CHAPTER 27

GAINS AND LOSSES ON EIS SHARES

27.1 EIS shares sold at a gain

Where EIS shares are sold at a gain, that capital gain is **sometimes exempt** from CGT. TCGA 1992, s. 150A(2)

The gain is exempt from CGT if **two conditions** are satisfied.

1. The shares must be sold outside the "relevant period", which is **three years** after the issue of the shares.

2. Secondly, the investor must have **obtained income tax relief** on the subscription. To obtain income tax relief on the subscription, the investor must not have been "connected" with the company. Therefore if the investor is connected with the company – eg. he is an employee or owns more than 30% of the shares – he will not obtain income tax relief on the subscription, so the gains on the shares will not be exempt from CGT.

The maximum investment qualifying for income tax relief is limited to £500,000 so subscriptions in excess of this ceiling would not have obtained income tax relief. The limit was £400,000 for 2007/08, £200,000 between 6 April 2004 and 5 April 2006 and £150,000 prior to 6 April 2004.

If these conditions are **not** satisfied, a gain on EIS shares is a chargeable gain as usual.

27.2 Share matching rules for EIS shares

Where the disposal of EIS shares gives rise to a gain, specific share matching rules must be considered. Where EIS shares are sold, disposals are always **matched with shares acquired earlier rather than later** (i.e. a simple "FIFO" basis). EIS shares are **never pooled**. ITA 2007, s.246

In the case of shares acquired on the same day, disposals are matched with acquisitions on which no income tax relief is obtained before those shares on which income tax relief is given. This helps taxpayers preserve their tax reducers.

Illustration 1

Bradley subscribed for the following shares in Hi-Return Ltd, a qualifying EIS company:

Date	*Shares*	*Amount subscribed*
21.12.99	100,000	£300,000
30.4.09	150,000	£600,000

Bradley is not an employee or director and his shareholding never amounted to more than 10% of the issued share capital. He claimed the maximum income tax relief on each subscription.

On 30 September 2011, Bradley sold 125,000 of the Hi-Return Ltd shares for £1.2m. Bradley's disposal in September 2010 is matched as follows:

1st: with 100,000 shares acquired 21.12.99
2nd: with 25,000 shares acquired 30.4.09

1) Shares acquired 21.12.99

There is no withdrawal of income tax relief as the shares were held for at least 3 years.

As the disposal was more than 3 years after subscription, there is no chargeable gain on shares on which income tax relief was obtained. Bradley subscribed £300,000 as follows:

	£
Income tax relief on 50,000 @ £3	150,000
No income tax relief on 50,000 @ £3	150,000
Total subscription	£300,000

There is therefore a chargeable gain on the sale of 50,000 shares only:

	£
Proceeds: £1.2m x $\frac{50}{125}$	480,000
Less: cost	(150,000)
Gain	330,000

2) Shares acquired 30.4.09

Bradley subscribed £600,000 as follows:

	£
Income tax relief on 125,000 @ £4	500,000
No income tax relief on 25,000 @ £4	100,000
Total subscription	£600,000

On 30.9.11 he sells 25,000 shares.

These are matched with shares on which no income tax relief is obtained (i.e. the 25,000 shares bought for £100,000). There is therefore no clawback of income tax relief.

A chargeable gain will arise as follows:

	£
Proceeds: £1.2m x $\frac{25}{125}$	240,000
Less: cost	(100,000)
Gain	£140,000

Summary of gains 2011/12:

	£
Hi-Return shares:	
Acquired 21.12.99	330,000
Acquired 30.4.09	140,000
Chargeable gains 2011/12	£470,000

27.3 EIS shares sold at a loss

Where EIS shares are sold at a loss, the loss is **always an allowable loss** regardless of when the shares were sold. However, in order to calculate the amount of the allowable loss, any **income tax relief** obtained on the EIS subscription reduces the base cost for capital gains tax purposes. Essentially, any income tax relief obtained by the investor **will reduce the capital loss** that he or she may claim. TCGA 1992, s. 150A(2A) TCGA 1992, s. 150A(1)

As we know, an investor will receive income tax relief by way of a tax reducer of 20% of the amount of the subscription, now capped at £500,000. However, this **income tax relief** will be **withdrawn** if the EIS shares are **sold within three years** of their issue. The amount of the income tax relief withdrawn, is the proceeds of sale multiplied by the rate at which income tax relief was originally given. ITA 2007, s. 209

In the vast majority of instances, the rate of relief will be 20%. The withdrawal will never exceed the amount of relief given in the first place. Income tax relief is withdrawn by means of an assessment for the year in which the relief was originally obtained.

Illustration 2

In May 2009, Karen subscribed £50,000 for shares in a qualifying EIS company. She received income tax relief of £10,000 on the subscription. Karen sells the shares in March 2011. Her proceeds of sale are £35,000, so as you can see, Karen has made a capital loss.

Karen paid £50,000 for the shares, so her cash loss is £15,000. However, to arrive at the allowable loss for CGT purposes, we must deduct any income tax relief Karen has been given from the base cost of the shares for CGT purposes.

Karen's original income tax relief was £10,000. However, because she sold the EIS shares within three years of issue, some of this income tax relief will be withdrawn. The income tax relief withdrawn is £35,000 – i.e. the sale proceeds – multiplied by 20% to give £7,000. In total therefore, Karen has only received £3,000 worth of income tax relief. The base cost of Karen's EIS shares is therefore £47,000. Karen's allowable loss for CGT purposes is therefore £12,000.

March 2011		£
Proceeds		35,000
Cost	50,000	
Income Tax relief		
Original – Amount withdrawn		
(10,000 – 7,000)	(3,000)	
		(47,000)
Allowable loss		£(12,000)

Another way of arriving at this figure, is to look at the loss on the sale of the shares and deduct any income tax relief given. Karen lost £15,000 on the sale of the shares, but received £3,000 worth of income tax relief. Her effective loss is therefore £12,000 and this is the allowable loss for CGT.

Illustration 3

Consider whether the position would have been different if Karen had sold her shares in March 2013, again for £35,000.

Karen paid £50,000 for the shares in May 2009. The income tax relief obtained on the subscription was £10,000. This time, because Karen has sold the shares more than three years after their issue, none of the income tax relief is withdrawn. The total income tax relief given is therefore £10,000. This reduces the base cost of the EIS shares to £40,000.

Karen's allowable loss for capital gains tax purposes is therefore £5,000. Again this is the loss on the shares of £15,000, less income tax relief given of £10,000.

March 2013		£
Proceeds		35,000
Cost	50,000	
Income Tax relief	(10,000)	
		(40,000)
Allowable loss		£(5,000)

27.4 Use of EIS losses against income (s131 ITA 2007 election)

Assuming Karen sold the EIS shares in March 2011, she has an allowable capital loss of £12,000 for the tax year 2010/11. This capital loss will **first be set** against Karen's capital **gains in the same tax year,** and any **excess** will be **carried forward** and set against future capital gains. Therefore losses on EIS shares are relieved in much the same way as losses on other assets.

However, there is one more thing that Karen could do with this capital loss. Section 131 ITA 2007 allows an individual to use losses on EIS shares in a slightly different way. Here the capital loss **can be deducted in computing Karen's net income**, either of the **current year or of the preceding year.** ITA 2007, s. 131

Therefore, if Karen makes a claim under Section 131, instead of setting the capital loss against other capital gains, Karen could elect to set the loss against her income for 2010/11 or indeed against her income for the preceding year 2009/10. This is very unusual and is the **only time** when a taxpayer can **set a capital loss against income.** Section 131 allows a taxpayer to use a loss on EIS shares in much the same way as a trading loss can be used – i.e. in computing net income.

This **relief is available on qualifying shares.** These are **shares which are either EIS shares or shares in a qualifying trading company which have been subscribed for by the individual**. In practice, relief will most commonly arise when an individual makes losses on EIS shares.

Whether or not it is beneficial to make the claim will depend on the taxpayer's individual circumstances. However, given that CGT rates are generally lower than income tax rates, this will often be a desirable claim.

There is a summary at the end of this chapter which recaps on both the income tax and capital gains tax implications of subscribing for and selling EIS shares.

Example 1

George sold his shares in British Airways plc (<1% holding) in May 2010 making a gain of £100,000. He had owned the shares for many years.

In September 2010 he subscribed for £75,000 of shares in Wot-Widget Ltd, an EIS company.

George sold the Wot-Widget Ltd shares in December 2011 for £85,000.

Calculate George's gains in 2011/12, assuming maximum claims for relief are made.

Example 2

Vic subscribed for the following EIS shares in June 2009.

Corner Shop Ltd	£60,000
Street Cars Ltd	£50,000

He received income tax relief on both subscriptions.

In December 2010, Vic sold the Corner Shop Ltd shares for £40,000 and the Street Cars Ltd shares for £75,000.

Calculate Vic's chargeable gains and/or allowable losses in 2010/11.

Answer 1

2010/11	£
Gain on British Airways shares	100,000
Less: EIS reinvestment relief	(75,000)
Gain	£25,000

The maximum claim for reinvestment relief is £75,000 so this much of the gain will be frozen.

2011/12	
Sale of EIS shares	£
Proceeds	85,000
Less: cost	(75,000)
Gain	10,000
Plus frozen gain now crystallising	75,000
Chargeable gains	£85,000

Answer 2

Corner Shop Ltd shares
IT relief withdrawn as sold within 3 years

	£	£
Proceeds		40,000
Cost	60,000	
Less: IT relief		
Original - Amount withdrawn		
£(12,000 – 8,000)	(4,000)	
		(56,000)
Loss		£(16,000)

Street Cars Ltd shares
Gain is chargeable as sold within 3 years

	£
Proceeds	75,000
Cost	(50,000)
Gain	£25,000

Note that the loss on the Corner Shop shares can either be set against the current year gain or could alternatively be deducted in computing Vic's net income in 2009/10 or 2010/11. Which is the most beneficial position will depend on the level of Vic's taxable income.