Business tax

The disposal of shares and securities

The disposal of shares and securities will always feature in the computer based assessment (CBA) and the questions may be based on a disposal by an individual or a company.

The rules for individuals and companies are different and each will be covered in turn in this module.

Matching rules

The difference between the disposal of shares and securities (from now on just referred to as shares) and other assets is that it can be more complicated to establish which shares have been disposed. There may have been several different share purchases over a period of time, for example:

Joe disposed of 1,500 shares in Torch Ltd on 1 December 2012; he had made purchases of shares in Torch Ltd as follows:

- 1 November 2011 – 400 shares
- 6 January 2012 – 200 shares
- 7 March 2012 – 1,450 shares
- 1 December 2012 – 200 shares
- 6 December 2012 – 600 shares
- 26 December 2012 – 150 shares

As long as the shares are from the same company and in the same class, we can identify which shares have been disposed of by applying the matching rules. As stated above, the rules are different for disposals by individuals and companies.

Matching rules for individuals

The matching rules for individuals are as follows.

1. Match the disposal with share purchases on the same date as the disposal.
2. Match with purchases made in the 30 days after the date of disposal, on a first in, first out basis.
3. Match with shares in the share pool, the pool contains all the other shares purchased other than in 1 or 2 above.

Use the matching rules above to determine which of the shares were disposed of by Joe on 1 December 2012, and show the balance of shares left after the disposal.

Click to display/hide the solution.

For each disposal we will need to calculate a capital gain, we can do this by putting some values on each purchase and disposal by Joe in the shares of Torch Ltd as follows.

Date	Transaction	Number of shares	Price per share
1 November 2011	Purchase	400	£19.00
6 January 2012	Purchase	200	£19.50
7 March 2012	Purchase	1,450	£20.00
1 December 2012	Purchase	200	£22.00
1 December 2012	Disposal	(1,500)	£22.50
6 December 2012	Purchase	600	£21.00
26 December 2012	Purchase	150	£21.50

For the purchase of the 200 shares on 1 December 2012 the capital gain is:

		£
01/12/2012	Sale proceeds (£22.50 x 200)	4,500
01/12/2012	Cost (£22.00 x 200)	(4,400)
	Gain	100

Calculate the gains for the 6 December 2012 and 26 December 2012 purchases.

Click to display/hide the solution.

For the share pool, use the following steps.

1. Calculate the cost of each purchase and total the number of shares and cost:

	Number	Cost (£)
01/11/2011	400	7,600
06/01/2012	200	3,900
07/03/2012	1,450	29,000
	2,050	40,500

2. Calculate the cost of the shares disposed using the average cost:

   (£40,500.00 x 550 / 2,050) = £10,865.85

3. Show the remaining balance in the share pool:

	Number	Cost (£)
01/11/2011	400	7,600
06/01/2012	200	3,900
07/03/2012	1,450	29,000
	2,050	40,500
01/12/2012	(550)	(10,865)
Balance	1,500	29,634.15

4. Calculate the gain:

	£
Sale proceeds (£22.50 x 550)	12,375
Cost	(10,865.85)
Gain	1,509.15

Matching rules for companies

The matching rules for companies are as follows.

1. Match the disposal with share purchases on the same date as the disposal.
2. Match with purchases made in the previous nine days on a first in, first out basis.
3. Match with shares from the 1985 pool. The pool contains all the shares purchased from 1 April 1982 onwards and the indexed cost is calculated before each purchase or disposal (known as an operative event).

Please note the purchase of shares prior to 1 April 1982 is not covered in the CBA.

Let's have a look at an example, Plaster Ltd owns shares in Cardigan Ltd and has made the following purchases and disposals.

Date	Transaction	Number of shares	Price per share
16 June 2002	Purchase	800	£10.00
2 May 2012	Purchase	500	£26.50
10 May 2012	Disposal	(1,000)	£28.00

The indexation factor for June 2002 to May 2012 is 0.376.

We will work through the example by following a number of steps.

1. Use the matching rules to identify the shares which have been disposed:

		£
Purchases from the previous nine days	2 May 2012	500
1985 pool		600
		1,100

2. Calculate the gain on the 2 May 2012 purchase:

		£
10/05/2012	Sale proceeds (£28.00 x 500)	14,000
02/05/2012	Cost (£26.00 x 500)	(13,000)
	Gain	1,100

3. Construct the 1985 pool:

		Number	Cost (£)	Indexed cost (£)
16/06/2002	Purchase	800	8,000	8,000

a) Initially the cost and indexed cost figures will be the same, the cost will be indexed before the next operative event.
b) Take the indexed cost and multiply it by the indexation factor.

Indexation allowance – June 2002 to May 2012

	£
(£8,000.00 x 0.376)	3,008
	11,008

c) Deduct the average cost and indexed cost of the shares disposed.

		£	£	£
10/05/2012	Disposal	(600)		
	(£8,000.00 x 600 / 800)		(6,000)	
	(£11,008.00 x 600 / 800)			(8,256)
d) Calculate the balances carried forward		200	2,000	2,752

4. Calculate the gain from the 1985 pool:

		£
10/05/2012	Sale proceeds (£28.00 x 600)	16,800
	Indexed cost	(8,256)
	Gain	8,544

Rights issues

Sometimes existing shareholders are offered additional shares at a reduced price, in accordance with their shareholding. Treat each rights issue in the same way as you would a purchase.

Have a go at the question below to test your knowledge.

Zippy Ltd purchased 5,000 shares in Mary Ltd for £25,000 in January 2002. A rights issue of 1 for 5 was bought in August 2009 for £4 per share. Zippy Ltd sold 4,000 of the shares in April 2012 for £8 per share. Calculate the chargeable gain.

The indexation factors are:
January 2002 to August 2009 – 0.237
August 2009 to April 2012 – 0.131

Click to display/hide the solution.

Bonus issues

Sometimes existing shareholders are given additional shares at no cost, this will increase the number of shares in the pool but it will have no effect on the total cost. A bonus issue is not considered to be an operative event for indexation purposes.

If we revisit the share disposal by Zippy Ltd, but this time instead of a rights issue there is a bonus issue and the indexation factor for the period from January 2002 to April 2012 is 0.399. The share pool and the gain will now be as follows.

		Number	Cost (£)	Indexed cost (£)
Jan 2002	Purchase	5,000	25,000	25,000
Aug 2009	Bonus issue	1,000		
		6,000		
Indexation allowance – Jan 02 to Apr 12 (£25,000.00 x 0.399)				9,975
				34,975
Apr 2012	Disposal	(4,000)		
	(£25,000 x 4,000 / 6,000)		(16,666.67)	
	(£34,975 x 4,000 / 6,000)			(23,316.67)
Carried forward		2,000	8,333.33	11,658.33

		£
Apr 12	Sale proceeds (£8.00 x 4,000)	32,000
	Indexed cost	(23,316.67)
	Gain	8,683.33

When you attempt questions of this nature, make sure you consider carefully whether any issues are rights issues or bonus issues as the treatment is different.