Chapter 8

Taxation of shares - FIFO rules / Bonus and Rights Issues

1. General

Like any other Capital Gains Tax computation, a chargeable gain on the disposal of company shares is arrived at by deducting the cost of the shares (adjusted for inflation as appropriate) from the net consideration received for the disposal of the shares (see Chapter 3).

The calculation is relatively straightforward where a person acquires one block of shares and at a later date, without there having been any changes in the number or type, etc. of the shares held, sells all or part of that holding:

Calculation of gain*

2004: Bought 100 Ordinary €1 shares for €2 per share

2006: Sold 50 Ordinary €1 shares for €3 per share

Gain is €50 (Proceeds €150, less cost €100 (50 x €2))

* *ignoring indexation, expenses of sale and personal exemption for ease of illustration*

Often, however, there will be increases in the shareholding, either because a person purchases additional shares of the same type or they receive additional shares under bonus or rights issues. There are special Capital Gains Tax rules for these situations.

2. First In - First Out (or FIFO rule)

Where a person holds shares of the same class which have been acquired at different dates, the shares acquired at the earlier time are deemed to be disposed of first. For example:

2001: Bought 1,000 Ordinary €1 shares in X Ltd. for €1 per share

2003: Bought 200 Ordinary €1 shares in X Ltd. for €1.50 per share

2005: Bought 500 Ordinary €1 shares in X Ltd. for €2 per share

2006: Sold 1,500 Ordinary €1 shares in X Ltd. for €3 per share

Sold 1,500 shares for €4,500 in 2006

Allowable cost (ignoring indexation up to 31/12/2002)

Using FIFO Rule:

1,000	@	€1.00	=	€1,000
200	@	€1.50	=	€300
300	@	€2.00	=	€600
1,500				

Remaining shares 200 Ordinary €1 shares in X Ltd. acquired in 2005 cost €2 per share.

(See **Example 6** in Chapter 11).

Disposal of shares within four weeks of acquisition

The FIFO rules are modified in any case where shares of the same class are bought and sold within a period of four weeks. Where shares are sold within four weeks of acquisition the shares sold are identified with the shares acquired within that period. Furthermore, where a loss accrues on the disposal of shares and shares of the same class are acquired within a four week period, the loss is not available for offset against any other gains arising. Instead the loss is only available for set off against any gain that might arise on the subsequent disposal of the shares so acquired in the four week period - this provision does not apply where there is a gain on the disposal.

3. Bonus/Rights Issues

Sometimes the holder of a class of shares will receive additional shares, being either a bonus issue (no additional cost) or a rights issue (for a cost which is usually less than open market value), in respect of their holding. In these situations, despite the fact that the new shares are actually acquired at a later date, they are deemed to have been acquired at the date the original shares giving rise to the bonus or rights issue were acquired. Thus, if a person acquired, say 100 shares in company X Ltd. in 2003 and in 2005 received 50 shares as part of a bonus or rights issue they will be deemed to have held the entire holding of 150 shares from 2003.

Furthermore, there is no question of imputing a notional cost or value for the new shares acquired but the actual price paid to acquire the shares under a rights issue is allowed as enhancement expenditure (see Chapter 3, Point 1(b)).

Bonus Issue

The effect of the above on a bonus issue is that the original cost is diluted between the original shares and the new shares acquired, for example:

2003: Acquired 100 Ordinary €1 shares in X Ltd. for €300 (or €3 per share)

2005:Acquired 50 Ordinary €1 shares in X Ltd. for no cost (bonus issue 1 for 2)

All 150 shares are deemed to have been acquired in 2003 for a total cost of €300.

The revised cost per share is €2 (i.e. all 150 shares are deemed to have been acquired in 2003 for a total cost of €300 which “dilutes” the allowable cost per share to €2, €300 allowable cost ÷ 150 shares).

(See **Example 7** in Chapter 11).

Rights Issue

The treatment for shares acquired under a rights issue is the same as for a bonus issue except that an allowance has to be made for the amount paid to acquire the additional shares. Such payments are treated as enhancement expenditure, so that on the subsequent disposal of any of the shares, part of the cost of the rights issue will be attributed to the shares sold.

Using the same figures from the example immediately above, but assuming the additional shares acquired represented a rights issue for which a payment of €150 was made (€3 per share in rights issue) the resulting position would be as follows:

All 150 shares are deemed to have been acquired in 2003 for a cost of €300, i.e. cost of €2 per share in 2003. They are also deemed to have a further additional cost (enhancement expenditure) of €150 in 2005. This enhancement expenditure (EE) is again divided equally between the total number of shares held (i.e. €150 ÷ 150 shares or €1 per share EE). In simple terms, each share is deemed to have been held since 2003 and each has an allowable cost of €2 paid in 2003 and further enhancement expenditure of €1 paid in 2005.

(See **Example 8** in Chapter 11).

Shares of a different class

Occasionally the shares received in a bonus or rights issue will be shares of a different class to the shares held, e.g. one new Preference share for every two Ordinary shares held and so on. Where this happens the position is essentially the same as above except that it is necessary to apportion the allowable cost (including enhancement expenditure in the case of rights issues) between the different classes of shares. In the case of quoted shares this apportionment is done on the basis of the first day price of the respective shareholdings after the bonus/rights issue is made (for unquoted shares this apportionment is done by reference to the respective values of the shares at the date of disposal).

(See **Example 9** in Chapter 11).