€400 x	= 400	
Indexation factor (2000/2001 = 1.144)		€400 x 1.144	= 458	
Enhancement Expenditure (Rights issue):				
June 2010 (€2/share)	$\frac{500}{2,500}$ x €1,000 =	€200	= 200	(658)
No indexation after 2003				
Chargeable gain:				842

X continues to hold 2,000 shares, the base cost of which, for the purposes of any future disposal, is as follows:

Cost in June 2000	€1,600
Cost by way of enhancement expenditure in June 2010	€800

6.7 Reorganisation or reduction of a company's share capital

The reorganisation or reduction of a company's share capital includes –

(a) the allotment to its shareholders, whether for payment or not, of shares or debentures in the company in proportion to their shareholding, i.e., a bonus (or scrip) or rights issue (TDM Part 19-04-01);

(b) the alteration of rights attached to any shares where there is more than one class of share.

6.8 New shares in a company are issued without payment

Where, without payment, new shares in a company are issued in proportion to the holding of original shares, the cost of the original shares becomes the cost of the new holding.

6.9 The right to subscribe for new shares

Where a shareholder of a company is allotted the right to subscribe for new shares in the company in proportion to his or her existing holding and he or she accepts the allotment, the new shares together with the original shares, are deemed to be one and the same asset acquired at the same time as the original shares. As noted in **para 6.1** this also applies to debentures allotted before 4 December 2002 or, if later, pursuant to a written binding agreement made before that date.

6.10 Apportioning

Section 584(6) TCA 1997 contains the main rule for apportioning the cost of acquisition of a new "holding" where there is a part disposal.

6.11 Computing a gain or loss accruing from the new holding

The main rule **(section 584(6) TCA 1997)** is that, for the purpose of computing a gain or loss accruing from a part disposal of the new "holding", the total cost of the new "holding" is apportioned on the basis of the respective market values, at the date of the part disposal, of what is disposed of and what is retained.

Example 2

In 2014, A buys 1,000 shares for €1,200 (including expenses). In 2015, the company makes a bonus issue of one share of the same class for every two shares. The shares are not quoted. In 2021, A sells 400 shares at €1 each (€400). A has other chargeable gains against which the small gains exemption has been allowed.

				€
Sale proceeds of 400 shares				400
Less apportioned cost	€1,200	x	$\frac{400}{1,000 + 500}$	320
Gain				80
Less expenses (say)				5
Chargeable gain				75

(The "cost" of the remaining 1,100 shares is €880 (€1,200 less €320)).

Example 3

In 2016, B buys 1,000 €1 ordinary shares for €1,500 (including expenses). In 2017, the company makes a bonus issue of one €1 "A" ordinary (non-voting) share and one €0.50 preference share for every two ordinary shares. Neither the ordinary shares nor the preference shares are quoted. In 2021, B sells 200 "A" ordinary shares at €0.90 each (€180) when the market values of the component parts of her new holding are as follows: -

	€
1,000 ordinary shares at €1.10	1,100
500 ordinary "A" shares at €0.90	450
500 preference shares at €0.50	250
	1,800

The computation of the chargeable gain is as follows (note - B has other chargeable gains against which the small gains exemption has been allowed): -

				€
Sale proceeds of 200 "A" shares				180
Less apportioned cost	€1,500	x	<u>€180</u>	<u>150</u>
			€1,800	
Gain				30
Less expenses (say)				<u>5</u>
Chargeable gain				25

(The cost of the remaining 1,300 ordinary shares and 500 preference shares is €1,350 (€1,500 less €150).)

Example 4

On 1 January 2017, C buys 1,000 ordinary shares for €1,500 (including expenses). On 1 January 2018 the company makes a rights issue of one "A" ordinary share for every four ordinary shares at €0.90 each (€225). The combined cost of the total holding is therefore €1,725. Neither "class" of shares is quoted.

In January 2021, C sells 250 ordinary shares at €1.80 each (€450). The market value of the remaining 750 ordinary shares is therefore €1,350 (750 at €1.80). At the date of sale, the market value of the 250 "A" ordinary shares is €1.10 (€275).

The computation of the chargeable gain is as follows (note - C has other chargeable gains against which the small gains exemption has been allowed): -				€
Sale proceeds of 250 ordinary shares				450
Less apportioned cost				
€1,725	x	€450 / (€450 + €1,350 + €275)	=	374
				76
Less expenses (say)				5
Chargeable gain				71

6.12 Reorganisation or reduction of a company's share capital

Section 584(7) TCA 1997 provides a special rule to have effect if, following the reorganisation or reduction of a company's share capital -

(a) the new "holding" consists, of more than one "class" of shares of the company, and

(b) one or more of those classes was quoted on a Stock Exchange in the State or elsewhere at any time not later than three months beginning with the date from which the reorganisation or reduction of capital took effect. The time limit of three months, which may be extended by the Revenue Commissioners at their discretion, is to cover the case where, for example, the reorganisation is to enable the company to make the first public issue of a class of its shares.

Section 584(7) TCA 1997 provides that, in cases where any of the shares in the new holding are quoted on a Stock Exchange, the apportionment, instead of being based on the market value of the new holding at the time of the first part disposal, is to be made by reference to the market value of those separate classes following the reorganisation. The same basis of apportionment thus applies to all shareholders concerned.

The rule applies to unit trusts (TDM Part 19-02-07), conversions of securities (TDM Part 19-04-09), company amalgamations (TDM 19-04-10) and special types of company reconstruction and amalgamation (TDM Part 19-04-11).

6.13 Apportioning the cost among the classes of shares

The special rule in **section 584(7) TCA 1997** provides that the cost of the new holding (which includes the acquisition cost of the original holding) is to be apportioned among the "classes" of shares in the new holding by reference to their market values on the first day on which market values or prices were quoted or published for the shares or securities in question.

Where, on a disposal, it is necessary to make such an apportionment, the cost should first be apportioned between the entire classes of shares of which it consists by reference to their respective market values on the first day (whether that day fell before the reorganisation took effect or later) on which the market values of the quoted shares, etc., in the new holding were quoted. (For this purpose, it is necessary to ascertain the market value on that date of any unquoted shares in the new holding.) Thereafter, the new holding is regarded as having been finally divided, and each class then has its own adjusted cost. It follows that, for the purposes of any disposal on the occasion giving rise to the apportionment of cost (or for any other purpose thereafter), each class of the new holding is treated as if it had been acquired separately at its apportioned cost at the date of acquisition of the original shares from which it derives.

Example 5

In 2015, A buys 1,000 ordinary shares in a private company for €1,150 (including expenses).

In 2018, in the course of a reconstruction of the company's share capital for the purpose of a public issue of shares, A's shares are converted into 1,000 founder's shares which remain unquoted and A receives (without consideration) 500 ordinary shares which are first quoted on 1 May 2018, at €1.05 (€525). In 2021, A sells the 500 ordinary shares for €580 (after deduction of expenses).

The market value of the 1,000 founders' shares at 1 May 2018 is agreed at €1,200.

The chargeable gain is computed as follows (note - A has other chargeable gains against which the small gains exemption has been allowed): -

	€
Sale proceeds of 500 ordinary shares	580
Less apportioned cost of original holding of 1,000 ordinary shares	
$€1,150 \times \frac{€525}{€525 + €1,200} =$	350
Chargeable gain	230

6.14 Date on which a reorganisation is deemed to take place

Section 584(7) TCA 1997 provides that the date on which a reorganisation of capital involving the allotment of new shares or securities is deemed to take place is the day following the expiry of the shareholder's right to renounce the allotment. Where, under the terms of a rights issue, the shareholder has the right to renounce the allotment either before or after the date on which the first instalment of the subscription price of the new shares or debentures becomes due, the date on which the reorganisation is deemed to take place is the day following the expiry of the shareholder's right to renounce the allotment before payment of the first instalment.

6.15 Computing the gain or loss on disposal

For the purposes of computing the gain or loss on disposal, the shareholder is deemed to have paid the full subscription price for the new shares or debentures. If that amount has not yet been paid, or wholly paid, a corresponding addition should be made both to the price which the shareholder receives for the new shares and to the market value thereof for the purpose of apportioning cost.

Example 6

C buys 400 shares for €1,900 (including expenses). The shares are not quoted. Subsequently, there is a rights issue of one ordinary share at €2.50 for every four held (€250), payment being due in three instalments of €1, €1 and €0.50 respectively. The combined cost of the total holding is therefore €2,150. When the first instalment of €1 has been paid, C sells 50 rights shares at €3.25 each (€162.50) at a time when the market value of the original shares is €5 (€2,000) and of the rights shares €3.25 (€325).

The chargeable gain on the sale of the 50 rights shares is computed as follows (note - C has other chargeable gains against which the small gains exemption has been allowed): -

(a)	Adjusted market value of holding		€
	Market value of 400 original shares at €5		2,000
	Adjusted market value of rights shares		
	100 shares at €3.25	325	
	Add outstanding calls		
	€1.50 (€2.50 less €1) x 100	150	475
	Adjusted market value of holding		2,475
(b)	Chargeable gain		
	Sale price of 50 rights shares at €3.25		163
	Add amount outstanding 50 at €1.50		75
			238
	Less apportioned cost of 50 rights shares		
	$€2,150 \times \frac{€475}{€2,475} \times ½$ (say)		206
	Gain		32

On a later disposal of the original or the remaining rights shares, a similar apportionment of the residue of the cost (€2,150 less €206) will be necessary by reference to the market value at the date of that disposal.

Example 7

B buys 1,200 quoted €1 ordinary shares for €1,279 (including expenses).

The company makes a rights issue of one €1 preference share at par for every five ordinary shares held, payment being due in four instalments of €0.25 each. B accepts the provisional letter of allotment. On the basis of the full subscription price (240 at €1 = €240), the total cost of the new "holding" is €1,519 (€1,279 plus €240).

One month later, when the first three instalments of €0.25 have been paid, B sells 100 preference shares for €98 (after deduction of expenses). The market value of the preference shares on the day when they were first quoted (TDM Part 19-04-02) and after payment of the first instalment of €0.25 is €0.29 and of the ordinary shares is €1.25 (1,200 at €1.25 = €1,500).

The chargeable gain on the sale of the 100 rights preference shares is computed as follows (note - B has other chargeable gains against which the small gains exemption has been allowed): -

(a)	<u>Adjusted market value of 240 rights preference shares</u>	€
	240 rights preference shares at €0.29	70
	Add outstanding calls	
	€0.75 (€1 less €0.25) x 240	180
	Adjusted market value	250

(b)	<u>Apportioned cost of 240 rights preference shares</u>	
	Total cost of new "holding"	1,519
	Less apportioned cost of 1,200 ordinary shares	
	$€1,519 \times \frac{€1,500}{€1,500 + €250} =$	1,302
	Apportioned cost	217

(c)	<u>Chargeable gain</u>	€
	Sale proceeds of 100 rights preference shares	98

Add outstanding calls	
€0.25 (€1 less €0.75) x 100	25
	123
Less apportioned cost of 100 rights preference shares	
$€217 \times \frac{100}{240} =$	90
Chargeable gain	33

6.16 Capital distributions in cash or assets

A shareholder who receives a capital distribution from a company (or consideration given by any person other than the company) in respect of his or her original holding (other than as part of a new holding in the company) should be treated as disposing, in consideration for that distribution, of an interest in the original shares at a market value equal to that of the distribution.

Where a company makes a bonus or rights issue of shares, there is a practice whereby shares which would fall to be allotted to satisfy fractional entitlement (e.g., on an issue of one for three, the entitlement of a person holding 100 shares would be 33 1/3 shares) are sold on the market and the proceeds distributed pro rata to the shareholders entitled to the fractions. Where the amount involved is small, and if the taxpayer agrees, such a distribution may be set off against the cost of the shares in determining the cost of the new holding instead of being treated as a part disposal.

6.17 Payments actually made or due to be made

Only payments actually made or due to be made by the taxpayer should be taken into account in the computation of liability. No account should be taken of -

(a) any surrender, cancellation or other alteration of the original shares or of the rights attached thereto;

(b) any consideration consisting of any application, in paying up the new holding (or any part of it), of assets of the company or of any dividend or other distribution declared out of those amounts but not made.