

INCOME TAX ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 4: Loss relief

Overview

Chapter 6: Losses on disposal of shares

Overview

421. This Chapter is based on sections 305A and 574 of ICTA and, to the extent that they supplement section 574 of that Act, sections 575 and 576 of that Act. So far as sections 575 and 576 of ICTA supplement section 573 of that Act (share loss relief for companies), they continue in force, together with new sections 576A to 576L of ICTA (see Schedule 1 to this Act and the commentary on those new sections of ICTA).
422. Section 574 of ICTA provides for relief against income tax for allowable losses for capital gains tax purposes incurred on the disposal of ordinary shares in qualifying trading companies for which an individual has subscribed.
423. Section 305A of ICTA provides that section 574 of that Act also applies, with minor modifications, on the disposal by an individual of shares to which enterprise investment scheme income tax relief is attributable under Chapter 3 of Part 7 of ICTA. The provisions of section 305A of ICTA are included as an integral part of this Chapter and a signpost to this Chapter is included in section 161 in Part 5 (Enterprise investment scheme).
424. Section 125A of TCGA introduced by Schedule 1 to this Act is based on section 576(2) and (3) of ICTA, which have effect only for the purposes of capital gains tax or corporation tax on chargeable gains, and on sections 573(4) and 574(1) of ICTA which have effect only for the purposes of corporation tax on chargeable gains and capital gains tax respectively. See the commentary on section 125A of TCGA in Schedule 1.
425. This Chapter contains 21 sections structured as follows:
- three setting out the basic conditions for share loss relief, the entitlement of the individual to make a claim and how the relief works;
 - thirteen applying only to shares to which EIS relief is not attributable and setting out requirements to be satisfied if relief is to be available on the disposal of such shares;
 - three applying generally and dealing with limits on relief and the identification of shares disposed of; and
 - two containing miscellaneous and supplementary provisions.

Section 131: Share loss relief

426. This section deals with eligibility for share loss relief and the requirements relating to the kinds of disposal and to the type of shares disposed of. It is based on sections 305A(1), 574(1) and 575(1) and (3) of ICTA.
427. *Subsection (1)(b)* provides that the disposal must be of “qualifying shares”. *Subsection (2)* provides that shares are qualifying shares if either EIS relief is attributable to them or they are shares in a qualifying trading company for which the individual has subscribed. EIS relief is defined in section 151(1) and includes not only relief under Part 5 of this Act attributable to shares issued on or after 6 April 2007 (see section 201) but also relief under Chapter 3 of Part 7 of ICTA attributable to shares issued after 31 December 1993 and before 6 April 2007 (see section 289B of that Act).
428. *Subsection (3)(a)* is based on section 575(1)(a) of ICTA which specifies as one of the kinds of disposal:
- “a disposal by way of a bargain made at arm’s length for full consideration.
- Subsection (3)(a) omits the words “for full consideration” on the basis that they add nothing. See *Change 20* in Annex 1.

Section 132: Entitlement to claim

429. This section deals with the making of a claim for share loss relief. It is based on section 574(1) of ICTA.
430. This section makes explicit what is only implicit in section 574(1) of ICTA:
- in *subsection (1)*, that a claim may be made for both the tax year in which the allowable loss is incurred and the previous tax year;
 - in *subsection (2)*, what is required in practice to establish how the claim is to apply to each year; and
 - in *subsection (3)*, that, in the case of a claim in respect of one year only, the claim must specify which year.

Section 133: How relief works

431. This section explains how deductions for the loss are to be made. It is based on section 574(1) and (2) of ICTA.
432. *Subsection (1)* states explicitly what is implicit in section 574(1) of ICTA, that:
- the whole amount of the loss must be deducted in calculating the claimant’s net income for the specified tax year; and
 - if a claim is made in respect of two tax years, then only so much, if any, of the amount of the loss which it has not been possible to deduct from the claimant’s income for the specified year can be deducted in calculating the claimant’s net income for the other year.
433. This section does not include the words in section 574(1)(a) and (b) of ICTA which limit the amount of the deduction for any tax year to the whole of the claimant’s income for the year, where the income is less than the amount of the loss. That limit is included in section 25(5) and (6). Section 25 explains how the reliefs listed in section 24, which include share loss relief, are to be deducted at Step 2 of section 23 in order to calculate the claimant’s net income.
434. *Subsection (5)* is new. It makes explicit that the balance of any allowable loss for which share loss relief is not obtained continues to be capable of being claimed as a deduction under TCGA.

Section 134: Qualifying trading companies

435. This section is the first of 13 sections which apply only to shares to which EIS relief is not attributable. It is based on section 576(4) of ICTA. It defines what is a qualifying trading company. Shares, other than shares to which EIS relief is attributable, must form part of the ordinary share capital of a qualifying trading company if they are to be qualifying shares (see section 131(2)(b) and the definition of “shares” in section 151(1) and (3) to (6)).
436. Section 576(4) of ICTA defines a “qualifying trading company” in terms of its being an “eligible trading company” and having been such for a specified continuous period. Section 576(4A) of ICTA defines an “eligible trading company” by applying the requirements of section 293 and other provisions of Chapter 3 of Part 7 of ICTA (Enterprise investment scheme) with modifications.
437. This section avoids the double layer of definition in section 576(4) of ICTA and omits the concept of an “eligible trading company”.
438. *Subsection (2)*, therefore, directly introduces the four requirements of section 293 of ICTA (as modified and applied by section 576(4A) and (4B) of that Act) which must be met on a continuing basis (see also *subsection (3)*).
439. Subsections (2)(b) and (3)(b) omit the words “that is not an eligible trading company” which qualify “trading company” in section 576(4)(a)(ii) and (b)(ii) of ICTA on which those paragraphs are based. Those words are otiose.
440. *Subsection (4)* directly introduces the two requirements of section 293 of ICTA (as modified and applied by section 576(4A) and (4B) of that Act) which are to be met only when the shares in respect of which share loss relief is claimed are issued.
441. This direct application of these two requirements resolves the apparent inconsistency between sections 293 and 576(4) of ICTA. Section 293 of ICTA requires them to be met only at the time of issue of the shares. But section 576(4) of that Act requires the company to be an eligible trading company at a subsequent time and during a continuous period. Section 576(4) of ICTA thus appears to require the company to meet these requirements also at that subsequent time and during that period.

Section 135: Subscriptions for shares

442. This section sets out the requirements relating to the subscription for shares in a qualifying trading company. It is based on section 574(3) of ICTA and includes a new provision relating to “corresponding bonus shares”.
443. *Subsection (2)* provides that shares are subscribed for by the individual if they have been issued to the individual in consideration of money or money’s worth. See also *subsection (4)*.
444. *Subsection (3)* is based on section 574(3)(b) of ICTA, which provides that:
“an individual shall be treated as having subscribed for shares if his spouse or civil partner did so and transferred them to him by a transaction inter vivos.
445. Subsection (3)(a) is extended to cover not only the case where A is the actual subscriber but also cases where A is treated as having subscribed under the provisions relating to the issue of “corresponding bonus shares” (see *subsection (4)*) or under an earlier application of this subsection. See *Change 21* in Annex 1.
446. Subsection (3)(c), read with the definitions of “civil partner” and “spouse” in section 151(1), makes explicit that the relevant time at which A and B must be spouses or civil partners living together is the time of the transfer. See *Change 22* in Annex 1.

447. Subsection (4) is new and treats “corresponding bonus shares” issued in respect of shares which have been subscribed for as themselves having been subscribed for. See *Change 23* in Annex 1.

Section 136: Disposals of new shares

448. This section applies to the disposal of qualifying shares (other than shares to which EIS relief is attributable) which are identified by virtue of section 127 of TCGA with shares previously held by the individual. The section denies or restricts share loss relief unless certain conditions are met. It is based on section 575(2) of ICTA.
449. The cross-reference to section 145(3) at the end of *subsection (2)* makes clear that this section does not apply to an exchange of shares to which section 145(1) applies. See the commentary on section 145 and *Change 24* in Annex 1.

Section 137: The trading requirement

450. This section is the first of ten new sections relating to the requirements for a company to be a qualifying trading company. These sections replace the provisions of section 576(4A) and (4B) of ICTA which apply section 293 and certain associated provisions of Chapter 3 of Part 7 of that Act, with modifications and omissions.
451. All these sections correspond to sections in Part 5 of this Act (Enterprise investment scheme). So far as possible cross-references to sections of Part 5 have been minimised. Cross-references have, however, been retained where the material referred to is lengthy, for example the definition of “excluded activities” in sections 192 to 199.
452. This section corresponds to section 181 with modifications. Section 181 is based on section 293(2) and (3A) to (3F) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period, which is the effect of the modification of section 293(2) of ICTA made by section 576(4A)(d) of that Act.
453. *Subsection (2)* corresponds to section 181(3) and *subsection (6)* corresponds to section 181(7). For the reason for the introduction of subsections (3) and (7) of section 181, see *Change 42* in Annex 1 and the commentary on section 181.
454. *Subsection (5)* corresponds to section 181(6), including the change made in section 181(6)(d) by *Change 41* in Annex 1.
455. In the definition of “incidental purposes” in *subsection (7)* the words “capable of”, which appear in the definition in section 293(2) of ICTA on which it is based, have been omitted. This mirrors the definition of “incidental purposes” in section 181(8), which is also based on the definition in section 293(2) of ICTA. See the commentary on section 181.
456. The definition of “non-qualifying activities” in *subsection (7)* includes the change affecting the definition of that term for the purposes of section 181(8) made by *Change 43* in Annex 1.

Section 138: Ceasing to meet trading requirement because of administration or receivership

457. This section corresponds to section 182 with two changes. Section 182 is based on section 293(4A) to (6) and (8A) of ICTA.
458. The first change modifies section 182(3) by substituting for the reference to “the end of period B” a reference to “the time that is relevant for the purposes of section 134(2)”. This is the substitution required by section 576(4A)(d) of ICTA to section 293(5) of that Act, on which section 182(3) is based.
459. The second change modifies section 182(4) by omitting the reference to dissolution and adding the condition that the company continues, during the winding up, to be a

trading company. These are the modifications required by section 576(4A)(b) of ICTA to section 293(6) of that Act, on which section 182(4) is based.

Section 139: The control and independence requirement

460. This section corresponds to section 185 with modifications. Section 185 is based on section 293(8) and (8A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period, which is the effect of the modification of section 293(8) of ICTA made by section 576(4A)(d) of that Act.
461. *Subsections (1) to (3)* correspond to section 185, with the omission in subsections (1)(a) and (2)(a) of the words “at any time in period B” and the substitution in subsection (3) of a reference to section 145(3) for the reference to section 247(4). *Change 44* in Annex 1 relating to section 185(1)(a) is replicated in this subsection.
462. The term “control” is used in both subsection (1)(a) and subsection (2)(a)(ii). There is a definition of “control” in *subsection (4)*, which refers to section 416(2) to (6) of ICTA, but this applies only to the use of that term in subsection (1)(a). This reflects section 257(3), which applies the definition of “control” in section 416(2) to (6) of ICTA in section 185(1)(a) but not in section 185(2)(a)(ii). By virtue of section 1021(2), the term “control” in sections 139(2)(a)(ii) and 185(2)(a)(ii) has the meaning given by section 995.

Section 140: The qualifying subsidiaries requirement

463. This section corresponds to section 187 with modifications. Section 187 is based on sections 293(3A) and 308(1) and (5A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period. This, together with the omission of the words “at any time in period B”, gives effect to the modification of sections 293(3A) and 308(1) of ICTA made by section 576(4A)(d) of that Act.

Section 141: The property managing subsidiaries requirement

464. This section corresponds to section 188 with modifications. Section 188 is based on section 293(6ZA) to (6ZC) and (8A) of ICTA. Section 134(2) and (3) provide that this requirement must be met over a continuous period. This, together with the omission of the words “at any time in period B”, gives effect to the modification of section 293(6ZA) of ICTA made by section 576(4A)(d) of that Act.

Section 142: The gross assets requirement

465. This section corresponds to section 186 with modifications. Section 186 is based on section 293(6A) to (6C) of ICTA. This requirement has to be met only at the times specified in *subsections (1) and (2)* (see section 134(4)(a)).
466. Section 576(4A)(c) of ICTA requires that for the words “the eligible shares” in section 293(6A) of that Act there be substituted the words “the shares in respect of which the share loss relief is claimed under section ... 574”. This substitution has been reflected in subsections (1)(a) and (2)(a). Section 150 applies for the purposes of those paragraphs to determine the time of issue of the shares in certain circumstances.

Section 143: The unquoted status requirement

467. This section corresponds to section 184 with modifications. Section 184 is based on sections 293(1A), (1B) and (8A) and 312(1), (1B), (1C) and (1E) of ICTA. This requirement has to be met only at the time specified in *subsection (1)* (see section 134(4)(b)).
468. *Subsection (1)* corresponds to section 184(1) with the substitution for “the beginning of period B” of “the time at which the shares in respect of which the share loss relief is claimed are issued”. This is the substitution required by section 576(4A)(ab) of ICTA

to section 293(1A) of that Act, on which section 184(1) is based. Section 150 applies for the purposes of this subsection to determine the time of issue of the shares in certain circumstances.

469. In subsection (1)(c)(i) a reference to section 145 is substituted for the reference in section 184(1)(c)(i) to section 247.

Section 144: Power to amend requirements by Treasury order

470. This section is included to enable sections 137 to 143 to be amended by Treasury order whenever the corresponding sections in Part 5 are amended by such an order under the power in section 200. It is based on sections 298(4) and 576(4A) of ICTA.
471. This preserves the position under the source legislation if an amendment were made under the power in section 298(4) of ICTA. In the case of an amendment of a provision which is applied by section 576(4A) of ICTA, the amendment would also have effect for the purposes of section 574 of that Act.

Section 145: Relief after an exchange of shares for shares in another company

472. This section corresponds to section 247 with modifications. Section 247 is based on section 304A(1), (2), (6), (7) and (8) of ICTA.
473. Section 576(4A)(e) of ICTA requires that for the words “eligible shares” in section 304A(1)(e)(i) of that Act there are substituted the words “shares in respect of which relief is claimed under section ... 574”. Those words are not entirely apposite, as the relief will be claimed, if at all, in respect of the new shares not the old shares.
474. Section 304A(1)(e)(i) of ICTA is needed in the context of EIS relief (see section 247(1)(e)(i)). But that provision is unnecessary in the context of share loss relief. Section 576(4A)(a) and (4B)(d) require the omission of section 304A(1)(e)(ii) of that Act. Accordingly, section 247(1)(e) has not been replicated in this section.
475. The provision in *subsection (1)(e)* has been based on paragraph 8(1)(f) of Schedule 5B to TCGA (Enterprise investment scheme: re-investment) rather than section 304A(1)(f) and (8) of ICTA. Accordingly, section 247(2), which is based on section 304A(8) of ICTA, has not been replicated in this section. See *Change 25* in Annex 1.
476. *Subsection (3)* corresponds to section 247(4) with two modifications.
477. *Subsection (3)(a)* is new and resolves the apparent conflict between section 136 and this section. See *Change 24* in Annex 1.
478. In *subsection (3)(b)* reference to section 139(1) has been substituted for the reference in section 247(4) to section 185.

Section 146: Substitution of new shares for old shares

479. This section corresponds to section 249 with modifications. Section 249 is based on section 304A(3) and (4) of ICTA.
480. **Section 249** makes separate provision for circumstances where the shares are held by the individual who subscribed for them and for circumstances where the shares have been transferred to the individual by the individual’s spouse or civil partner.
481. The structure of section 249 is dictated by the differing forms of subsections (2)(d) and (4)(d) which are based on section 304A(3)(d) and (4)(d) of ICTA. The difference between those provisions is necessary for the purposes of EIS relief. But section 576(4B)(d) of ICTA requires that section 304A(3)(d) and (4)(d) of that Act are omitted in the application of section 304A for the purposes of share loss relief.

482. **Section 135** provides that references in this Chapter to an individual having subscribed for shares include, in relation to shares to which EIS relief is not attributable, references to the individual being treated as having subscribed for shares for which the individual's spouse or civil partner subscribed. The structure of section 146 is, therefore, simpler than that of section 249.
483. *Subsection (1)* corresponds to section 249(1) and (3), with the omission, as required by section 574(4B)(d) of ICTA, of the words "to which EIS relief becomes attributable under section 247" and with two further changes.
484. The first of these changes is that the words "and issued to" in section 249(1) have not been reproduced having regard to the meaning given to "subscribed for" by section 135(2).
485. The second of these changes is that the words "or by a nominee for an individual" have been added. These words reflect so much of section 250(1) as relates to the holding or disposal of shares by a nominee for an individual. In this way, the requirements of section 135 relating to the subscription for the shares by the individual are preserved, while recognising that the individual may have subsequently transferred the shares into the name of a nominee for the individual.
486. *Subsection (2)(a)* and *(b)* correspond to section 249(2)(a) and (b) and (4)(a) and (b), with the substitution of "this Chapter" for "this Part". As required by section 576(4B)(d) of ICTA, section 249(2)(c) and (d) and (4)(c) and (d) are not reproduced in this subsection. Section 150 applies for the purposes of subsection (2)(b) to determine the time of issue of the shares in certain circumstances.
487. *Subsection (2)(c)* is new. It expressly sets out the effect of sections 145 and 146. This is that, in determining whether the shares in the new company are, on their disposal, qualifying shares, any requirements of this Chapter for the new company to be a qualifying trading company which were met by the old company before the exchange are to be treated as met by the new company.

Section 147: Limits on share loss relief

488. This section deals with the calculation of the amount of share loss relief. It is based on section 576(1) of ICTA. It is the first of a group of three sections which apply generally for the purposes of this Chapter.
489. Section 576(1) of ICTA provides that, if a person disposes of shares for which the person has subscribed and which form part of a holding, the share loss relief in relation to those shares is not to exceed the sums which would have been allowable as deductions in computing the allowable loss for capital gains tax purposes if the shares had not formed part of the holding.
490. To cater for the abolition of pooling in relation to shares issued on or after 6 April 1998 and the changes in section 148 described in *Change 29* in Annex 1, section 147 refines the circumstances in which the provision applies. See *Change 26* in Annex 1.
491. *Subsection (8)* explains what is meant by shares "that are not capable of being qualifying shares" for the purposes not only of this section but also of section 148. *Change 27* in Annex 1 contains a detailed explanation of why a mixed holding is defined for the purposes of section 148 in terms of a holding which includes such shares.
492. *Subsection (9)* extends this meaning for the purposes only of *subsection (5)* to cover reorganisations involving the issue of shares of a different class.

Section 148: Disposal of shares forming part of mixed holding

493. This section deals with the identification of shares disposed of where those shares form part of a “mixed holding”. It is based on section 576(1) to (1B) and (5) of ICTA, with a number of changes.
494. Section 576(1) of ICTA defines a mixed holding as one which comprises shares for which a person has subscribed and shares which the person has acquired otherwise than by subscription.
495. *Subsection (1)* provides that this section applies to a holding in which some only of the shares are shares “that are not capable of being qualifying shares” (as defined in section 147(8)). See *Change 27* in Annex 1 which contains a detailed explanation of why a mixed holding has been defined in terms of a holding which includes such shares.
496. *Subsection (2)* provides that the section applies for the purpose of answering the questions:
- whether the shares disposed of are qualifying shares; and
 - which of any qualifying shares acquired at different times are disposed of.
497. This is a change from section 576(1) of ICTA, which is not expressed to apply for the purpose of determining which of any qualifying shares are disposed of. See *Change 28* in Annex 1.
498. *Subsection (3)* introduces the rules for determining the answers to the questions in subsection (2).
499. Section 576(1) of ICTA, on which subsection (3)(a) is based, identifies the shares disposed of on a last in first out (LIFO) basis. Section 576(1) of ICTA and its predecessor, section 37 of FA 1980, were enacted at a time when shares were pooled and treated as a single asset for capital gains tax purposes. Accordingly, it was and remains necessary to have a rule identifying the order in which shares in the pool are disposed of, in order to ensure that share loss relief is obtained only on the disposal of qualifying shares.
500. FA 1998 made changes to the identification rules in TCGA, as a result of which shares acquired on or after 6 April 1998 are not pooled but, on a disposal, are in most cases identified on a LIFO basis.
501. Taking account of those changes, subsection (3)(a) applies the FA 1998 rules (see *subsection (4)*) or, in the case of shares acquired on different dates before 6 April 1998, a specific LIFO rule (see *subsection (5)*). See *Change 29* in Annex 1.
502. Subsection (3)(b) is based on section 576(1A) of ICTA and applies the rules in *subsection (6)*, based on section 576(1B) of that Act, if the mixed holding includes any of:
- shares issued before 1 January 1994 to which business expansion scheme relief is attributable;
 - shares to which EIS income tax relief is attributable; and
 - shares to which EIS deferral relief is attributable.
503. *Subsection (7)* is new and puts on a statutory basis the practice under which questions which cannot be determined by the specific provisions of this section are to be determined on a just and reasonable basis. This subsection will principally be required in cases where some but not all of the shares of the same class acquired, or treated as having been acquired, on the same day are shares that are not capable of being qualifying shares. See *Change 29* in Annex 1.

Section 149: Section 148: supplementary

504. This section supplements section 148. It is new.
505. *Subsection (1)* corrects the absence of an amendment to section 299 of ICTA as applied by section 576(1B) of that Act consequential upon the enactment of section 105A of TCGA by FA 2002. It applies if an individual has a mixed holding which includes shares to which business expansion scheme relief, EIS income tax relief or EIS deferral relief is attributable.
506. *Subsection (1)* ensures that, if the individual makes an election for the alternative identification rule under section 105A of TCGA to apply for the purposes of capital gains tax on the disposal of shares in the holding where “approved scheme shares” are acquired on the same day as other shares of the same class, the alternative rule will also apply for the purposes of share loss relief. See *Change 30* in Annex 1.
507. *Subsection (2)* determines the time of acquisition for the purposes of section 148 of shares issued in a reorganisation within the meaning of section 126 of TCGA to which section 127 of that Act applies. See *Change 31* in Annex 1.
508. *Subsection (3)* clarifies that shares held or disposed of by a nominee or bare trustee for an individual are part of the individual’s holding for the purposes of section 148. See *Change 32* in Annex 1.

Section 150: Deemed time of issue for certain shares

509. This section contains provisions which determine the time of issue of shares for the purposes of the provisions listed in *subsection (1)*. It is based on section 574(3) of ICTA.
510. *Subsection (2)* mirrors section 135(3) and applies in cases where the shares have been transferred to an individual by that individual’s spouse or civil partner. See *Change 33* in Annex 1.
511. *Subsection (3)* mirrors section 135(4) and applies to corresponding bonus shares. See *Change 34* in Annex 1.

Section 151: Interpretation of Chapter

512. This section explains the meaning of expressions used in this Chapter. It is based on section 576(5) of ICTA.
513. *Subsection (1)* includes the definition of “corresponding bonus shares”. *Subsection (2)* amplifies that definition. See *Change 23* in Annex 1.
514. The introduction of sections 137 to 146 makes it necessary to ensure that the word “shares” has the same meaning in those sections as it does in the sections of Part 5 to which they correspond with modifications. Accordingly, *subsections (3) to (6)* provide that the application of the definition of “shares” in *subsection (1)* is subject to the exceptions mentioned in section 576(5) of ICTA, those required for the purposes of sections 137 to 146 of this Act and those required for the purposes of section 147 as a result of the changes described in *Change 26* in Annex 1.
515. *Subsection (8)* is new and clarifies that the date of disposal is the time when the disposal is made or treated as made for the purposes of the capital gains tax legislation. See *Change 35* in Annex 1.