

Gift relief – What to remember (Lecture P1417 – 12.15 minutes)

As we approach the end of the tax year, this article reminds us of the tax consequences of making gifts and highlights the various 'I's which need to be dotted and 'T's which need to be crossed along the way.

Capital Gains Tax (CGT)

A gift is a disposal at market value by the donor (and to balance the equation, a similar acquisition at that same market value by the recipient).

Do not forget that that this is still the case even where the parties are not connected with each other. That includes transfers from an uncle to a niece or godparent to godson. Any gift which is not at "arm's length" takes place at market value.

Once a value has been established (more on this later...), we simply deduct CGT base cost and any expenses of transfer to arrive at the chargeable gain.

In the absence of any claim, the gain is chargeable to CGT in the usual way, meaning that there is a potential 'dry' tax charge with no cash to meet the liability.

Gift relief

Gift relief (or "holdover relief") may be available to help us out of this dry tax charge. However, gift relief is not a panacea and is not always available.

The tax code only provides for gift relief to be available to defer ('holdover') the gain in the following situations:

- On the gift of a business asset falling within TCGA 1992, S.165;
- On the occasion of a chargeable transfer for Inheritance Tax (most commonly a gift into a trust), s.260; or
- On a transfer of agricultural property (farmland) qualifying for agricultural property relief, Schedule 7, para 1.

Business assets

A "business asset" within TCGA 1992, S.165 includes:

- Shares in an unlisted trading company;
- Shares in the donor's personal trading company (being a company in which the donor holds 5% or more of the voting rights);
- Assets used in a trading business (for example, a sole tradership or partnership);
- Qualifying furnished holiday lets.

If the gift does not fall into any of the above categories, no gift relief is available, and CGT may fall due. This is typically the case for assets such as quoted shares, shares in non-trading companies or land and buildings used in a property investment business.

HMRC use the same test as for Business Asset Disposal Relief (BADR) to determine whether a business is “trading”. Remember here that we have now moved away from the blanket “20% test” which we previously applied to factors such as non-trading income and the value of non-trade assets and instead we take a more holistic approach to see whether any non-trading activities are “substantial” in the context of the activities of the business as a whole. If in doubt, HMRC can be approached for a non-statutory clearance.

Making a Gift Relief claim

Once it is established that gift relief is available, the next step is to make a claim.

The effect of the claim is (usually) to reduce the donor’s gain to zero and similarly reduce the donee’s CGT base cost by the same amount. In effect, the donor’s gain is rolled over and transferred to the donee meaning that the donee will take over the historic CGT base cost for a future disposal. No tax is saved here. We’re just kicking the can down the road by giving the inherent gain to the recipient.

But remember here that:

- Gift relief is not mandatory. Therefore, if the resulting gain is covered by capital losses or the annual exempt amount, not making a claim may be the correct call; and
- Gift relief is not available where a loss arises (only gains can be deferred).

Note also that where a gift to a connected person triggers a loss, that loss may only be used against gains on disposals to the same connected person in the same or future tax years. There is no sideways offset against general gains. In these cases, it may be better either retaining the asset, or selling it to a third party and gifting the cash (as these options will release the resulting loss for general use).

Gift relief claims generally require the consent of the recipient (the only exception to this being a gift into trust when the consent of the trustees is not needed).

To this end it is often good practice to get one’s ducks in a row before the asset in question is formally signed over by organising the gift relief claim forms to be signed and placed on file pending submission to HMRC. Indeed, making consent to a gift relief claim a condition of the asset transfer is never a bad idea.

Claims are typically made on the hold-over claim form which you will find on the HMRC website alongside HMRC Helpsheet 295. A separate claim is needed for each gifted asset. The form is self-explanatory and is typically printed off and completed by hand, then scanned-in along with the self-assessment return for the year in which the gain is made. Or you can go “old school” and pop it in the post.

The formal deadline for making a gift relief claim is four years from the end of the tax year in which the gift took place. However, this time limit is rarely relevant as failing to make the claim by the normal SA deadline will trigger a demand by HMRC for the tax.

Page 2 of the claim form contains a “request for valuations to be deferred”. We all know that obtaining an open market value for an asset can be a difficult, painstaking and tiresome process, particularly where assets such as family company shares are concerned. And professional valuation fees are rarely cheap.

To this end HMRC SP 8/92 recognises that where a gain arises on a gift and that gain is to be fully deferred, the value of the asset transferred is largely immaterial since the donee will simply take over the asset at its historic CGT base cost. Therefore, in these cases, no formal valuation is required. All the donor needs to do is provide details of the date of the transfer and the CGT base cost of the asset together with the names, addresses and UTRs of the transferor and transferee.

Oddly box 4 does ask us to provide the “Value of asset at date of transfer” which seems strange given that we are asking for a valuation to be deferred.

However, HMRC are just wishing to content themselves here that the value in box 4 is above the CGT base cost of the asset gift such that a gain of some sort arises. They nor we care what that gain is. This value can therefore be no more than a “best guess” and is by no means binding on the taxpayer going forward.

Gift relief restrictions

Sometimes a gift relief claim does not reduce a chargeable gain to zero. This will be the case where either:

- a) The donor gives away shares in a personal trading company and the company holds chargeable assets which are not used in its business;
- b) The donor gives away an asset used in a sole trade or partnership business which has either been previously used for a non-trade purpose or partly used for a non-trade purpose; or
- c) The donee pays the donor for the asset and the amount of consideration exceeds the donor’s CGT base cost.

In each of these cases the donor is likely to be left with a chargeable gain (and accordingly the amount of the holdover gain is also reduced). In the case of c) above, the passing of consideration could also bring with it a charge to Stamp Duty / SDLT depending on the asset in question (which is again easy to miss in all the excitement).

In these cases, HMRC will not allow a valuation to be deferred under SP 8/92 on the basis that they will need to know the chargeable gain before holdover relief is applied.

CGT by instalments

One often overlooked point here is that if a gift takes place and either gift relief cannot be claimed (due to the nature of the asset gifted) or a gift relief claim is made but relief is restricted and a chargeable gain arises, CGT can in some cases be paid by instalments.

The instalment option is only of limited use because:

- a) it only applies to gifts of land and buildings and shares in unlisted companies and
- b) the instalments are interest bearing.

But it can help alleviate the cash flow difficulties of a dry tax charge. If a claim is made, the CGT is paid in ten annual instalments.

Post transaction valuation check

You should also be aware of the CG34 “post transaction valuation check” procedure here if a valuation is required. This permits the taxpayer to approach HMRC to agree a valuation after the transfer has taken place but before the SA return is filed in order to provide certainty over the resulting tax liability by the date of payment.

Google the form, download it, fill in it and make sure it is with HMRC at least three months before the filing date for the relevant return. A separate form is required for each valuation. And as long as you have disclosed all the relevant details, HMRC’s opinion on the valuation will be binding.

Gifts to Trust

If a client has an asset which is to be the subject of a gift but does not tick any of the “business asset” boxes in S.165, the gain can still be deferred with a transfer into trust. This is because TCGA 1992 S.260 provides general holdover relief where a transfer gives rise to an immediate charge to Inheritance Tax (IHT).

Nowadays it does not normally matter what type of trust you choose as long as it’s not a bare trust (which isn’t a trust for CGT) or a qualifying disabled person’s trust (as gifts into these are potentially exempt transfers which are not immediately chargeable). But otherwise, a gift of any asset into a discretionary or interest in possession (IIP) trust will open up a claim to gift relief. Well...most of the time.

There are a couple of caveats to this you need to be aware of:

1. Your trust needs to be UK resident (in simple terms it should have UK trustees). There is an exception for gifts of UK land and buildings where gains can be deferred on a gift to a non-UK trust on the basis that the asset will remain within the charge to UK CGT under the Non-Resident Capital Gains (NRCG) rules;
2. There is no gift relief if the trust is “settlor interested”. Be careful here as the definition of a ‘settlor interest’ for CGT is wider than it is for income tax and includes not only the settlor and their spouse but also any minor unmarried children of the settlor. And you can’t swerve the rules by excluding minor children then sneakily adding them in as beneficiaries once the dust has settled. If the trust becomes settlor interested within six tax years, the heldover gain becomes chargeable.

Note that for a S.260 claim to be made, the transfer needs to be chargeable to IHT although there is no requirement for an IHT liability to arise. This means that transfers falling within the settlor’s nil rate band or transfers covered by IHT reliefs (such as BPR and APR) would still qualify for gift relief. The good old ‘nil band discretionary trust’ here defers CGT without creating an IHT charge.

If an IHT liability does arise, the CGT base cost of the asset in the hands of the trust can be increased by the IHT attributable to that asset (this applies whether or not a holdover claim is made). Effectively the IHT is treated as an incidental cost of acquisition for CGT. Again, this is a valuable relief which is often overlooked.

Private residences

Finally, be careful with private residences going into trust. This is not a CGT point per se, but if there is a mortgage on the property, you are likely to get push back from the lender if you want to transfer that asset into trust and take the mortgage along with it. Computer invariably says 'no'.

Also, if you do gift a property into trust and take the S.260 gift relief on offer, on a subsequent sale of that dwelling house by the trustees, no private residence relief will be available.

Therefore, if the property going into trust is likely at some point to become the main residence of one of the beneficiaries, it is prudent to forsake the CGT holdover on entry in return for much more valuable private residence relief further down the line.

The same principle applies for a dwelling house gifted to a beneficiary by a trust as a S.260 claim at that point will preclude a later private residence relief claim by the beneficiary.

Again, this underlines the principle that just because gift relief is available, it doesn't always mean you have to take it.

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