HMRC - CG58065 - TCGA92/S138A Does Not Apply: Example

TCGA92/S138A

This example illustrates the most common type of transaction. The consideration to be received is immediate cash, immediate shares and an unascertainable deferred amount of shares.

NOTE From 6 April 2008 only companies and other concerns within the charge to Corporation Tax may be able to claim indexation allowance, see

FACTS

In year 0 V Ltd acquires all the shares in T Ltd for £100,000.

In year 10 V Ltd sells the shares in T Ltd at arm’s length to P Ltd.

The consideration is

cash £500,000, and

80,000 shares in P Ltd at market value of £2.25 each (total £180,000), and

the right to two payments of deferred consideration, the amount depending on future profits of T Ltd, to be satisfied only by an issue of shares in P Ltd.

The market value of the right to deferred consideration at the time of disposal is agreed by Shares and Assets Valuation at £300,000.

In year 11 shares in P Ltd to the value of £202,940 (73,000 shares at £2.78 each) are issued to V Ltd in part satisfaction of the right to deferred consideration. The market value of the remainder of the right in year 11 is agreed by Shares and Assets Valuation at £90,000.

In year 12 shares in P Ltd to the value of £118,440 (47,000 shares at £2.52 each) are issued in full satisfaction of the remainder of the right to deferred consideration.

P Ltd is a company whose shares are quoted on the Stock Exchange. All of the conditions are satisfied and the earn-out right is treated as a security by TCGA92/S138A.

COMPUTATIONS

A) IMMEDIATE CHARGEABLE GAIN

B) COST OF SHARES IN P LTD

C) COST OF NOTIONAL SECURITY = RIGHT TO DEFERRED CONSIDERATION

D) COMPUTATIONS WHEN DEFERRED CONSIDERATION RECEIVED

E) SHARES IN P LTD

EXPLANATION

The statutory reasons for the method of computation are;

A. CASH RECEIVED

The cash received is treated as a part-disposal of the old holding of T Ltd shares under TCGA92/S128(3). The apportionment of the base cost of the old holding is made on the basis of market value at the date of disposal (section 128(4) and TCGA92/S129).

B.

V Ltd has acquired shares in P Ltd and a `notional security’ under the terms of section 138A. These are treated as two classes of shares. Together they form the `new holding’ under TCGA92/S127 as applied by TCGA92/S135(3).

If the shares in P Ltd are not quoted the apportionment should be made by reference to market values at the date of a disposal of all or part of the new holding.

D. RIGHT TO UNASCERTAINABLE DEFERRED CONSIDERATION

The part satisfaction of the right to deferred consideration is a part disposal of the right. But because of section 138A it is treated as a conversion of securities within TCGA92/S132. Section 127 applies with the necessary adaptations to the part disposal and part of the base cost of the `notional security’ is transferred to the holding of shares in P Ltd.

The procedure for obtaining valuations of the right to unascertainable

deferred consideration is described at

E. SHARES IN P LTD

The shares in P Ltd which are acquired go into the TCGA92/S104 holding of shares of the same class. The base cost and indexed pool of expenditure is calculated in accordance with B and C above.

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