

Transfers of value derived from assets (S.543)

Manual Part 19-1-16

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- 16.1** Where a person transfers an asset otherwise than at arm's length and for a consideration less than market value the asset is deemed to have been disposed of at market value and the chargeable gain or allowable loss computed accordingly (see, however **Par. 4** as respects transfers to employees and directors). Certain transactions whereby value or valuable rights are transferred from one person to another are to be treated as disposals on which Capital Gains Tax is chargeable. Details of these are given in **Par. 5**.
- 16.2** Where the disponent of an asset transferred at an undervalue fails to pay all the tax on any gain on the disposal, the Revenue has power to recover a due proportion from the acquirer as if the transaction were a gift of the asset to him - **Section 978(1)**.
- 16.3** As regards the transfer of assets by a close company at an undervalue, see **Tax Instruction [Part 19.4.12](#) Par. 1** et seq.
- 16.4** The transfer of an asset at undervalue by an employer to an employee or director is a disposal for Capital Gains Tax purposes. Normally the consideration is deemed to be market value (**Section 547(4) - T.I [Part 19.2.6](#) Par. 3**) but if the employer is within Case I or II of Schedule D, the consideration for his disposal should be treated as the cash consideration, if any, received by him provided that the following conditions are satisfied:
- (a) The employee or director is liable to tax under Schedule E on the excess of the market value over the cash consideration. This condition should be regarded as satisfied even though the excess, or part of it, is not actually charged under Schedule E as, for example, when **Section 201(5)** applies.
 - (b) The transfer of the asset at undervalue is not in satisfaction of an antecedent debt for unpaid remuneration. Where there is such a debt, the cash consideration, if any, given by the employee or director for the asset should be regarded as increased by the amount of the debt.

Where the cash consideration payable by the employee or director is less than the cost of the asset to the employer, no allowable loss accrues to the employer because a deduction for his loss is given under Case I or II of Schedule D (**Tax Instruction [Part 19.2.5](#) Par. 3(c)**).

The employee's cost of acquisition is the market value of the asset.

If the employee or director is not charged on the excess under Schedule E but **Section 130(3)**, applies in relation to the transfer at undervalue, then the company (the employer) should be treated as disposing of the asset at market value (**Section 547(4) - Tax Instruction [19.2.6](#) Par. 3**).

16.5 Where value or valuable rights are transferred from one person to another other than for full consideration, in circumstances such that there would otherwise be no occasion of charge, the transfer should be treated as a disposal and acquisition at market value, and as an occasion on which tax is chargeable. The provision is effective in the following situations:-

- (a) Where a person who has control of a company so exercises that control that value or valuable rights are transferred from shares which he owns (or which are owned by persons connected with him) into other shares. Such a transfer should be treated as a disposal of the whole (or part) of the shares in question.
- (b) Where the lessee of a property was formerly its owner and the terms of the lease are adjusted in favour, generally, of the lessor. Such an adjustment should be treated as a disposal of property by the lessee.
- (c) Where a person is entitled to enforce a right over an asset, the extinction of that right by the person in question should be regarded as a disposal of the right.

Example I

In 2003, A bought 2000 €1 ordinary shares in XYZ Ltd., which gave him control of the company. The purchase price was €100,000.

In 2006 A arranged for the authorisation and issue at par of 1,000 of a new class of €1 "A" ordinary shares to his son. Immediately thereafter, the rights attaching to the original ordinary shares were reduced to the status of preference shares carrying only an 8 per cent dividend; and all other rights of voting, in profits, and on liquidation were passed to the "A" shares.

The value of the original shares was thus reduced and value passed to the new shares.

If the value of the old shares immediately before the arrangement in 2006 was agreed at €150,000 and immediately after that date at €20,000, the computation of the gain chargeable on A (subject to expenses) would be as follows:-

Value of shares before the change	150,000
Value of shares after the change	<u>20,000</u>
Value passing from old to new shares	130,000
Part cost allowable:-	
100,000	x
130,000	
130,000	+ 20,000
Chargeable gain	<u>86,667</u>
	<u>43,333</u>

The acquisition price of the "A" shares to the son would be €130,000 plus €1,000 = €131,000.

Example 2

In 2003, RST Ltd., was formed with an authorised share capital of €10,000 in €1 ordinary shares. B subscribed for 7,500 shares at par and his wife subscribed for 2,500 shares at par.

In 2006, B arranged for the authorisation and issue of 5,000 new €1 ordinary shares, 2,500 to be subscribed for by each of his two children at €1 per share.

Before the new issue, the value of B's shares was €50 per share. As a result of the new issue and due to his loss of control, the value of B's shares after the new issue was €30 per share. After the new issue, the value of the three holdings of 2,500 shares (ie by the wife and each of the 2 children) was €20 per share. The value of the original shares was thus reduced and some value passed from the old to the new shares. The computation of the gain chargeable on B (subject to expenses) is as follows:-

	€
Value of B's shares before this issue of new shares	375,000
Value of B's shares after the issue of new shares	<u>225,000</u>
Value passing out of B's shares	<u>150,000</u>

But the value passing out of B's shares is greater than that which passed into the new shares so that some restriction of the gain must be made.

	1st child €	2nd child €
Value of children's shares (2,500 at 20 per share)	50,000	50,000
less price paid per share (1)	<u>2,500</u>	<u>2,500</u>
	47,500	47,500
Total value passing into new shares	95,000	

The acquisition cost of the new shares is €50,000 in the case of each child ie €2,500 cash subscription plus €47,500 value passing from the old shares.

The figure of disposal proceeds used in the computation of B's chargeable gain is restricted to the value passing into the new shares as follows:-

Disposal proceeds	95,000
Less portion of cost allowable	
7,500 x <u>95,000</u>	<u>2,227</u>

	95,00	+	225, 000	
	0			
Chargeable gain				<u>92,773</u>

Example 3

In 2003, B buys freehold property for €400,000.

In 2004, he gives the freehold to his son C subject to a 99-year lease reserved to B himself, the rent payable by B to his son being 5c per year, if demanded. The effect of this transaction is to leave B with virtually the whole property, since C is entitled only to a reversion at the end of 99 years and this has negligible value. (B has made a part disposal, but the value passing to his son is too small to warrant a computation of the gain on that part disposal).

In 2006, B agrees to pay to C a full economic rent for the remainder of the term of the lease. The real value has now passed out of B's leasehold interest, and he is treated as making a disposal at market value of the interest passed to C. If that value was €500,000, the gain chargeable on B (subject to expenses) is as follows:-

Value transferred	500,000
Cost of freehold	<u>400,000</u>
Chargeable gain	<u>100,000</u>

The acquisition price of C's interest in the property is €500,000.

Example 4

The owner-occupier of a farm which cost €800,000 in 2003, gives the farm to his son subject to the father's continuing occupation of the farm under a lease. The father is under 55 years of age. If the market value of the farm subject to that lease is €900,000, the gain chargeable on the father at the date of the gift will be computed by reference to that value as a part disposal, the value of the right to occupy being included in the denominator of the part disposal fraction (see **Tax Instruction [Part 19.2.14](#) Par.7**).

If the father subsequently gives up his lease, there is a further disposal by him (within the terms of **Section 543(4)**) of his rights in the property.

If the value of the right to occupy is €180,000 at the date of the gift and €150,000 at the end of the lease, the chargeable gains (subject to expenses and to relief for the principal private residence - see **Tax Instruction [Part 19.7.3 Par. 2](#)**) will be as follows:-

On the gift:-	€
Market value of farm subject to lease	900,000
Part cost allowable -	
€800,000 x $\frac{900,000}{900,000 + 180,000}$	<u>666,667</u>
Chargeable gain	<u>233,333</u>
On the father giving up the lease:-	€
Market value of the right to occupy	150,000
Balance of cost €800,000 less 666,667	133,333
Part wastage (see below)	<u>33,333</u> <u>100,000</u>
Chargeable gain	<u>50,000</u>

[The father's right of occupation is a wasting asset (see **Tax Instruction 19.2.16 Par. 2**). If his expectation of life at the date of the gift (in 2003) was 20 years and the lease was ended 5 years later (in 2008), the part not allowable is

$$\frac{5}{20} \times 133,333 = 33,333.]$$