Gift hold-over relief

Synopsis: Key features and conditions for gift hold-over relief.

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Capital gains tax (CGT) gift hold-over relief (also known as hold-over relief) is a very useful relief for people who wish to make a gift of an asset on which there is a capital gain.

The gifting of the asset, although potentially advantageous from an inheritance tax (IHT) standpoint, would be a disposal for CGT, and, therefore, would usually crystallise a capital gain.

To overcome this problem, gift hold-over relief can be used so that an immediate charge to CGT is avoided, and instead the recipient of the gift takes over the gain of the original owner.

Where gifts of qualifying business assets are being made, gift hold-over relief can be claimed on any gift, i.e. to an individual or to a trust.

What it is and when it applies
Gift hold-over relief applies only in two sets of circumstances:

- relief for gifts of business assets – section 165 TCGA 1992;
- relief on gifts on which IHT is chargeable – section 260 TCGA 1992.

Who can get it?
To qualify for gift hold-over relief under section 165 or section 260 of TCGA 1992, the donor (transferor) must be...

- an individual; or
- the trustees of a settlement.

Gift hold-over relief is not available where the donee (transferee) is not resident in the UK.

If the donee is a company then gift hold-over relief is not available where...

- the company is controlled by non-residents and the non-residents are connected with the donor; or
- the donee is a company and the gift is of shares or securities of any kind.

Gift hold-over relief is not available to personal representatives.

When personal representatives transfer the assets of the estate to the persons entitled to them, no gain will arise in any event, and the legatees will receive the asset with a base cost equal to that at death.

Qualifying conditions

(a) Definition of business assets
The relief applies on a gift of a business asset.

An asset is a business asset for this purpose if...

- it is, or is an interest in, an asset used for the purposes of a trade, profession or vocation carried on by the transferor, their personal company or member of a trading group of which the holding company is the transferor's personal company; or...

- it consists of shares or securities of a trading company or the holding company of a trading group, where either the trading company or holding company is the transferor's personal company or the shares are unquoted.

A personal company is a company where not less than 5% of the voting rights are exercisable by the transferor.

To be a trading company, a business has to demonstrate that its non-business assets account for no more than 20% of the company's activities. This 20% limit can be linked to a number of factors, such as turnover from non-trading activities, asset value, and expenses incurred by or time spent by officers/employees of the company in undertaking its activities. For this reason, the application of the rule can be quite arbitrary.

Where the owner of shares in a trading company is considering making a gift of those shares to, say, an adult child or a trust, it is important that he or she ensures that the company's circumstances are not such that the 20% rule may be infringed. If it is, CGT may be payable immediately.

The definition of business assets is the same for trustees as individuals with the exception that the only trades which can be taken into account are those carried on by the trustees themselves and those carried out by a beneficiary with an interest in possession under a settlement.

It is important to note that there is no requirement that the transferor be a full-time working officer or employee of the company to qualify for gift hold-over relief. The only restrictions are on the nature of the asset itself.

Agricultural property within the meaning of the IHT provisions also qualifies for gift hold-over relief.

Assets used in a trade
Gift hold-over relief is available if the asset is an asset used for the purposes of a trade. This means that it has to have been used in a trading business just before it is gifted.

Previous periods of non-trade use will restrict the relief.

(b) Gifts on which IHT is chargeable
Here, there are no restrictions on the type of asset being gifted; what is important is the gift is a chargeable transfer for IHT purposes (or would be, but for the annual exemption under S19 IHTA 1984, and is not a potentially exempt transfer within the meaning of IHTA 1984). At present, there is no requirement that an actual IHT liability should arise.

For example, a gift to a discretionary trust, the value of which falls within the transferor's available nil-rate band, would qualify as it will be a chargeable transfer, notwithstanding that no actual tax would arise on the gift.

In practice, this means that gift hold-over relief under this heading will be available on a transfer to a relevant property (discretionary) trust or a transfer by the trustees out of a relevant property trust. Any trust created after 21 March 2006, other than a bare trust or one that gives a qualifying interest in possession, is a relevant property trust.

A qualifying interest in possession can only arise under a new trust where it is created by Will or under the law relating to intestacy (an immediate post-death interest) or it is a disabled person's interest.

Gifts to political parties, gifts for public benefit or maintenance funds for historic buildings will also qualify for gift hold-over relief under section 260 TCGA 1992.

Where the transfer is to trustees who are not UK resident, the relief under section 260 will be denied. Effectively any transfers of assets to offshore trusts will result in gift hold-over relief being denied where the transfer is made after 18 April 1991.

How it operates
The "held-over" gain on a disposal (gift) is the chargeable gain otherwise accruing and relief is given by deducting this amount from the gain otherwise accruing to the transferor and from the consideration otherwise regarded as being given by the transferee.

The result of gift hold-over relief being claimed is to effectively transfer the gain to the donee. Therefore, the net effect of it is to defer payment of the CGT until a subsequent disposal by the donee (unless, of course, such a disposal would also qualify for further gift hold-over relief and such relief is claimed).

Limits on the relief
There are no limits on the amount of gain that can be held-over under these provisions.

In practice, where relief is claimed under section 260 TCGA 1992, i.e. on a transfer to a relevant property trust, the value of the gift is likely to be restricted to the available nil-rate band of the donor for IHT purposes. If the gift causes the nil-rate band to be exceeded, an IHT liability at 20% on the excess will arise and taxpayers would usually wish to avoid this.

How to claim it
When a disposal is made to another individual a joint claim for relief must be made by the transferor and the transferee. When the gift is to a trust, then the claim for relief is made by the settlor alone.

The claim must be made within four years of the 31 January next following the end of the year of assessment in which the disposal occurred.

Anti-avoidance
Legislation, that came into effect on 10 December 2003, was introduced, to combat the use of gift hold-over relief in two circumstances...

1. To prevent people using trusts to exploit the interaction between private residence relief and gift hold-over relief with a view to avoiding CGT.

2. To prevent gift hold-over relief being available in respect of transfers of assets, including residential property, to the trustees of settlor-interested settlements. For this purpose, a settlement is settlor-interested if a settlor, a settlor's spouse/civil partner or any child or stepchild of a settlor who is under 18 and not married or in a civil partnership, can benefit under the trust. This does not include a disabled trust.

   In addition, gift hold-over relief obtained in relation to transfers to trustees of settlements will be clawed-back if the trust becomes settlor–interested within six years from the start of the tax year following that in which the transfer is made.

Gift hold-over relief and private residence relief – more detail
Trustees of a trust are entitled to CGT principal private residence relief on the sale of a property that has been used by a beneficiary as their sole or main residence. This would enable a person to make a gift of a second residential property to a relevant property trust under which they (as settlor) were a potential beneficiary.

Provided one of the beneficiaries under the trust occupies the property as a sole or main residence then, on a subsequent sale of the property, there would be no CGT on all capital gains – including any held-over gains. The proceeds of sale, free of CGT, could then be distributed by the trustees to the settlor who is one of the potential beneficiaries.

The effect of these provisions is that principal private residence relief is not available in certain circumstances where the disposal in question is made on or after 10 December 2003 by an individual or the trustees of a settlement.

These circumstances arise where the computation of the amount of any gain arising on the later disposal by the trustees has to take account of gift hold-over relief obtained under section 260 TCGA in respect of an earlier disposal. This is subject to a transitional provision that restrict the amount of principal private residence relief available if the earlier disposal concerned was made before 10 December 2003.

If there was more than one relevant earlier disposal the transitional provision will apply only if all those earlier disposals were made before that date.

The provisions do not apply in any case where the gain arising on the disposal is not in any way affected by a gift hold-over relief claim under section 260 TCGA in respect of an earlier disposal into the trust.

On or after 10 December 2003, principal private residence relief, which is available to the trustees of settlement when they dispose of property which has been occupied by a beneficiary under the settlement as that person's only or main residence, will only be available only where a claim for it is made by the trustees.

Example of how these rules operate – Jill

Pre 10 December 2003 rules
Jill owns a house that is not her only or main residence. It has a market value of £250,000 and if she were to sell it a chargeable gain of £150,000 would arise to her on the disposal. She wants to sell the house and give the proceeds to her children, Sandra and Paul.

She transfers the house to the trustees of a relevant property trust. She claims gift hold-over relief. The settlement is drawn up so that Jill does not have, and may not acquire, an interest under the settlement. The beneficiaries are Sandra and Paul. So, Jill claims gift hold-over relief and the gain is held over.

The terms of the settlement permit the trustees to allow certain persons to occupy the house. The trustees allow Paul to do so, and he occupies the house as his only residence.

After a few months, Paul vacates the house and the trustees sell it within a further few months for a sum (net of expenses) of £270,000. A chargeable gain of £170,000 (most of which is effectively the held-over gain) arises to them. However, this gain is not chargeable to CGT because the trustees benefit from principal private residence relief. The trustees can then distribute the sale proceeds to Sandra and Paul.

The full value of the house has thus been transferred from Jill to Sandra and Paul without any CGT being paid.

Post 9 December 2003
The 2003 provisions countered schemes of this nature. Where a house is transferred, either the transferor can benefit from gift hold-over relief under section 260 or the recipient can benefit from principal private residence relief on a subsequent sale of the house. It is no longer possible for both reliefs to apply.

So, in the example of Jill above, if Jill claimed gift hold-over relief under section 260, the trustees´ gain of £170,000 on the sale of the house would not be covered by gift hold-over relief, and they would be liable to CGT on that gain. Alternatively, if Jill did not claim gift hold-over relief on the transfer of the house to the trustees, she would be chargeable to CGT on her gain of £150,000. The trustees´ gain on the

sale of the house would be reduced to £20,000, which could be covered by private residence relief.

A problem can however arise. Because of the time limits for making claims, it is possible that the recipient of the transfer has sold the house and accounted for the gain before the claim for gift hold-over relief is made.

Suppose that Jill did not make a claim for gift hold-over relief before the trustees sold the house. As there had at that time been no claim for gift hold-over relief, there would have been no held-over gain to affect the computation of the trustees´ gain, which would be £20,000 (proceeds £270,000 less acquisition value £250,000). They would be entitled to claim private residence relief and therefore would not be chargeable on that gain.

But if Jill then made a claim for gift hold-over relief within the statutory time limit, her claim would be valid and she would be entitled to the relief.

In that situation, the legislation provides that the trustees´ gain should be recomputed. Because of the claim to gift hold-over relief, the trustees now have a gain of £170,000 (effectively including Jill´s held-over gain of £150,000) and, because Jill had claimed gift hold-over relief, they would not be entitled to private residence relief. So, they would be assessed on a gain of £170,000.

Key planning points

Planning using gift hold-over relief is inextricably connected with estate planning, particularly lifetime gifts. In many cases, use of gift hold-over relief would generally be made in respect of family businesses where assets are passed to the next generation without any plans for a subsequent disposal to third parties.

Even where business assets may qualify for 100% relief from IHT, so that there is no tax incentive to gift assets, a gift of shares in a family company, or taking a younger person into partnership, may be appropriate where, in practice, the younger generation is involved in the business.

The availability of gift hold-over relief allows transfers of shares in the business or the transfer of business assets in such circumstances, e.g. largely in family businesses, to take place without any untoward tax implications.

When gifts to trusts are contemplated as part of IHT planning it must be borne in mind that where the taxpayer is of advanced age a gain which is held-over simply means a gain that is deferred and which will crystallise on subsequent disposal. On the other hand, if the asset is retained by the taxpayer until death, all the inherent gains will be wiped out on death.

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