

Amendment to Clause 77: Employee shareholder shares: limit on exemption

Summary

1. Clause 77 introduced a lifetime limit of £100,000 on the Capital Gains Tax exempt gains that a person can make on the disposal of shares acquired under Employee Shareholder Agreements entered into after 16 March 2016.
2. This amendment maintains the practice of no chargeable gain accruing on certain transactions relating to Employee Shareholder shares where no chargeable gain, and hence no tax, would arise if shares that were not Employee Shareholder shares were involved.

Details of the amendment

3. Amendment 29: Subsections (3A) and (3B) insert eleven new subsections ((1A) to (1K)) into section 236F of the Taxation of Chargeable Gains Act (TCGA) 1992.
4. New subsections (1A), (1B), (1C), (1D) and (1K) of section 236F provide rules which apply when Employee Shareholder shares owned by a person ("P") are involved in transactions which would normally be within the scope of section 127. These transactions are referred to in this amendment as "reorganisations". Where these rules apply, the value of the consideration that is treated as received for the disposal of the Employee Shareholder shares is determined as set out in new subsections (1E) to (1I).
5. The rules ensure that on such transactions, P will not have to pay Capital Gains Tax (CGT) at that time, and will receive the maximum benefit from any unused part of his £100,000 lifetime limit on CGT exempt gains. The effect is that latent gains which are not exempted will be rolled over in the shares etc. which are received as consideration for the Employee Shareholder shares and may therefore be chargeable on disposal.
6. Existing section 236F(1) ensures that the current rules will continue to apply to exempt Employee Shareholder shares that have been issued to P in respect of Employee Shareholder agreements entered into **before 17 March 2016** and are then involved in a reorganisation. A disposal in the course of such a reorganisation will continue to be recognised for CGT because of section 236F(1). Since gains on such shares are wholly exempt from CGT charge, no tax is payable on this reorganisation, leaving the shareholder exposed to tax only on gains on the shares etc. received as consideration from the date of the reorganisation.
7. For shares that have been issued to P as consideration for entering into Employee Shareholder agreements **after 16 March 2016** and are then involved in a reorganisation:
 - new subsection (1E) has the effect that where the whole of P's £100,000 lifetime limit on CGT exempt gains has been used up before the reorganisation, the disposal of the Employee Shareholder shares is treated as being made for consideration which gives rise to no gain and no loss. For example Mrs A owns

post-16 March 2016 shares worth £75,000 with deductions allowable in computing her gains and losses of £20,000. She has previously used up all her £100,000 lifetime CGT exemption on Employee Shareholder shares. Her notional gain of £55,000 is a chargeable gain, so the disposal is treated as being for consideration £20,000 giving no gain and no loss. After the reorganisation the deemed cost of the shares etc. she received as consideration is £20,000.

- new subsection (1G) has the effect that where there is a notional gain of an amount which is *less* than P's unused lifetime limit of CGT exempt gains, so that none of that gain is a chargeable gain, the disposal and acquisition are treated as taking place for consideration of an amount equal to the market value of the shares transferred. For example Mrs B owns shares worth £75,000 with deductions allowable in computing her gains and losses of £5,000. She has previously used up £10,000 of her lifetime CGT exemption on Employee Shareholder shares, giving her £90,000 of unused exemption. She has a notional gain of £70,000 which is not a chargeable gain so the disposal is treated as being for consideration equal to the market value (£75,000). Her actual gain is £70,000 and this is exempt under section 236B, leaving unused lifetime exemption of £20,000. Following the reorganisation the deemed cost to Mrs B for any future disposal of the consideration shares etc. is the market value, £75,000.
 - new subsection (1F) has the effect that where there is a notional gain of an amount which is *more* than the balance remaining of P's lifetime allowance, the disposal is treated as being for consideration which gives rise to a gain of an amount equal to the balance of the lifetime allowance. For example Mr X owns shares worth £75,000 with deductions allowable in computing his gains and losses of £5,000. He has previously used up £80,000 of his lifetime allowance, giving him £20,000 of unused exemption. His notional gain is £70,000 of which £50,000 would be a chargeable gain. His disposal is treated as being for consideration of £25,000 which gives rise to a gain of £20,000. Following the reorganisation the deemed cost for Mr X for any future disposal of the consideration shares etc. is £25,000.
8. New subsection (1H) of section 236F applies where there is no notional gain on the disposal of Employee Shareholder shares at the time of the reorganisation. It provides that the disposal is treated as being for consideration giving rise to no gain, no loss. The effect of this is that a loss which is latent in the shares will be rolled over into the consideration shares etc. so that it may accrue and be allowable on a later disposal.

Background note

9. The Capital Gains Tax code provides for no tax to be payable on reorganisations of a company's share capital. Transactions such as rights issues and bonus issues made by a company, and certain "paper-for-paper" transactions such as company take-overs which take the form of share swaps, may be treated for CGT purposes as if they were reorganisations. The rules normally operate by ignoring any disposal of shares which has taken place and hence preventing any chargeable gain from accruing. The cost and allowable deductions connected with the original shares are available on a disposal of the shares etc. held after the relevant transaction, so any latent gain or loss is effectively rolled-over into the new holding.
10. When the CGT exemption for Employee Shareholder shares was first introduced in Finance Act 2013 it was decided for reasons of fairness not to adopt this treatment. Instead, to the extent that a reorganisation involves exempt Employee Shareholder shares, under section 236F TCGA 1992, any disposal of those shares is recognised and the gain calculated in the normal way. Before the introduction of the lifetime limit in Clause 77 there was no tax to pay at that point because of the unlimited CGT exemption for gains on such shares. The Employee Shareholder would be subject to tax only on the gains which represented an increase in value from the date of the reorganisation, and that tax would be payable when all or part of the new holding was disposed of.
11. Clause 77 introduced a lifetime limit of £100,000 on the Capital Gains Tax exempt gains that a person can make on the disposal of shares acquired under Employee Shareholder Agreements entered into after 16 March 2016.
12. Without this amendment, Clause 77 as currently drafted will result in a chargeable gain accruing and CGT being payable on a reorganisation, or a transaction which is treated like a reorganisation, which involves exempt Employee Shareholder shares where the shareholder has previously used up the whole of his £100,000 lifetime limit on CGT exempt gains. The nature of these transactions means that the shareholder will often not have received any cash proceeds from which to pay the tax, so this would be a "dry" charge. That would be unfair and inconsistent with previous policy and treatments. If the shares had not been Employee Shareholder shares, the gain would have been "rolled over", and the tax payable only when the new holding of shares sold.