Divorce: A holdover relief pitfall

(Lecture P1218 – 10.02 minutes)

Background

As a general rule, where one unconnected individual gifts a capital asset to another individual, the gift is treated for CGT purposes as having been made at market value (TCGA 1992, s 17(1)).

However, there is a relatively well-known exception to this general rule, which applies in the case of transfers between spouses (TCGA 1992, s 58). This states that where the spouses are living together in the tax year and one of them disposes of an asset to the other, they are both treated as if the asset transfer was for consideration deemed to give rise to neither a gain nor a loss.

Separation and divorce

Care is needed when inter-spouse transfers of assets are made in the tax year following separation. This is because for CGT purposes 'no gain, no loss' treatment is not available; however, the individual is still connected with their spouse (TCGA 1992, s 286(2)).

This brings the CGT rule for transfers between connected persons (in TCGA 1992, s 18) into play. The connected persons rule broadly means that disposals and acquisitions of assets between spouses are treated as having been made otherwise than by way of a bargain at arm's length.

When the couple divorces, their connection ends for CGT purposes. This means that the market value rule no longer applies automatically (unless exceptionally the individuals are connected for other purposes, such as by being business partners).

Holdover relief

If there is a genuine gift of a business asset (or a transfer at undervalue), CGT holdover relief (under TCGA 1992, s 165) will potentially be available. If the transfer is not a pure gift but a transfer at undervalue (in other words, if some consideration is given, but it is less than market value), unrestricted holdover relief may still be available if the proceeds are less than the base cost of the business asset (TCGA 1992, s 165(7)).

However, no gift relief is available if market value consideration is given for the business asset. Unfortunately, there is no statutory definition of 'consideration' for CGT purposes. In practice, 'consideration' can include not only cash but also non-cash assets.

HMRC guidance and case law

Until relatively recently, HMRC guidance (in its Capital Gains manual, at CG67192) stated that where a court makes an order (such as under the Matrimonial Causes Act 1973), HMRC's view was that the transferee spouse did not give actual consideration in the form of surrendered rights, for the transfer. This was on the basis that the court order reflected the exercise by the court of its independent statutory jurisdiction and was not the consequence of one party to the divorce agreeing to surrender rights in return for assets. As there was no consideration, HMRC accepted that there would be no restriction in holdover relief if the assets transferred were business assets.

This approach followed judicial observations made G v G [2002] EWHC 1339 (Fam). Although this case was a divorce case, the following observation was made in the context of holdover relief for CGT purposes:

> "[43] This transfer is ordered on the footing that business hold-over relief will be available to the husband; that the wife will receive the shares at the husband's base value; and that, accordingly, no liability to CGT will arise on the husband as a result of the transfer. I have seen an extract from an Inland Revenue manual which confirms that a court-ordered transfer of business assets does in principle satisfy the conditions for a claim for hold-over relief; but which goes on to suggest that actual consideration given by the donee may reduce the gain potentially eligible to hold-over relief to nil. The view of the Inland Revenue appears to be that the actual consideration is the surrender by the donee of rights, which she would otherwise be able to exercise to obtain alternative financial provision. I do not share their view about that and I have to say that this view seems to me to be based on a misconception."

However, HMRC's view subsequently changed. Its current view (at CG66886) is that where the court makes an order (e.g. for ancillary relief under the Matrimonial Causes Act 1973, which results in a transfer of assets from one spouse to another):

> '...then, following Haines v Hill [2007] EWCA Civ 1284, the court's order quantifies the value of the applicant spouse's statutory right by reference to the value of the money or property ordered to be transferred by the respondent spouse. The value of the statutory right surrendered is actual consideration for the assets received, which may restrict or preclude the availability of hold-over relief on the transfer.'

As indicated, HMRC's change of view on the availability of holdover relief follows the decision in Haines v Hill.

Haines v Hill

In Haines v Hill (a case on bankruptcy law and its interaction with matrimonial law), the transfer of an interest in a property in a divorce settlement was held to be a transaction made for consideration in money or money's worth for the purpose of bankruptcy law.

HMRC's view now appears to be that a court order quantifies the value of the applicant spouse's statutory right, by reference to the value of the money or property ordered to be transferred by the respondent spouse. Accordingly, the value of the statutory right surrendered represents actual consideration for the assets received, which may restrict or preclude the availability of holdover relief on the transfer of business assets

However, in an article ('Dispensing the correct treatment') by Robert Maas in Taxation on 16 January 2000, Robert questions HMRC's guidance at CG66886 and the effect of Haines v Hill in the context of holdover relief under TCGA 1992, s 165. Accordingly, taxpayers and advisers will need to decide whether to accept HMRC's guidance and its interpretation of Haines v Hill, or to adopt the reasoning in Robert Maas' article, when considering the approach to adopt in respect of any claim for holdover relief on the transfer of business assets upon divorce.

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