CHAPTER 24

GIFT RELIEF - RESTRICTIONS

24.1 Restrictions for non business assets

Gift relief will not always be available to completely wipe out the capital gain. **Sometimes gift relief is restricted**. The most common example when full gift relief will not be available, is where a donor gives away **shares in his personal company**, and that **company holds "non-business assets".**

If this is the case, the amount of the gain which qualifies for gift relief is restricted by the following fraction:

$$\text{Gain eligible for gift relief} = \frac{CBA}{CA} \times \text{gain}$$

TCGA 1992, Sch 7 para 7(1)

CBA is the market value of the company's chargeable business assets.

CA is the market value of the company's chargeable assets.

This restriction only applies where a donor and donee are making gift relief claims under Section 165. Where a donor is giving shares to a trust and is claiming gift relief under Section 260, there is no such restriction.

Also note that this restriction only applies to gifts of shares in the donor's **personal company**. As such, we only need to consider "CBA over CA", where the donor has **at least 5%** of the shares in the company.

24.2 Chargeable assets and chargeable business assets

In the fraction restricting gift relief above, "CBA" is the market value of the company's chargeable business assets and "CA" is the market value of the company's chargeable assets.

A **chargeable asset** (CA) in this context, is any asset which is chargeable to capital gains tax. Therefore, assets such as stock or debtors or cars are non-chargeable assets, as they are outside the scope of CGT. Chargeable assets will include land and buildings, goodwill, plant and machinery or other assets held for investment purposes such as rental properties and shares.

TCGA 1992, Sch 7 para 7

A **chargeable business asset** (CBA), is a chargeable asset used for business purposes. An asset is used for business purposes if it helps the company generate profits which will be taxed as trading income.

An example of a chargeable asset which is not used in the business, would be shares held for investment purposes, as these produce dividend income. Buildings which are let out and produce rental income would also be non-business assets.

Therefore to calculate the gain that qualifies for gift relief, we must look at the balance sheet of the company at the date of the gift. This will give us our figures of "CBA" and "CA", and help us calculate the gift relief available.

Illustration 1

Danny owns shares in McNamara Ltd. McNamara Ltd is Danny's personal company where he has worked full time. Danny bought his shares in December 1994 for £100,000. He gave them to his daughter in December 2010 when they had a market value of £250,000.

The balance sheet of McNamara Ltd at December 2010 is as follows:

	£
Premises	390,000
Machinery	2,500
Car	4,000
Shares in listed companies	10,000
Stock and cash	3,500
Total	£410,000

As Danny is giving away shares in a personal company, gift relief will be available to defer his capital gains. However before we can calculate the gift relief, we must identify the chargeable assets and the chargeable business assets of McNamara Ltd. We start with chargeable assets.

The premises are chargeable assets. Land and buildings are chargeable to CGT.

Plant and machinery, in this context, is not a chargeable asset. The machinery is valued at £2,500. This asset will be treated as exempt under the chattels rules, because no gains arise if a chattel is sold for proceeds of less than £6,000.

The car is an exempt asset for CGT. The shares in listed companies are chargeable assets. Stock and cash are not chargeable assets for CGT – if a company sells stock it generates trading profits rather than a capital gain.

The total value of the chargeable assets is therefore the value of the premises, plus the shares – these add up to £400,000.

We need to identify which of these chargeable assets are used in the business. The premises are used for business purposes. However, the shares will not be regarded as business assets. The shares will generate dividend income rather than trading profits, so they will not be chargeable business assets. Therefore of the £400,000 of chargeable assets, chargeable business assets total £390,000.

		CAs	*CBAs*
Premises	390,000	√	√
Machinery	2,500	X	
Car	4,000	X	
Shares in listed companies	10,000	√	X
Stock and cash	3,500	X	
Total	£410,000	£400,000	£390,000

We now have enough information to calculate Danny's chargeable gains. We start by calculating the gain:

	£
Proceeds (MV)	250,000
Less: cost	(100,000)
Gain	£150,000

We next work out how much of this gain qualifies for gift relief, by taking the gain, and multiplying it by the fraction CBA/CA.

$$\text{Qualifying gain: } £150{,}000 \times \frac{390}{400} = £146{,}250$$

We can now deduct this from the gain. Any gain remaining after a gift relief claim, will be chargeable to tax.

	£
Gain	150,000
Less: gift relief	(146,250)
Chargeable gain	3,750

Entrepreneurs' relief will be available in respect of the remaining gain as Danny had worked in the business. We'll consider this in more detail at the end of this session.

Danny's daughter is deemed to have bought the shares for their market value of £250,000. The £146,250 of deferred gain is transferred over and reduces the base cost of the donee. The daughter therefore acquires the shares as at the date of the gift with a base cost as follows:

	£
Cost	250,000
Rolled over gain	(146,250)
Base cost	£103,750

24.3 Restriction for sales at undervalue

TCGA 1992, s. 165(7)

The second occasion where full gift relief will not be available, is in the instance of a "sale at undervalue". A "sale at undervalue" means the donee will pay the donor for the transfer of the assets. However the **amount paid by the donee is less than the market value** of the asset at the date of the gift. Therefore we have a sale, but the consideration is less than market value.

A sale at undervalue is **treated as a gift** for CGT purposes. As with all gifts, we calculate the capital gain by **assuming sale proceeds are the market value** of the asset at the date of the gift. This means that when calculating the capital gain, we completely ignore any actual proceeds changing hands.

Assuming the asset being transferred is a business asset, gift relief will be available to reduce this gain. The amount of the gift relief will then be rolled over and deducted from the donee's base cost.

In many instances, a sale at undervalue will result in gains being left chargeable after a gift relief claim has been made. In this instance, the **gain will be equal to the "excess proceeds":**

Excess proceeds = Cash received - Base cost /March 1982 value

If the donor makes a **cash profit** on the sale at undervalue, this profit will be **immediately charged** to capital gains tax.

Illustration 2

Phil bought a building for £30,000 in March 1987. In September 2010, Phil transfers the building to Jamie when it is worth £100,000. The building is used in Phil's trade and is therefore a qualifying asset under s.165.

Jamie pays Phil £40,000 for the asset in September 2010. We therefore have a sale at undervalue, because the amount that Jamie pays to Phil for the asset is less than its market value.

The first thing we do is calculate Phil's capital gain.

	£
Proceeds (MV)	100,000
Cost	(30,000)
Gain	£70,000

We now consider gift relief. Where we have a sale at undervalue, we must consider whether Phil has "excess proceeds". Phil actually sold the asset for £40,000, having paid £30,000 for the asset in May 1987. Phil is therefore making a **cash profit of £10,000**. This is his gain which is taxed in the usual way.

The difference between Phil's gain and his chargeable gain, is the gift relief, which will be rolled over and deducted from Jamie's base cost.

	£
Gain	70,000
Less: Gift relief	(60,000)
Chargeable gain £(40,000 – 30,000)	10,000

	£
Cost	100,000
Less: Rolled over gain	(60,000)
Base cost	£40,000

Note here that the £40,000 paid by Jamie to Phil for the asset, is only relevant for the purposes of working out how much gift relief is given to Phil. If there are **no excess proceeds** – i.e. the gift is **an outright gift**, or if Jamie had paid Phil less than £30,000 for the asset – **full gift relief** is available.

24.4 Interaction with entrepreneurs' relief

A gain on a gift may be **eligible for both gift relief and entrepreneurs' relief**. This would apply, for example, where a sole trader is gifting the whole of his business or where shares are gifted in a personal trading company in which the donor works.

Where a gain is eligible for both gift relief and entrepreneurs' relief, **gift relief is applied first**. Therefore, if the full gain qualifies for gift relief and a claim for gift relief is made, entrepreneurs' relief will not apply as there is no gain left in charge.

If part of the gain in respect of a gift remains chargeable after a claim for gift relief, entrepreneurs' relief can be claimed on the balance. This assumes that the gift meets the conditions of a qualifying disposal for entrepreneurs' relief purposes.

Gift relief claims are not mandatory and a taxpayer may prefer not to make a gift relief claim and instead allow the full gain on a gift to qualify for entrepreneurs' relief. This may be the case if, for example, the recipient of the gift will not be eligible to claim entrepreneurs' relief on a subsequent disposal and will therefore be taxed at a higher rate on the deferred gain.

Illustration 3

Steven, owns the entire share capital of Smith Enterprises Ltd, a family trading company, for which he has worked as a director for many years. The base cost of his shares is £280,000. He is a higher rate taxpayer

In July 2010, Steven sold the shares to his son Tom for £400,000. Tom also works for the company. Steven's shares were worth £900,000 in July 2010.

The disposal qualifies for gift relief and entrepreneurs' relief and Steven decides to claim both. Steven makes no other disposals in 2010/11.

The capital gains tax computation is as follows:

	£
Market value	900,000
Less: Base Cost	(280,000)
Gain	620,000
Less: gift relief (S.165)	(500,000)
Chargeable gain £(400,000 – 280,000)	120,000
Less: Annual exemption	(10,100)
Taxable gain	£109,900
CGT @ 10%	£10,990

The decision as to whether or not to claim gift relief and/or entrepreneurs' relief will depend on the facts of each particular case. It will involve the consideration of a number of factors, for example, the rate of tax paid by the donor and the recipient, the availability of losses and the annual exemption, and whether the recipient can claim entrepreneurs' relief on a future disposal.

Example 1

Dad gives away shares in Dad Limited to his son. The shares are worth £200,000 at the date of the gift. Dad paid £120,000 for the shares.

Dad Limited has chargeable assets of £500,000 of which £440,000 are used in the business.

What is the base cost of the shares for the son if gift relief is claimed?

Example 2

Bernard sold 1,000 shares (a 30% holding) in Widget Ltd, an unquoted trading company, to his niece Zoe in February 2011. The shares were worth £90,000. Zoe paid £48,000 for the shares.

Bernard had bought the shares in 1980 for £20,000. They were worth £25,000 in 1982.

Assuming Bernard and Zoe make a gift relief claim, calculate the amount of Bernard's gain that can be deferred under gift relief.

Answer 1

Dad's gain before reliefs is:

	£
Proceeds	200,000
Cost	(120,000)
Gain	80,000

Qualifying for gift relief = £80,000 x 440/500 = £70,400

The son is deemed to have bought the shares for their market value of £200,000.

The £70,400 of deferred gain is transferred over and reduces the base cost of the donee.

The son therefore acquires the shares as at the date of the gift with a base cost as follows:

	£
Cost	200,000
Rolled over gain	(70,400)
Base cost	£129,600

Answer 2

Proceeds (MV)	90,000
Less: cost	
Less: 1982 value	(25,000)
	65,000
Less: gift relief	(42,000)
Gain £(48,000 – 25,000)	£23,000

The amount that can be deferred is **£42,000.**