

Gifts and gift relief: Some pitfalls (Lecture P1264 – 11.44 minutes)

Gift relief: Background

Where an individual makes a gift of chargeable assets (e.g. land and buildings or shares), they are generally treated as having received disposal proceeds equal to the market value of the asset for capital gains tax (CGT) purposes (TCGA 1992, ss 17, 18).

However, the effect of relief for gifts of business assets in TCGA 1992, s 165 (where the relief conditions are satisfied and a claim is made) is broadly to hold over all or part of the CGT liability that would otherwise arise on the gift of a chargeable asset, normally until a later disposal by the recipient of the gift.

Foreign-controlled companies

Gift relief is subject to various restrictions and anti-avoidance provisions, one of which was amended by legislation published in Finance Act 2021. This amendment concerns gifts to foreign-controlled companies (TCGA 1992, s 167).

Prior to the above amendment, the legislation provided that gift relief was not available (subject to an exception for gifts of direct or indirect interests in UK land to non-residents) if the transferee was a company ‘...controlled by a person who, or by persons each of whom—

- a) is not resident in the United Kingdom, and
- b) is connected with the person making the disposal.’

In *Reeves v HMRC* [2018] UKUT 293 (TCC), the Upper Tribunal concluded that attributions of interests in this context are limited to connected persons who ‘control’ the recipient company, essentially by being able to exercise direct or indirect control over the company’s affairs, and/or by possession or entitlement to acquire the greater part of the share capital, voting power or assets and distributions on winding up. The existence of non-resident relatives who were otherwise not involved in the company was held not to preclude the availability of the relief.

The effect of the amendment is that gift relief is denied if the company is controlled by the same individual who made the disposal. Consequently, for disposals from 6 April 2021, a non-UK resident individual with a UK trade would be unable to incorporate by transferring the trade to a wholly-owned UK company and claiming gift holdover relief on a gain arising from the disposal of the goodwill. This measure effectively blocks gift relief in similar circumstances to the *Reeves* case.

The A/B reduction

In certain instances involving gifts of shares, a held over gain may be reduced or completely eliminated. This can arise if the company’s assets include chargeable non-business assets.

If the donor of the shares was able to exercise at least 25% of the company's voting rights in the 12 months prior to the disposal, or if the donor is an individual and the gifted shares were in a company which was the individual's personal company within that 12-month period, the held over gain is reduced by the fraction A/B, where:

- A = market value of the company's chargeable business assets at the time of the share disposal; and
- B = market value of all chargeable assets of the company (TCGA 1992, Sch 7, para 7).

Example: Business and investment assets

Adam gave his 100% shareholding in Widgets Ltd to his adult daughter, Brenda. The shares were acquired for £100 and are now worth £1 million.

At the date of disposal, the market value of Widgets Ltd's assets are:

Trading premises - £600,000;

Quoted share investments - £200,000; and

Cash - £200,000.

Applying the formula A/B, Adam's held over gain (ignoring the £100 base cost of the shares, and the cash as it is not chargeable to CGT) is:

$$£1 \text{ million} \times £600,000/£800,000 = £750,000$$

Adam therefore has a chargeable gain of £250,000.

A further problem arises if (say) the company's business commenced after the introduction of the intangible fixed assets provisions from 1 April 2002. Suppose that in the above example, Adam's company was a consultancy business set up in 2010, and instead of the company owning business premises of £600,000, it had goodwill with a market value of £600,000.

Applying the formula A/B, the held over gain reduction becomes:

$$£1 \text{ million} \times £0/£200,000 = £1 \text{ million}$$

This position might be prevented if the company sold its chargeable investment assets for cash some time prior to the gift of shares, such that the company would have had no chargeable assets at the date of the share disposal. Hence, holdover relief would not be subject to restriction.

Gifts and interest relief

Individuals can claim income tax relief in respect of interest paid on commercial loans borrowed for various purposes. One such purpose is to buy shares in a close company, where certain conditions are satisfied (ITA 2007, ss 392-393). Those conditions include that when the interest is paid, the company is not a 'close-investment holding company', and the individual meets a 'capital recovery' condition and either a 'full-time working' or a 'material interest' condition.

The 'capital recovery' condition is broadly that between the making of the loan and the payment of the interest, the individual has not recovered any capital from the company (other than to repay their own borrowing, as the loan interest would be reduced in any event). If this condition is not met, the individual is treated as if they had used the capital recovered to repay their borrowing, whether or not it was actually repaid. The eligible interest paid is reduced by an amount equal to interest on the capital recovered and ceases to qualify for income tax relief from the date the capital was recovered.

There is a potential trap here for gifts or sales at undervalue. If the shares are sold and the disposal proceeds are not at arm's length, the proceeds are treated as being equal to the market value of those shares (ITA 2007, ss 406-407). In HMRC's view, this market value rule applies even if the shares are gifted (see HMRC's Savings and Investment manual at SAIM10250).

Thus if (say) the market value of gifted shares exceeds the amount of the outstanding loan, interest relief thereafter will be lost entirely.

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