Quoted option linked to loan stock/debentures (s540)

Part 19-01-12

This document should be read in conjunction with section 540 of the Taxes Consolidation Act 1997

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Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

Introduction

An option is specifically included as an asset for Capital Gains Tax (CGT) purposes – see section 532(a) of the Taxes Consolidation Act 1997 (“TCA 1997”). Section 540 TCA 1997 sets out a number of detailed rules for the treatment of options, including double options and option payments, whether options to buy or sell or to enter into any transaction which is not a sale (for example, the grant of a lease); see Tax and Duty Manual (TDM) Part 19-01-11 for guidance on **section 540 TCA 1997** generally. The purpose of this TDM is to give guidance in respect of quoted options linked to loan stock or debentures.

12.1 Quoted option linked to loan stock/debentures

Where quoted options are acquired by subscribing for loan stock or debentures, whether through a new issue or a rights issue (see TDM Part 19-04-06 for further guidance), the options and the loan stock or debentures should be regarded as separate assets and the respective costs of acquisition determined by apportioning the subscription payment on a just and reasonable basis (**section 544(5) TCA 1997**), i.e., normally by reference to their respective market values.

Where an option is inseparable from loan stock or debentures, i.e., where the registered holder of the security for the time being has a right to subscribe for the company’s ordinary shares, the option should not be regarded as an asset distinct from the security. If, however, the option is detached from the security by the company issuing a separate option certificate, the value of which is quoted on the Stock Exchange (or by the exercise of the option), the option should be regarded as “derived” from the security (see TDM Part 19-02-15 for further guidance) and its costs of acquisition determined by apportionment by reference to the respective market value of the option and the loan stock, etc., at the date of severance.

12.2 Quoted options

Section 540(8)(b) TCA 1997 provides that in the case of quoted options, if the option is to buy shares in the company granting the option, the option certificates are to be treated as shares in the company granting the option for the purposes of any “roll-over” under **sections 584 to 587 TCA 1997** (re-organisation of share capital, etc. - see TDM Part 19-04-06) provided that they are quoted and dealt with on a stock exchange within three months of the date of the re-organisation taking effect. The time limit may be extended by the Revenue Commissioners. Market value is to be ascertained as if the options were quoted shares - see TDM Part 19-04-02. An example is given below showing the position where rights originally inseparable from loan stock are later detached and sold.

Example 1

As a result of a successful take-over bid which had become unconditional on 1 January 2016, Company B issued loan stock with quoted option rights in exchange for shares in Company A, so that for every 50 shares in Company A the shareholders in Company A received €100 nominal loan stock in Company B with rights to acquire 20 ordinary shares in Company B at €2 per share in 2018. On 1 February 2016 the rights were severed from the loan stock and quoted option certificates (warrants) issued to the registered loan stockholders. At 1 February 2016, the London quotations were: -

Loan stock: €95 (low) - €100 (high) per €100 (nominal)

Quoted option certificates (warrants)

€0.15 (low) - 0.25 (high).

A shareholder who originally held 100 shares in Company A costing €100 sold his quoted option certificates (warrants) on 1 January 2017 for €50 (net of expenses). The gain is calculated as follows: -

Market value* of loan stock			2	x	€96.25	=	€192.50
Market value* of quoted option certificates			40	x	€0.17	=	€7.00
Cost of loan stock	€100	x	€192.50			=	€96.50
			€192.50	+	€7.00		
Cost of quoted option certificates	€100	x	€7			=	€3.50
			€192.50	+	€7.00		
Gain on disposal	=	€50	less		€3.50	=	€46.50

*On severance of the rights the cost is apportioned by reference to market value, which in this case is the lower quotation plus one quarter of the difference between the two quotations - see TDM Part 19-04-02.

Under **sections 584 and 586 TCA 1997**, the holding of €200 loan stock (including the rights) is deemed to have cost €100.

12.3 Options to buy and sell

Where the option binds a grantor both to buy and sell, the option is to be treated as if it were two separate options with half the consideration attributed to each.