THE BORDERS OF RETIREMENT RELIEF

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"Words and figures do not match" is a banker's phrase, yet it could be applied not unfairly to the Government. We hear much about simplifying the tax system and lifting the burden of administration from small business. What we hear, though, is not always what we see, and in the field of Capital Gains Tax retirement relief the gap between word and deed is particularly large.

Typically, on retirement a business proprietor may decide to make some sales and some gifts of business assets which he no longer needs. What his advisers must do in such circumstances is to pay very careful attention to the order of events.

The problem might arise like this. Suppose the owner decides to sell his shares in one company and give away his shares in another. Both companies are trading companies qualifying for retirement relief under TCGA 1992 s.165 and Schedule 6. Gifts being easier to arrange than sales, he might, if ill advised, make the gift first, perhaps to a family settlement, claiming "hold-over" relief. Subsequently he might sell the shares in the other company for a good price to a third party purchaser, and claim retirement relief on the sale. Unwittingly, this order of events would have brought disaster upon him. Hold-over relief would not be available on the gift and retirement relief would not be available on the sale.

The trap originates in the fact that, where the conditions are satisfied, retirement relief under s.163 is mandatory, and is given automatically. This is the result of s.163(1) which, so far as relevant, provides as follows:

> "Relief from Capital Gains Tax *shall* be given ..." (emphasis added).

The availability of the relief does not depend upon a claim, and it follows that there is no ability either to omit to claim the relief or (at least by statute) to "disclaim" it. The consequence is that no chargeable gain is left to be "held over" and the hold-over claim accordingly fails.

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Where the hold-over relief in question is being sought under TCGA 1992 s.165, the disallowance of hold-over by reference to retirement relief is expressly provided for, and is therefore presumably the intention of the draftsman (see s.165(3)(a). By contrast, there is no such express provision in relation to the alternative type of hold-over relief given under TCGA 1992 s.260. The difference of wording does not, however, produce a difference in the result because the effect of retirement relief is to prevent gains being "chargeable gains"; TCGA 1992 Schedule 6 paragraphs 6 and 7. Since hold-over relief under s.260(3) can only operate to the extent that a chargeable gain would otherwise have arisen, retirement relief can deny hold-over.

This unfortunate interaction of the two reliefs does not of course destroy retirement relief altogether. It merely grants it to a disposal for which the relief was not wanted by the taxpayer, and leaves exposed to tax a gain which the taxpayer had intended to shelter by retirement relief. In some cases the damage caused by doing things in the wrong order will be limited to a short-term timing problem. In others, for example where the donees of the first gift retain the gift indefinitely or until death, the damage will be serious.

The arbitrary operation of the two reliefs is compounded when traditional "roll-over" relief under TCGA 1992 s.152 is considered. Unlike "hold-over", roll-over relief operates by treating the consideration for the disposal of the "old" asset and acquisition of the "new" asset as reduced. Where it applies (only on a claim, of course) roll-over relief reduces or eliminates a gain on the disposal of the old asset, with the result that retirement relief cannot apply. Since the availability of roll-over relief requires the making of a claim, the taxpayer can decide whether or not he either wants roll-over relief or wants to use up any retirement relief available on the disposal. That luxury of choice is not available where hold-over relief and retirement relief interact. This is because although hold-over relief also requires a claim, it can be claimed only in relation to chargeable gains and the effect of retirement relief is mandatorily to reduce or eliminate chargeable gains.

What is needed, short of a benevolent interpretation by the Inland Revenue (none has been published, and so far as is known none is available), is a right to disclaim retirement relief. Or, alternatively, an obligation to claim it.

Where a taxpayer falls into this trap on a gift of assets, all may not be lost. All will be lost if the subject-matter of the gift was shares, since shares can never (except in ESOP cases) be the subject of a "roll-over" relief claim. If instead the asset given was land or some other asset which qualified for "roll-over", then subject to re-investing in new qualifying assets used for a trade within three years, it might be possible to salvage a s.152 "roll-over" claim from what had been intended to be a s.165 or s.260 hold-over. This would leave the retirement relief unscathed, to be used on a later occasion. This possible solution depends of course on the ability to claim roll-over relief in relation to a gift, but there is no reason why the deemed market value consideration for a disposal by way of gift should not be notionally regarded as "applied in acquiring" new qualifying assets within the three year period. The words "applied in acquiring" in s.152(1) cannot be read literally so as to require a physical application of identified proceeds of sale. If that is accepted, it should equally be accepted that deemed sale proceeds can be regarded as applied in acquiring new assets.

A trap akin to the hold-over trap also arises where a business carried on by a sole trader or by a partnership is incorporated under TCGA 1992 s.162. This applies:

> "... Where a person who is not a company transfers to a company a business as a going concern, together with the whole assets of the business ... and the business is so transferred wholly or partly in exchange for shares issued by the company to the person transferring the business."

The effect of s.162 is, by s.162(2), that:

> "[Part of the chargeable gain] shall be deducted from the aggregate of the chargeable gains less allowable losses [on the old assets.]"

It follows that in circumstances where retirement relief is available, the effect of a transfer of a business qualifying for the special kind of "roll-over " relief available under s.162 is to reduce the chargeable gain available to be "rolled-over" into the shares of the acquiring company under s.162. The unfortunate result for the taxpayer here is that he has used up his retirement relief and in its place benefited only by a corresponding reduction in the rolled-up gain in the shares he receives in return for the business. That may of course give him a tax advantage in future, but it will deny him, or restrict his entitlement to, retirement relief on any other disposals made after the incorporation of the business. In such cases, disposals where retirement relief is available and wanted should obviously precede incorporations under s.162.

Taxpayer-clients can find it bizarre that the availability of a relief so plainly intended to assist them in declining years should depend on such arbitrary technicalities such as these. Legislative reform is overdue, the 1985 "simplification" having clearly failed in some of its objectives. Pending that, an extra-statutory concession could offer help to those who unwittingly fall into a hole that should not be there.