The true cost of a gift

Personal tax



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Sofia Thomas explores the changes to gift relief when business assets are transferred in a divorce

Key Points

What is the issue?

Current guidance from HMRC suggests that gift relief is no longer available when business assets are transferred in a divorce.

What does it mean for me?

If you are providing tax advice on the transfer of qualifying business assets and a court order is in place, gift relief is unlikely to be available. This could drastically re-shift the implications of the order.

What can I take away?

You may need a much greater understanding of the order handed down by the courts or of how the gift was set up if there was no court order.

When a couple gets divorced, assets are often transferred between them to satisfy financial claims. Tax reliefs help to mitigate much of the potential capital gains tax that would otherwise arise on the transfers. Transfers in the year of separation take place on the usual no gain, no loss basis between spouses. However, not everything can be agreed in time for this to apply. One valuable and frequently claimed relief in divorce is gift relief; however, HMRC's guidance has been updated, meaning that the availability of the relief is much reduced.

HMRC now refers to the case of *Haines v Hill* [2007] EWCA Civ 1284, where the judgment states that 'the ability of one spouse to apply to the court... is a right conferred and recognised by the law' and the right is equal to the value of the assets being transferred. Therefore, the spouse giving up the business asset is in fact receiving consideration equal to the value of the assets being transferred. If the deemed proceeds are equal to the market value of the transfer, the gain available for the relief is reduced to nil. The fact that business asset disposal relief (the replacement for entrepreneurs' relief) is now restricted to gains of £1 million exacerbates the numbers who may have hoped to rely on gift relief applying.

I have recently become aware of two divorce judgments where the Family Court judge has assumed that gift relief will be available on transfer of business assets. The fact that it may not be available drastically distorts the final position, as the tax liability shifts from the donee to the donor.

What is gift relief?

Briefly, gift relief is available to defer the gain on gifts of qualifying business assets. The relief is given under Taxation of Chargeable Gains Act s 165. The relief defers the gain to the donor by holding over the gain against the base cost of the shares in the hands of the donee. The amount of the gain eligible for relief is reduced by any consideration received for the gift.

What was the previous position?

To show the implications of the change, we will look at the implications of availability and removal of gift relief in the following scenario.

Bette and Tina married in 2014. They separated in March 2019 and have the assets of Yellow Ltd, Bette's trading company. Bette owns 100% of the shares and the business has been valued at £10 million. The judge has ordered Bette to transfer 40% of the shares in Yellow Ltd to Tina. The transfer is outside the tax year of separation.

The judge has assumed that gift relief will be available to Bette, thus meaning that the position is as follows:

- Bette has a gain equal to £4 million on the transfer of the shares but she can claim gift relief on the transfer to reduce her capital gains tax liability to nil. The held over gain will transfer
  to Tina.
- Tina has shares worth £4 million. When Tina sells the shares, her base cost will be effectively nil. She has a potential future capital gains tax liability of £800,000. Therefore, her net holding is £3.2 million.

Why have things changed?

As above, where consideration is received for a gift, the amount of consideration reduces the value of the gift eligible for gift relief. HMRC's guidance at CG66886 states:

'Where there is no recourse to the courts, such a disposal is usually made in exchange for a surrender by the donee of rights which they would otherwise have been able to exercise to obtain alternative financial provision. In these cases, the value of the rights surrendered represent actual consideration of an amount which may reduce the gain potentially eligible for hold-over relief to nil.'

If there is no court order, HMRC takes the view that Bette must have made the transfer of shares to Tina, and in exchange Tina is giving up rights which she would otherwise have been able to use to secure another financial provision. The rights that Tina gives up are equal to the value of the shares and is the deemed consideration that Bette is receiving.

Where there is a court order, the CGT manual states:

'...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.'

This seems to say that in our case if a judge has ordered Bette to transfer 40% of her shares to Tina, then the court order establishes the value of the rights given up by Tina which are equal to the market value of the shares. In this case, the consideration again reduces the gain eligible for relief to nil, thereby making the whole gain taxable.

What's the new position?

Applying these principles to Bette and Tina, the tax position of each after the transfer is:

- Bette has a taxable gain of £4 million. She will pay capital gains tax at 20% on the gain, amounting to tax due of £800,000 (ignoring business asset disposal relief).
- Tina has shares worth £4 million. When Tina sells the shares, her base cost will be £4 million and she will pay substantially lower capital gains tax at the point of disposal than she would have done had a gift relief claim been available. Her net holding is £4 million.
- Bette has a capital gains tax liability of £800,000 and Tina has effectively received a benefit of £800,000 by way of the base cost of her shares being uplifted to £4 million.
- There is therefore a swing of £800,000 and an immediate charge to capital gains tax.

The removal of gift relief on divorce is significant for many reasons:

- It creates a tax liability when there is potentially no cash available to settle the liability.
- As there is no cash, the transferor (Bette,in our case) cannot defer the capital gains tax by utilising rollover relief as they have no cash to invest.
- If it was assumed the relief would be available, the fact that it will not be creates a distortion in the order that was unintended. This could result in individuals lodging appeals against orders.
- With the reduction of entrepreneurs' relief and business asset disposal relief, more couples may be looking to gift relief to remove the immediate charge to capital gains tax.

Where, as advisers, we are instructed on cases in divorce, we should clearly articulate the change and the impact that this will have. In my experience, it is not the liability that is the main pain point but rather the fact that it is an immediate liability which they may not have the funds to meet.

What's an exceptional circumstance?

Further on in the guidance, HMRC comments that it does allow that 'exceptionally' it may be possible for gift relief to apply. Unfortunately, it does not go on to give an example. I surmise that the exceptional circumstance is therefore one where there is a true gift.

For example, Harry and Sally are married and own Blue Ltd, a trading company. Sally owns 30% of the company and Harry owns 70%. They have been separated for two years but still get on well. Sally has decided that she no longer wants to be as involved in the company and gifts 20% of the shares to Harry. Sally gets nothing in return for this gift. Harry does not sign any document saying that he forgoes the right to make a financial claim against Sally, etc. Harry and Sally both agree that gift relief is a sensible option for them and they make a joint claim. In a few more years, they formalise their divorce.

In this scenario, would gift relief apply? I would suggest it might, though I would been keen to hear others' views. And if the above scenario would apply, would you then open the floodgates for couples gifting shares outside of any informal or formal agreement to secure gift relief?

There are several things I hope this article draws attention to:

1. HMRC has changed its approach and now a donor is deemed to receive consideration equal to the value of the transfer of business assets on divorce.
2. If it is a genuine gift, then gift relief may be available.
3. With the restriction of entrepreneurs' relief or business asset disposal relief, we may see more couples hoping to rely on the gift relief concession. They will need to be advised early on in proceedings that this is unlikely to be an option.
4. Do we, as advisers, think that this approach is open to being challenged?

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