CHAPTER 14

BONUS ISSUES AND RIGHTS ISSUES

All statutory references are to the Taxation of Chargeable Gains Act (TCGA) 1992 unless stated otherwise.

14.1 Bonus issues

A bonus issue is a **free issue of shares** by a company to its shareholders. Bonus shares are issued to shareholders in proportion to their existing holdings. TCGA 1992, s. 127

For example, if a taxpayer owns 20,000 shares in ABC Plc and the company announces a "1 for 5 bonus issue", the shareholder will receive 1 bonus share for every 5 shares he already owns. The shareholder will be given 4,000 free shares, taking his holding up to 24,000 shares. There is no cost involved – the shares are issued free of charge.

A company will announce a bonus issue in order to reduce the share price and to make the shares more marketable or more tradeable.

To illustrate this, assume that before the bonus issue the 20,000 shares had a market value of £120,000. Before the bonus issue, the shares were worth £6 each.

After the bonus issue, even though the shareholder has more shares, his total holding is still worth £120,000. A bonus issue will therefore increase the number of shares, but will not affect the overall value. After the bonus issue, the shareholder has 24,000 shares, valued in total at £120,000. The price per share has therefore come down to £5.

14.2 Effect on the computation

Bonus shares are treated as having been **acquired at the same time as the original shares** for CGT purposes.

Illustration 1

Nita buys 10,000 shares in Cobra Ltd in May 1994 for £1 per share. A further 4,000 shares are acquired in January 1997 for £1.50 per share and another 2,000 are acquired in October 2001 for £2.50 per share. These are all allocated to the s.104 pool.

Cobra Ltd announce a "1 for 2 bonus issue" in December 2010. Nita currently has 16,000 shares, so she is entitled to receive 8,000 free shares.

The shares are allocated to the existing shares to which they relate. This means that the 8,000 also go into the s.104 pool.

	Shares	*Cost*
		£
May 1994	10,000	10,000
January 1997	4,000	6,000
October 2001	2,000	5,000
	16,000	21,000
Bonus 1:2 December 2010	8,000	NIL
Total	24,000	21,000

Nita sells 6,000 shares in March 2011 for £4.50 per share. Her gain is as follows:

Pool b/fwd	24,000	21,000
Less: Sale March 2011	(6,000)	(5,250)*
Total	18,000	15,750

* CGT base cost is 6,000/24,000 x £21,000 = £5,250

Capital gain:

	£
Proceeds (6,000 x £4.50)	27,000
Less: CGT base cost (above)	(5,250)
Capital gain	£21,750

14.3 Rights issues

A rights issue operates in a similar way to a bonus issue, except with a rights issue the shareholder will **buy** any new shares offered to him. There is therefore a cost attached to a rights issue. TCGA 1992, s. 128

Like bonus shares, rights shares are **issued in proportion to the existing holding.**

For example, if a taxpayer has 40,000 shares in a company and the company announces a "1 for 4 rights issue" at £2 per share, this means that the shareholder has a right to buy 1 additional share for every 4 shares that he holds, and he will pay £2 per share.

The shareholder can therefore buy a maximum of 10,000 shares for £20,000.

The shareholder can buy less than his rights entitlement (or none at all) if he so wishes.

The main purpose of a rights issue is to enable the company to raise additional cash from its shareholders.

The company obviously wants the shareholders to take up their rights and to buy the new shares. Therefore, as an incentive, the new rights shares are **usually** offered at a price which is less than the current market value of the shares. For instance in the above example, the company offer the rights shares at £2 each, when in fact their market value could be, say, £2.50.

14.4 Effect on the computation

Like bonus shares, rights shares are treated as having been acquired at the same time as the original shares for CGT purposes.

As there is a cost attaching to the rights shares, they are simply treated as a **normal purchase of shares** for CGT purposes.

Illustration 2

Danny owns shares in ABC Plc. Danny bought 2,000 shares in January 1980 for £1,000. The market value of these shares in March 1982, is £1 per share.

Danny bought an additional 1,000 shares in May 1990 for £2,000. On 4 February 2002, ABC Plc announced a 1 for 4 rights issue at £2.50 per share.

On 30 November 2010, Danny sold 2,700 shares for £9,450.

Danny bought a further 1,200 shares on 10 December 2010 for £3,600.

First we decide which shares Danny has sold by using the matching rules:

2,700 shares sold 30.11.10:

Same day?	X	
Next 30 days?	√	1,200 shares
S.104 pool	√	1,500 shares
		2,700

The first match is with 1,200 shares bought on 10 December 2010:

The gain will on these shares will be:

	£
Proceeds (1,200 / 2,700 x £9,450)	4,200
Less: CGT base cost (above)	(3,600)
Capital gain	£600

The second match is with 1,500 shares in the s.104 pool:

Date	*Shares*	*Cost*
		£
31 March 1982 (MV)	2,000	2,000
May 1990	1,000	2,000
	3,000	4,000
February 2002 (1:4 rights issue @ £2.50)	750	1,875
Total	3,750	5,875
Less: Sale (30.11.10)	(1,500)	(2,350)
Balance c/fwd	2,250	3,525

Gain on the S.104 pool shares:

	£
Proceeds (1,500 / 2,700 x £9,450)	5,250
Less: CGT base cost (above)	(2,350)
Capital gain	£2,900

Net gain on sale:

	£
Gain on s.104 pool shares	2,900
Shares bought 10.12.10	600
Net chargeable gain	£3,500

Example 1

Josh bought 10,000 shares in BCD plc for £20,000 in April 1999. He bought another 20,000 shares for £80,000 in August 2000.

In May 2002, BCD plc announced a 1:3 rights issue at £5 per share. Josh took up his rights in full.

In March 2009, BCD plc announced a 1:5 bonus issue.

Josh sold 12,000 shares for £100,000 in December 2010.

Calculate Josh's capital gain.

Answer 1

All shares in S.104 pool

Date	*Shares*	*Cost*
		£
April 1999	10,000	20,000
August 2000	20,000	80,000
	30,000	100,000
May 2002 (1:3 rights issue @ £5)	10,000	50,000
	40,000	150,000
March 2009 (1:5 bonus issue)	8,000	NIL
	48,000	150,000
Less: Sale (Dec 2010)	(12,000)	(37,500)
Balance c/fwd	36,000	112,500

Gain

	£
Proceeds	100,000
Less: CGT base cost (above)	(37,500)
Capital gain	£62,500