HOLD OVER RELIEF FOR LAND: DID SOMEONE LOSE THE PLOT?

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Those dealing with inheritance tax planning will have encountered one particular problem many times over: how can an interest in a holiday home be transferred down to the next generation with minimal tax liability? In most cases the properties are coastal homes around the UK and have been held for quite a few years. Because of their scenic locations, the gains on them can be quite enormous.

In the happy days of the 1980s there was a general relief from capital gains tax for gifts, but sadly this was abolished in the Finance Act 1989. It was replaced with the limited relief in section 260 TCGA 1992 which gives relief from capital gains where there is a chargeable transfer for inheritance tax purposes. The existing relief for gifts of business assets in section 165 TCGA 1992 was also continued. Section 260 meant that in general only one tax need be paid on a gift, either inheritance tax or capital gains tax. Unfortunately for most clients, this is not a satisfactory result and they would rather not pay either tax. Finding a solution to that problem is not easy.

For some bizarre and unexplained reason, the Finance Act 2015 provided a limited solution, albeit not one which was of help to many clients. In 2015 non-resident capital gains tax was introduced and as part of the deal it seems that HMRC decided that non-residents need not pay capital gains tax on a gift of UK residences so a holdover relief was introduced. Why non-residents were given this preferential treatment was not explained, as far as I am aware, because no similar treatment is available for gifts of residential property interests between United Kingdom resident individuals.

The holdover provisions introduced in 2015 were not the finest work of the Parliamentary draftsman. They are in sub-sections 7a, 7b and 7c of section 165, and these are extended in section 167A with section 167A being repeated verbatim in section 261ZA. The wording and general structure has cut across all attempts at re-

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writing tax law in plain English and I suspect that the draughtsman has confused both himself and HMRC. I find it difficult to see that he has introduced provisions which follow what appears to have been his instructions from HMRC at the outset.

The 2015 legislation

It's not all bad however. The new holdover reliefs in section 165 and section 167A(3) are very clear in providing that when there is a disposal which is a non-resident CGT disposal, the chargeable non-resident capital gain can be held over. Unfortunately, the provisions of section 167A and section 261ZA relating to disposals by UK residents are not so clear and problems of interpretation do arise. I set the section 167A out below as it appeared in the Finance Act 2015:

> **167A Gifts of UK residential property interests to non-residents**
>
> (1) This section applies where the disposal in relation to which a claim could be made under section 165 is a disposal of a UK residential property interest to a transferee who is not resident in the United Kingdom and, ignoring section 165—
>
> (a) a gain would accrue to the transferor on the disposal, and
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> (b) on the assumption that the disposal is a non-resident CGT disposal (whether or not that is the case), that gain would be a chargeable NRCGT gain (see section 57B and Schedule 4ZZB).
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> (2) Section 165(4) has effect in relation to the disposal as if it read—
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> "(4) Where a claim for relief is made under this section in respect of the disposal, the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, shall be reduced by an amount equal to the held-over gain on the disposal."
>
> (3) Where the disposal is a non-resident CGT disposal—
>
> (a) section 165(4), as modified by subsection (2) of this section, has effect in relation to the disposal as if the reference to "chargeable gain" were a reference to "chargeable NRCGT gain",
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> (b) section 165(6) has effect in relation to the disposal as if the references to "chargeable gain" were references to "chargeable NRCGT gain", and
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> (c) section 165(7) has effect in relation to the disposal as if the reference to "the excess referred to in paragraph (b) above" were a reference to "the chargeable NRCGT gain which,

ignoring this section and section 17(1), would accrue to the transferor on the disposal".

(4) Where a claim for relief is made under section 165 in relation to the disposal mentioned in subsection (1), on a subsequent disposal by the transferee of the whole or part of the interest in UK land which is the subject of the disposal mentioned in subsection (1), the whole or a corresponding part of the held-over gain (see section 165(6))—

(a) is deemed to accrue to the transferee (in addition to any gain or loss that actually accrues on that subsequent disposal), and

(b) if that would not otherwise be the case) is to be treated as an NRCGT gain chargeable to capital gains tax by virtue of section 14D accruing on a non-resident CGT disposal.

(5) Where the subsequent disposal mentioned in subsection (4) is (or proves to be) a chargeable transfer for inheritance tax purposes, section 165(10) has effect in relation to the disposal as if—

(a) the reference to "the chargeable gain accruing to the transferee on the disposal of the asset" were a reference to the chargeable gain accruing on the disposal as computed apart from subsection (4), and

(b) the reference in section 165(10)(b) to "the chargeable gain" were a reference to—

(i) the chargeable gain chargeable to capital gains tax by virtue of any provision of this Act accruing on the disposal, and

(ii) the held-over gain deemed to accrue under subsection (4).

(6) In this section, "interest in UK land" has the meaning given by paragraph 2 of Schedule B1."

These provisions have been replaced by new legislation in the Finance Act 2019, but unfortunately the same problems arise under that legislation.

HMRC guidance

HMRC has a help sheet dealing with holdover relief which is Helpsheet No 295 and this contains the following statements:

'Where a UK residential property is disposed of as a gift from a non-UK resident to a UK resident, non-resident capital gains tax gains may be included as held over gains.

> Hold over relief is available for a chargeable transfer of a property from a non-UK resident to a UK resident that would otherwise incur non-resident capital gains tax.'
>
> Further on the Helpsheet contains the following remark: 'in all cases the transferee must be at resident in the UK. For this purpose, persons treated as resident outside the UK by reason of a double taxation agreement may be excluded.'

The latter is an extraordinary statement, given that section 261ZA specifically allows a relief where the transferee is non-resident. It is a limited relief relating to UK residential property interests, but the Helpsheet makes no reference to it at all.

HMRC's capital gains tax manual cover this holdover relief but once again the statement made is controversial. What is said at paragraph CG66886 is the following:

> 'As is discussed in CG66884, hold-over relief is available where a direct or indirect interest in UK land is gifted:
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> - by a UK resident to a non-UK resident
> - by a non-UK resident to a UK resident, or
> - by a non-UK resident to a non-UK resident

In these instances, it is important to remember that the held-over amount cannot include any gain that has accrued before the gifted asset came within the scope of non-resident CG (or, for the first bullet point above, would have if it was owned by a non-UK resident).

As an example, Izzy bought a UK residential property in 2001 for £400,000, to rent out to tenants. On 5 April 2015, the value of that property was £800,000. In May 2017, Izzy gifts the property to Tilan (who is resident in Cyprus), when it is worth £900,000.

Here, the gain that accrued before the introduction of NRCGT (6 April 2015, so £400,000) will be chargeable on Izzy as the property (not having been used in a trade) was not a qualifying asset for hold-over relief before that time. However, the gain that accrued between 6 April 2015 and the gift can be held-over, such that Izzy will not have to pay CGT in respect of this part of her overall gain on the gift and Tilan's acquisition cost going forward will be £800,000.'

Analysis

The paragraph in the capital gains tax manual presumably sets out what HMRC wanted the legislation to achieve, but in my view it is debatable whether in fact the legislation has that result. One can see that the draftsman would not have spent so much effort in tying the holdover relief in with the non-resident capital gains tax

legislation if all he wanted was a simple and straight forward holdover relief for gifts of all capital gains on UK residential property interests where either the transferor or the transferee is non-resident. It would have been simple enough just to have an extension to the existing holdover provisions.

Looking at section 167A in more detail, the section applies where the disposal in relation to which a claim could be made under section 165 is the disposal of a UK residential property interest to a transferee who is not resident in the United Kingdom.

That is a rather odd statement in itself since any such disposal could not be the subject of a claim under 165. Section 165 deals only with disposals to UK resident individuals. Anyway, accepting that the idea is to extend the relief under section 165 we then have to assume that the disposal is a non-resident CGT disposal (whether or not that is the case). This must mean that it can be a disposal by a UK resident individual.

The next test is that the gain arising would, on the assumption above, be a chargeable non-resident capital gain and for that we have to refer to the non-resident CGT provisions, in particular schedule 4ZZB. Looking at that schedule, the detailed provisions in most cases mean that only the gain since April 2015 is a non-resident capital gain. So if one looks again at the example in paragraph 66886 of HMRC's capital gains tax manual, is it correct that the gain on the UK residential property which Izzy gave away in 2017 was a non-resident capital gain? I suggest that it is not. It includes a small amount of non-resident capital gain but most of it is not such a gain. It would be different if section 167A said that the gains would 'to any extent' be a chargeable non-resident capital gain, but it doesn't say that. That must be added in to make sense of it.

Moving on from there, we are told that where a claim for relief is made under this section the amount of any chargeable gain which would accrue on the disposal should be reduced by an amount equal to the held over gain on the disposal. The definition of the held over gain is in section 165(6) and allows all the chargeable gain on the disposal to be held over where there is no consideration. So how can the passage in HMRC's capital gains tax manual be correct in confining the relief only to the gain after April 2015?

Section 167A(3) confines the hold over relief to the amount of the 'chargeable NRCGT gain' but that subsection applies only where the disposal is a non-resident CGT disposal. If it is not, it does not apply. As already mentioned, subsection (1) does proceed on the assumption that the disposal is non-resident CGT disposal, but it does not ask us to treat it as such for all purposes of the hold over provisions if it is in fact a disposal by a UK resident. Even if it means that, it would then make no sense to have the separate provisions of sub-sections (2) and (3) of section 167A.

The 2019 legislation

These holdover provisions have been redrafted by the Finance Act 2019, but far from making the rules clearer, the 2019 provisions tend to make the confusion worse. Section 167A now reads as follows:

> **167A Gifts of direct or indirect interests in UK land to non-residents**
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> (1) This section applies where the disposal in relation to which a claim could be made under section 165 is a disposal of an asset within section 1A(3)(*b*) or (*c*) to a transferee who is not resident in the United Kingdom and, ignoring section 165
>
> (*a*) a gain would accrue to the transferor on the disposal, and
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> (*b*) on the assumption that the disposal is a direct or indirect disposal of UK land which meets the non-residence condition (whether or not that is the case) , that gain would be a relevant gain (see subsections (6) and (7)).
>
> (2) Section 165(4) has effect in relation to the disposal as if it read
>
> "(4) Where a claim for relief is made under this section in respect of the disposal, the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, shall be reduced by an amount equal to the held-over gain on the disposal."
>
> (3) Where the disposal is a direct or indirect disposal of UK land which meets the non-residence condition
>
> (*a*) section 165(4), as modified by subsection (2) of this section, has effect in relation to the disposal as if the reference to "chargeable gain" were a reference to ["relevant gain"],
>
> (*b*) section 165(6) has effect in relation to the disposal as if the references to "chargeable gain" were references to "relevant gain", and
>
> (*c*) section 165(7) has effect in relation to the disposal as if the reference to "the excess referred to in paragraph (*b*) above" were a reference to ["the relevant gain] which, ignoring this section and section 17(1), would accrue to the transferor on the disposal".
>
> (4) Where a claim for relief is made under section 165 in relation to the disposal mentioned in subsection (1), on a subsequent disposal by the transferee of the whole or part of the asset within section 1A(3)(*b*) or (*c*) which is the subject of the disposal mentioned in subsection (1), the whole or a corresponding part of the held-over gain (see section 165(6))

(*a*) is deemed to accrue to the transferee (in addition to any gain or loss that actually accrues on that subsequent disposal), and

(*b*) (if that would not otherwise be the case) is to be treated as a relevant gain.

(5) Where the subsequent disposal mentioned in subsection (4) is (or proves to be) a chargeable transfer for inheritance tax purposes, section 165(10) has effect in relation to the disposal as if

(*a*) the reference to "the chargeable gain accruing to the transferee on the disposal of the asset" were a reference to the chargeable gain accruing on the disposal as computed apart from subsection (4), and

(*b*) the reference in section 165(10)(*b*) to "the chargeable gain" were a reference to—

(i) the chargeable gain chargeable to capital gains tax by virtue of any provision of this Act accruing on the disposal, and

(ii) the held-over gain deemed to accrue under subsection (4).

(6) For the purposes of this section, a disposal is a "direct or indirect disposal of UK land which meets the non-residence condition" if it is

(*a*) a disposal on which a gain accrues that falls to be dealt with by section 1A(3) because the asset disposed of is within paragraph (*b*) or (*c*) of that subsection, or

(*b*) a disposal on which a gain accrues that falls to be dealt with by section 1A(1) in accordance with section 1G(2) because the asset disposed of is within section 1A(3)(*b*) or (*c*).

(7) For the purposes of this section, a "relevant gain" means so much of any chargeable gain accruing on a disposal as falls to be dealt with as mentioned in subsection (6)(*a*) or (*b*).

How much can be held over?

What will be seen from the above amendments is that references previously to chargeable non-resident capital gain are now turned into references to a 'relevant gain' and this is dealt with further by sub-sections 6 and 7. The relevant gain means so much of any chargeable gain accruing on a disposal as falls to be dealt with by sub-section 6 (a) or (b) and that in return refers us to section 1A (3) (b) or (c). Any reference to schedule 4ZZB has gone away and we now just look to see whether the gain falls to be dealt with by section 1A(3). That is the basic provision dealing with non-residents who are chargeable to capital gains tax on disposal of UK residential

property interests. None of the calculation rules are in section 1A(3) because it is no more than the starting point for non-residents who have capital gain on a UK property. That capital gain might be one which goes back many years prior to April 2015.

So reverting to those clients with holiday homes, the position now seems to be, somewhat strangely, that if their children are not resident in the United Kingdom gains can be held over on a gift of an interest to them but if the children are UK residents they cannot be held over. How much of the gain can be held over is a point of contention, and HMRC clearly want only the gain from April 2015 to be within the relief, which unfortunately is not much help in most cases. It will be a very bold tax adviser who recommends his client to give an interest in a UK holiday home to his non-resident child claiming full holdover relief as a challenge to HMRC's view in the Capital Gains Tax Manual, but it would be interesting to see the result of such a challenge.