

Goodwill and S165 TCGA 1992 relief (Lecture P1369 – 22.22)

S165 TCGA 1992 deals with holdover relief for gifts of business assets. A gift is not an arm's length transaction and so the donor is treated for tax purposes as having sold the asset for its market value. If this produces a gain, a CGT charge will arise in the absence of a specific relief. However, this is where S165 TCGA 1992 comes in: the section provides that, on a claim, the relevant gain can be held over and deducted from the asset's acquisition cost in the hands of the donee. This prevents what is often referred to as a 'dry' tax charge. Thus, there is no CGT for the donor to pay. The donee will then use the reduced base cost when calculating the gain on any future sale of the asset.

The most common types of asset to benefit from holdover relief are shares or securities. By virtue of S165(2)(b) TCGA 1992, they must be part of the capital of a trading company or the holding company of a trading group where:

- the shares (or securities) are not listed on a recognised stock exchange; or
- the trading company or holding company is the donor's 'personal company'.

A personal company is one where the individual has at least 5% of the company's votes. Holdings in most privately owned trading companies will fall under one (or both) of these headings.

However, it is important to appreciate that there is a key restriction which can catch shares covered by S165 TCGA 1992. This restriction does not apply to the alternative holdover facility under S260 TCGA 1992 for transfers into and out of a trust. This sometimes means that trusts need to be considered as part of a taxpayer's planning strategy where holdover relief might otherwise be curtailed.

The particular feature of the holdover regime of which advisers are too often unaware is the restriction to the quantum of the relief where there is a gift of shares and the company owns chargeable assets which are not chargeable business assets. Confusingly, this legislation does not appear in S165 TCGA 1992 but rather is set out in Para 7 Sch 7 TCGA 1992 (which may explain why this quirk can easily be overlooked).

Where a company owns non-business chargeable assets (such as a quoted share portfolio) on the date of a gift transaction, the qualifying gain on that gift is calculated as follows:

$$\text{Gain} \quad \times \quad \frac{\text{Chargeable business assets}}{\text{Total chargeable assets}}$$

with the chargeable business assets and the total chargeable assets being valued at their market values on the date of the gift.

Illustration 1

On 1 May 2023, Eric gave his son, Francis, shares in the family trading company (Eric Enterprises Ltd). These shares had cost Eric £20,000 when he acquired them on 24 June 1990 and their market value was £340,000 on 1 May 2023.

Eric Enterprises Ltd owned assets with the following values on 1 May 2023:

Goodwill (pre-2002)	300,000
Freehold offices	645,000
Plant and machinery (cost £180,000)	55,000
Shares held as investments	250,000
Trade debtors	80,000
Cash	130,000
Sundry net assets	25,000

The company's chargeable business assets (CBA) and chargeable assets (CA) are:

	CBA	CA
Goodwill	300,000	300,000
Freehold offices	645,000	645,000
Plant and machinery	55,000	55,000
Investment shares	<u>—</u>	<u>250,000</u>
	<u>£1,000,000</u>	<u>£1,250,000</u>

Eric's gain on the gift of the shares to Francis is:

Market value as at 1 May 2023	340,000
Less: Cost	<u>20,000</u>
GAIN	<u>£320,000</u>

The gain which is eligible for holdover relief is:

	<u>1,000,000</u>		
£320,000	x	1,250,000	£256,000

The balance of Eric's gain (£320,000 – £256,000), £64,000 is immediately chargeable to CGT.

In this context, a business asset is an asset used for the purposes of the company's trade. A chargeable asset is one which, if it was sold for a profit, would give rise to a chargeable gain. Assets currently standing at a loss may still be chargeable assets, given that the test is whether, if sold at a profit, this would crystallise a gain. Items such as plant and machinery which, in practice, seldom produce a profit are nonetheless normally regarded as chargeable business assets (unless both the cost and current market value are below £6,000). When making these calculations, it is important to appreciate that the values used are those at the date of the gift rather than cost or book value.

It is worth pointing out that, if the company in Illustration 1 had sold its investments for cash immediately prior to Eric's gift, there would have been no restriction to the held over gain, given that cash is not a chargeable asset. The relevant fraction would then have become:

$$\frac{1,000,000}{1,000,000}$$

Eric's entire gain would have been eligible for deferral.

The critical issue these days is increasingly the position of goodwill. In Illustration 1, the pre-2002 goodwill was a chargeable asset (and therefore a chargeable business asset). However, if a company owns goodwill which was created or acquired on or after 1 April 2002, it has an intangible fixed asset which is dealt with under Part 8 CTA 2009 and is not a chargeable asset. This can bring about some surprising results. For example, if a company has post-2002 goodwill of £2,000,000 and non-business chargeable assets of £10,000 (but no other chargeable assets), the percentage to be used for any prospective held over gain is:

$$\frac{0}{10,000} = 0\%$$

The fundamental point, as the CIOT have highlighted, is that the relief for gifts of shares in trading companies 'is intended to be restricted to the extent that the company has assets that are not related to the trade'. Because the restriction in TCGA 1992 is couched in terms of chargeable assets (i.e., assets which fall within the CGT regime), this has the unintended impact of denying holdover relief where companies have substantial goodwill and other intangible fixed assets which were created or acquired on or after 1 April 2002. Any resulting gain on a gift of such shares is caught by the restriction, even though goodwill is manifestly not a non-trading asset.

The problem is that the rules in S165 TCGA 1992, which date back nearly 35 years, were drafted long before the concept of the intangible fixed assets regime was invented in 2002. It seems clear that all this was never the intended result of FA 2002, given that it disadvantages owners of more recently created businesses. In the words of the CIOT:

'There seems to be no policy reason why the legislation operates in this way. It can only be concluded that this is an inadvertent oversight from when the intangible fixed assets (provisions were) introduced in 2002 which has never been rectified.'

They continue:

'It is a problem that is likely to become more prevalent going forward when shareholders consider ownership succession of companies which have been established or have purchased valuable "new" goodwill (on or) after 1 April 2002.'

Two further examples are set out below. They cover:

1. a gift of shares where the company owns 'new' goodwill; and
2. a gift of shares where the company owns 'new' goodwill and chargeable business assets.

Illustration 2

Jonathan Logistics Ltd is a successful unquoted trading company which was incorporated in 2010. Over the years, profits have been reinvested in purchasing investment property so that the company now holds a substantial rental portfolio.

The company owns investment property worth £3,000,000 and the goodwill associated with its trade has been valued at £6,000,000. The company has no other chargeable assets and it is considered to be a trading company for CGT purposes.

On 1 June 2023, Jonathan gave his 10% shareholding, which was worth £400,000, to his son. The base cost of these shares was £10, resulting in a gain for Jonathan of £399,990.

When considering the restriction in Para 7 Sch 7 TCGA 1992, the holdover relief available is:

$$\begin{array}{r r r r} & & 0 & \\ & & \hline \pounds 399,990 & \times & & \pounds 0 \\ & & 3,000,000 & \end{array}$$

Jonathan and his son are not entitled to make a holdover relief claim under S165 TCGA 1992 and so the 2023/24 gain of £399,990 will be assessed in full.

Illustration 3

The facts are the same as in Illustration 2, but, instead of the £3,000,000 investment property portfolio, the company owns freehold property assets used in the trade which are worth £3,000,000.

The holdover relief available to Jonathan under S165 TCGA 1992 is now:

$$\begin{array}{r r r r} & & 3,000,000 & \\ & & \hline \pounds 399,990 & \times & & \pounds 399,990 \\ & & 3,000,000 & \end{array}$$

In this case, full holdover relief can be claimed by the parties, reducing Jonathan's gain to nil, and the restriction in Para 7 Sch 7 TCGA 1992 does not apply.

The absurdity of the situation is that the restriction is the same whether the company has £1 of chargeable assets which are not chargeable business assets or £3,000,000 of such assets.

This whole issue was discussed at a meeting of the Capital Taxes Liaison Group on 23 March 2022. Minutes of this meeting are available at:

www.gov.uk/government/groups/capital-taxes-liaison-group

Interestingly, HMRC confirmed their agreement that there was a problem, but noted that there had been no live cases brought up to demonstrate the point at issue. They needed to gather, they said, evidence on the extent of the predicament before any changes to the legislation could be justified.

With respect, it is hard to see the real need to obtain live examples when a clear legislative deficiency has arisen without an obvious policy intention being identified and when what the CIOT call 'perverse outcomes' are being produced.

The suggested amendment is that, in Para 7 Sch 7 TCGA 1992, the word 'chargeable' should simply be removed, thereby restricting relief by reference to the ratio of a company's business assets to its total assets. Let us hope that this is implemented sooner rather than later.

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