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Capital Gains Tax – Relief for Gifts of Business Assets

Spring Budget 2023 representation by the Chartered Institute of Taxation

1 Executive Summary

1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

1.2 This Budget Representation focusses on the transfer of shares in a trading company and a specific consequence that arises for companies which have both trading and non-trading activities and assets, due to the way the legislation in section 165 Taxation of Capital Gains Tax Act (TCGA) 1992 is drafted.

1.3 Section 165 TCGA 1992 concerns holdover relief for gifts of business assets. A gift is not an arm's-length transaction, so the person making the gift is treated for tax purposes as selling the asset at its market value. If this produces a gain, in the absence of a specific relief, a capital gains tax (CGT) charge will arise. However, s165 provides that the gain can be held over and instead deducted from the asset's acquisition (base) cost in the hands of the person receiving the gift. The person who received the gift will use this reduced base cost when calculating the gain on any future sale of the asset.

1.4 There is however a restriction to the amount of section 165 gift relief available when the gift is of shares in a company which owns non-business assets, as provided for by paragraph 7 of Schedule 7 TCGA 1992.

1.5 Where a company owns non-business chargeable assets and assets which are not chargeable assets such as intangible fixed assets, like goodwill, care needs to be taken when calculating the gain eligible for gift relief as the application of the non-business asset restriction can result in unexpected tax charges.

1.6 In theory, a trading company which holds intangible fixed assets and no chargeable assets used in the business could technically own as little as £1 of non-business chargeable assets and no gift relief would be available for the shareholder when gifting shares in the company. In fact, the restriction would be the same whether

the company has £1 of non-business assets, or £2 million. The position is illustrated by three simple examples set out in section 4 below.

1.7 The fundamental point, however, is that the relief for gifts of shares of trading companies is intended to be restricted to the extent that the company has assets that are not related to the trade. This restriction is couched in terms of chargeable assets (ie assets subject to CGT), which has the unintended impact of denying relief where companies have substantial goodwill and other intangible fixed assets that were created or acquired on or after 1 April 2002. These assets are dealt with under Part 8 CTA 2009, the 'corporate intangibles' regime, and are not chargeable assets, so they can be caught by the restriction of gift relief, even though they are clearly not non-trading assets.

1.8 As section 165 predates the intangible fixed assets regime, it seems clear that this was not the intended result as it disadvantages owners of newer businesses. 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 regime was introduced in 2002, which has never been rectified.

1.9 We suggest that a legislative amendment to paragraph 7 of Schedule 7 is explored to rectify the problem. Our suggestion is that the word 'chargeable' could be removed from the paragraph. We discuss this further in section 6 below.

1.10 The issue was the subject of an article in Tax Adviser magazine in July 2021 entitled 'An unintended pitfall?'[1] A follow up article by the same author will be published in Taxation magazine in February 2023. It was also discussed with HMRC at the Capital Taxes Liaison Group (CTLG) meeting on 23 March 2022. The minutes of that meeting have been published on GOV.UK[2] and we refer to them in this representation.

1.11 In some cases it may be possible to put in place arrangements to mitigate the restriction to the relief that might otherwise arise. This was explored briefly in the Tax Adviser article. However, such arrangements are likely to be costly and complex. Ultimately, the issue is the application and drafting of the business asset gift relief legislation.

1.12 We would also point out that 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 after 1 April 2002.

1.13 Following the Government's decision to abolish the Office of Tax Simplification, and to embed simplification in HM Treasury's and HMRC's tax policy work going forward, we would urge the Government to consider rectifying the deficiency we have identified in the gift relief legislation so as to produce a simpler operation of the rules and clearer, more certain and fairer outcomes for businesses affected by them.

2 About us

2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it –

[1] https://www.taxadvisermagazine.com/search/node/cassandra%20graham
[2] https://www.gov.uk/government/groups/capital-taxes-liaison-group

taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

2.5 Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

3 The issue

3.1 Relief for gifts of business assets is provided by section 165 TCGA 1992. Without relief, a CGT tax liability may arise on the gift despite there being no funds to pay it (because it is a gift not a sale); the relief therefore prevents a 'dry' tax charge on gifts otherwise assessed at market value for CGT purposes. Section 165 provides that gains arising on gifts of business assets are held over and deducted from the recipient's acquisition (or base) cost of the asset, meaning held over gains will be taxable on a future sale of the asset.

3.2 The gain that can be held over when claiming business asset gift relief on a transfer of shares in a trading company is restricted by Paragraph 7 of Schedule 7 by reference to the value of non-business chargeable assets held by the company. The gain eligible for gift relief is calculated as:

$$\text{Gain} \times \frac{A}{B}$$

Where:

A = market value of chargeable business assets held by the company

B = market value of all chargeable assets held by the company

3.3 The restriction currently operates only by reference to the chargeable assets of the company and so does not include post April 2002 goodwill ('new goodwill'), which falls within the intangible fixed assets regime and so is not a chargeable asset. Where a company owns valuable new goodwill and a modest investment asset, holdover relief may not be available under the current legislation.

4 Examples

4.1 The impact of the issue with the non-business asset restriction is most easily demonstrated by way of three simple examples which highlight the absurd outcome of the legislation.

4.2 **Example 1: Gift of shares where company owns 'old goodwill'**

Rodney owns shares in a trading company, Trotters Ltd, which was incorporated in 1990. Due to its successful trading performance, profits have been reinvested over time in purchasing investment property, such that the company has built up a rental portfolio.

Trotters Ltd owns investment property worth £2 million and the goodwill associated with the trade has also been valued at £8 million. As the goodwill was created prior to 2002 (commonly referred to as 'old goodwill'), it is considered a chargeable asset for tax purposes. No other chargeable assets are owned by Trotters Ltd. For the avoidance of doubt, Trotters Ltd is considered as a trading company when looking at all tests in the round.

Rodney gifts a 10% shareholding in Trotters Ltd to Derek, worth £250,000, inclusive of an appropriate minority discount. The base cost of the shares is £10 resulting in a gain of £249,990. When considering the restriction, the gift relief available is:

£249,990 x £8m/£10m = £199,992

This reduces the gain chargeable to capital gains tax to £49,998.

4.3 **Example 2: Gift of shares where company owns 'new goodwill'**

The facts are the same as the above but Trotters Ltd was incorporated in 2005.

As the goodwill associated with Trotters Ltd was created after 1 April 2002, it is within the intangible fixed assets regime for corporation tax purposes and it is not a chargeable asset for the purposes of the restriction. The gift relief available is:

£249,990 x £0m/£2m = £0

No gift relief will be available and the gain chargeable to CGT is £249,990 and assessed in full.

4.4 **Example 3: Gift of shares where company owns 'new goodwill' and chargeable business assets**

The facts are the same as Example 2 in that Trotters Ltd was incorporated in 2005 but instead of the £2 million of investment property, the company owns £2 million of property assets used in the business.

The gift relief available is:

£249,990 x £2m/£2m = £249,990

Full gift relief would be available to reduce the gain to nil and the restriction would not apply.

4.5 The absurdity of the legislation is that the restriction is the same whether the company has £1 of non-business assets, or £2 million, as illustrated in the first two examples. For example, let us assume that, instead of buying investment properties, the company in the examples had reinvested the money in the business, so that the goodwill was, in fact, worth £10 million. However, for some reason, there is an asset worth £1 that is a non-business chargeable asset of the company. In that case, there is virtually no restriction of the relief in the first scenario but the relief is completely denied in the second example. This is because paragraph 7 of Schedule 7 only applies if there are any non-business assets in the company. If all the assets are business assets, there is no restriction, regardless of whether the goodwill is a chargeable asset.

4.6 The above three examples are overly simplified for the purposes of demonstrating the issue in question. In reality, where a company has a more complex asset base and has purchased goodwill or created goodwill (or other intangibles) both before and after 2002, the implications are more complicated, but the overall impact would be the same.

5 Evidence of the problem

5.1 At the CTLG meeting last March, HMRC said that to an extent they agreed with the Tax Adviser article and the point was being looked at. However, it was noted that there had been no live cases brought up to demonstrate the point at issue and HMRC needed to gather evidence on the extent of the problem before any changes to the legislation could be justified.

5.2 The CIOT is aware from discussions with some of our members that this is a real issue that is being faced in practice[3]. However, it has been difficult for us to obtain examples of live cases to share with HMRC. This may be because our members are reluctant to share live examples (due to confidentiality concerns and/or commercial sensitivities), or perhaps because workarounds are being adopted (potentially involving complex and costly reorganisations) to mitigate the restriction to the relief that might otherwise arise. In addition, it is possible that some practitioners may not fully understand the complexity of the issue.

5.3 It is hard to see the need to obtain live examples when a clear deficiency in the legislation without an obvious policy intention has been identified and perverse outcomes are being produced. Moreover, as noted above, obtaining examples can be difficult, even when we are made aware of cases by our members. In our view, this should not prevent the Government considering making changes to legislation which may be producing unintended and unfair outcomes, and unexpected tax charges, for some businesses. Hence, our decision to make a Budget Representation on this point.

5.4 It was also suggested at the meeting of the CTLG that HMRC may be able to interrogate their systems to explore how much data they hold on gift relief claims, including claims which are made to their clearance unit. We do not know if HMRC have had the opportunity to do this, but clearly HMRC are in the advantageous position of being able to see all cases that could potentially be being impacted, which our members are not.

[3] Whilst preparing this representation some cases have been brought to our attention which highlight the perverse outcomes that the legislation can produce (as illustrated by the examples we have provided).

6 Proposed legislative amendment

6.1 It is our view that a legislative amendment to paragraph 7 of Schedule 7 should be considered to rectify the problem that we have outlined above. Our suggestion is simply that the word 'chargeable' could be removed from paragraph 7, thereby restricting relief on the basis of the ratio of a company's business assets to its total assets. This is because the issue identified arises due to the reference to chargeable assets[4] throughout that paragraph. There would be no change to the impact that non-business assets have on the restriction.

6.2 If we apply our suggestion to Example 2 above, relief would be restricted by the proportion of business assets, including the goodwill and other intangibles, to total (business and non-business) assets (£8m:£10m), whereas at the moment no relief is available at all.

6.3 While we have focussed in this representation on assets within the intangible fixed assets regime, it is possible that paragraph 7 operates in a similar way when there are other assets owned by the business which are not chargeable assets, such as loan relationships, although we have not come across any evidence of this is practice.

7 Acknowledgement of submission

7.1 We would be grateful if you could acknowledge safe receipt of this representation. We would welcome the opportunity to discuss the issue we have identified and the solution we have proposed in more detail.

The Chartered Institute of Taxation

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[4] A chargeable asset is one that would give rise to a chargeable gain if it was sold or realised at a gain.