

## **Annuity Income Shares**

Further to the Association's circular of 23 September 1996 I summarise below the views of the Taxation Committee on the question of whether annuity income shares ('AISs') issued by investment trust companies ('ITCs') are wasting assets for the purposes of capital gains tax. The Appendix to this circular sets out the background to this issue and the tax consequences of an AIS being treated as a wasting asset.

- 1 The Committee's view is that the question of whether or not an AIS is a wasting asset is essentially a question of fact rather than law. Although the legislation concerned with wasting assets was clearly not originally aimed at shares, there is nothing within the tax legislation which precludes it from applying to shares.
- 2 The Inland Revenue have indicated, and the Committee agrees, that the question of whether or not an AIS is a wasting asset can only be determined on the individual facts of each case. The Committee has therefore concluded that it is not worth pursuing correspondence with the Inland Revenue on this issue.
- 3 The Committee believes that the Association should not lobby for a change in the legislation to exempt AISs from the wasting asset provisions on the grounds that such lobbying is unlikely to be successful.
- 4 The Committee believes the opinion expressed by the Inland Revenue in their correspondence of 23 July 1996 (copy attached) should not be taken as indicating that the Inland Revenue believe that all AISs are wasting assets, as this conclusion was based on specific examples put to the Inland Revenue. Whilst not necessarily agreeing with the conclusions drawn by the Inland Revenue, the Committee believes that the circumstances surrounding the issue of particular AISs could be such that it was not possible to say that their predictable life at the time of issue was less than 50 years.
  - 4.1 For example, it is often the case that the prospectus of a fixed life ITC will indicate that, when an ITC is liquidated, the shareholders who do not wish to

realise their investment in cash may be offered replacement shares in another ITC and so be able to roll over their gains into such shares. Under the legislation covering the taxation of capital gains, such shares are deemed to be the same asset as the original shares. There is therefore an argument that if such rollover opportunities are written into the terms of the issue, the shares, for the purposes of capital gains, have an existence capable of exceeding 50 years and that therefore their predictable life cannot be said to be less than 50 years. This argument has not been specifically put to the Inland Revenue.

- 5 The Committee therefore recommends that Member companies take their own tax advice regarding the tax treatment of such shares on a case by case basis.

25 March 1997

Ian Sayers  
Taxation Adviser

## ANNUITY INCOME SHARES (“AISs”)

### Background

AISs are issued by split capital investment trusts. The shares are entitled to all the income from the assets and their issue price is significantly greater than their future redemption value, which is fixed and normally of a nominal amount. As such, on redemption (or sale) a loss arises to the investor being the difference between the issue price and the redemption price (or sales price). The question arises as to whether this loss is also a capital loss which the investor could offset against other capital gains.

### Wasting Assets

Any capital loss on disposal could be restricted if the AIS is a ‘wasting asset’. A wasting asset is defined as ‘an asset with a predictable life not exceeding 50 years’.

If an AIS is a wasting asset then, in computing any capital gain or loss on disposal, the base cost of the asset (allowable as a deduction) is calculated by the following formula:

$$C - \frac{T \times (C - R)}{L}$$

Where:

L is the predictable life of the asset

T is the length of time between the acquisition and disposal of the asset

R is the predictable residual value of the asset at the end of its predictable life

C is the acquisition cost of the asset

### Example

A shareholder subscribes for 10,000 AISs at £1 each. The shares will be redeemed in 10 years time at 1 pence per share and the shareholder holds the shares until redemption.

If the AIS is a wasting asset the shareholder's capital gains position would be:

Redemption proceeds (10,000 x 0.01)		100
Base cost:		
	$1 - \frac{10 \times (1 - 0.01)}{10} \times 10,000$	= <u>(100)</u>
Capital gain / loss		<u>NIL</u>

If the wasting asset provisions did not apply then the shareholder would have a capital loss equal to redemption proceeds less original cost (i.e. £100 - £10,000 = £9,900).