These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 31Schedule 7: Gifts of Shares Etc to Charity

Summary

1. Section 31 and Schedule 7 introduce new rules to the calculation of relief for the disposal of qualifying investments to charities under section 431 of the Income Tax Act 2007 (ITA) and Chapter 3 of Part 6 of the Corporation Tax Act 2010 (CTA). Qualifying investments consist of certain shares, securities and land.

Details of the Schedule

2. Paragraph 1 introduces the new rules in relation to gifts of qualifying investments to charities by individuals.

3. Paragraph 2 amends section 437 of ITA.

4. Paragraph 2(2) substitutes the term "relevant value" for "market value" in section 437(1) of ITA. This allows for the new rule to adjust the relief due to the donor to the economic cost of the acquisition of the investment by the donor.

5. Paragraph 2(3) inserts three new subsections, (1A) (1B) and (1C), into section 437 of ITA.

6. New subsection (1A) of section 437 of ITA defines the new term "relevant value" as being the market value at the date of disposal of the qualifying investment unless new subsection (1B) applies. Where new subsection (1B) applies, the relevant value is the market value of the gift at the date of disposal or the cost of acquisition to the donor, whichever is the lower.

7. New subsection (1B) of section 437 of ITA sets the conditions for when the relevant value of the qualifying investment (or anything from which it partly or wholly derives) is to be determined by the cost to the donor of its acquisition, rather than by its market value at the date of disposal to the charity:

   - first, the period between the acquisition of the qualifying investment (or anything from which the qualifying investment derives) and its disposal to a charity must be four years or less;

   - second, the acquisition must be made as part of a scheme; and

   - third, the purpose or one of the main purposes of the individual in entering the scheme was to obtain relief or an increased amount of relief.

8. New subsection (1C) of section 437 of ITA defines a scheme for the purposes of new subsection (1B).

9. Paragraph 2(4) applies the provisions of new section 438A of ITA (acquisition value of qualifying investments) to section 437 of ITA.

10. Paragraph 3 inserts new section 438A in ITA.

11. New section 438A defines the acquisition value of a qualifying investment. New subsection (1)(a) provides that where there is no change in the asset disposed of to the charity and the period between acquisition and disposal is four years or less, then the acquisition value is the consideration given by the donor for acquiring the asset. New subsection (1)(b) provides that where the asset disposed of is not exactly the same as the asset initially acquired then the acquisition cost is the just and reasonable proportion of the acquisition cost of the asset initially acquired.

12. New section 438A(2) defines acquisition cost.

13. Paragraph 4 inserts the term "acquisition value of a qualifying investment" in Schedule 4 to ITA (index of defined expressions).

14. Paragraph 5 introduces the new rules in relation to gifts of qualifying investments to charities by companies.

15. Paragraph 6 amends section 209 of CTA.

16. Paragraph 6(2) substitutes the term "relevant value" for "market value" in subsection (1) of section 209 of CTA. This allows for the new rule to adjust the relief due to the donor to the economic cost of the acquisition of the investment by the donor.

17. Paragraph 6(3) inserts three new subsections into section 209 of CTA.

18. New subsection (1A) of section 209 of CTA defines the new term "relevant value" as being the market value at the date of disposal of the qualifying investment unless new subsection (1B) applies. Where new subsection (1B) applies, the relevant value is the market value of the gift at the date of disposal or the cost of acquisition to the donor, whichever is the lower.

19. New subsection (1B) of section 209 of CTA sets the conditions for when the relevant value of the qualifying investment (or anything from which it partly or wholly derives) is to be determined by its value at the time of acquisition rather than by its market value at the date of disposal to the charity:

    - first, the period between the acquisition of the qualifying investment (or anything from which the qualifying investment derives) and its disposal must be four years or less;
    - second, the acquisition must be made of part of a scheme; and
    - third, the purpose or one of the main purposes of the company in entering the scheme was to obtain relief or an increased amount of relief.

20. New subsection 1(C) of section 209 of CTA defines a scheme for the purposes of new subsection 1(B)

21. Paragraph 6(4) applies the provisions of new section 210A of CTA (acquisition value of qualifying investments) to section 209 of CTA.

22. Paragraph 7 inserts new section 210A (acquisition value of qualifying investments) into CTA.

23. Subsection (1) of new section 210A of CTA defines the acquisition value of a qualifying investment for the purposes of section 209 of CTA. New subsection (1)(a) provides that where there is no change in the asset disposed of to the charity and the period between acquisition and disposal is four years or less, then the acquisition value is the consideration given by the donor for acquiring the asset. New subsection (1)(b) provides that where the asset disposed of is not exactly the same as the asset initially acquired then the acquisition cost is the just and reasonable proportion of the acquisition cost of the asset initially acquired.

24. Subsection (2) of new section 210A of CTA defines the cost to the company of acquiring the asset disposed of.

25. Paragraph 8 inserts the term “acquisition value of a qualifying investment” in Schedule 4 to CTA (index of defined expressions).

26. Paragraph 9 applies the provisions in this Schedule to disposals on or after 15 December 2009.

27. Paragraph 10 applies the provisions in this Schedule to section 587B of the Income and Corporation Taxes Act 1988 for the period 15 December 2009 to 3 March 2010, the date CTA came into force.

Background Note

28. The clause and Schedule introduce new rules to block tax avoidance schemes that exploit the rules for tax relief on gifts of qualifying investments to charities. The legislation does not affect charities; it operates by restricting tax relief to a donor on gifts of qualifying investments to charities.

29. The avoidance depends on the donor receiving tax relief at their highest marginal rate of tax on the full market value of the qualifying investments at the date of the gift where:

    - the donor acquired the investments at below market value as part of a scheme or arrangement; or
    - the market value of the investment is artificially inflated at the date of the gift to charity.

30. The new rules adjust the amount of relief to the donor to the economic cost of acquisition of the gift to the donor where:

    - the qualifying investment gifted to the charity (or anything from which the investment derives) was acquired within four years of the date of disposal; and
    - the main purpose, or one of the main purposes, of acquiring the qualifying investment was to dispose of it to a charity and claim the tax relief.

31. The following examples show how the new rules are intended to work for individuals; the same principles apply for companies:

Example 1

Mr Jones enters into an agreement with Company X to buy £200,000 of shares in a FTSE 100 company from Company X for £30,000. The shares come with an option attached for Company X to buy them back after three years for £1.

Two days after purchasing the shares Mr Jones donates them to Charity B and claims under section 431 of ITA that this is a donation of £200,000 – the market value of the shares. He claims that the fact that the option to buy the shares back for £1 exists is not taken into account in valuing the shares because the option is a contingent liability which is ignored under section 440(2)(b) of ITA.

However new section 437(1A), (1B) & (1C) of ITA will apply because the shares were acquired within four years of the date of disposal and the reason Mr Jones purchased them was so he could donate them to Charity B and claim tax relief. As the cost of buying the shares was only £30,000, compared to their market value of £200,000, Mr Jones is only entitled to relief of £30,000 under section 431 of ITA.

Example 2

Mr Blake is a successful IT entrepreneur who buys a controlling stake in a small listed IT company in 2009 for £5 million. He has seen an opportunity to turn the company round and make a significant profit on his investment. He is successful and by 2011 the company is thriving and his shares are now worth £25 million.

In 2012 Mr Blake visits a hospice to see an old friend and is so impressed by what he sees he decides to donate £1 million of those company shares to the charity that runs the hospice to pay for a new treatment room and some equipment they need.

Although Mr Blake has donated shares to a charity less than four years after he purchased those shares, new section 437(1B) of ITA does not apply as when he purchased those shares in 2009 the main purpose, or one of the main purposes, of making that acquisition was not to obtain tax relief by donating the shares to a charity.
Example 3

Miss Smith inherited 10,000 shares in a listed company from her father in 1982.

In 2010 she decides to donate half the shares to a local animal shelter which is run by a charity. At the time of the donation the 10,000 shares are worth £80,000 so her donation is worth £40,000.

Miss Smith is entitled to relief on £40,000 under section 431 of ITA. The shares were acquired by her over four years ago so the new provisions do not apply.

Even if Miss Smith had inherited the shares in 2008 the new provisions would not apply as although the gap between acquisition and donation is less than four years, the shares were not acquired by her in circumstances where the main purpose, or one of the main purposes, of that acquisition was to obtain tax relief by donating those shares to a charity.
Example 4

Mrs Jackson lives in a small village in Suffolk and farms a 1,000 acre arable farm around the local village. A fellow farmer decides to sell 10 acres of land on the edge of the village next to the village hall. The village hall (a charity) would like to acquire two acres for a sports field but don't have sufficient funds.

Mrs Jackson agrees to buy the 10 acres for £40,000 (market value) and then donates two acres of the land to the village hall and claims the tax relief available. She keeps the remaining eight acres and incorporates the land into her farm.

Mrs Jackson only purchased the land so she could donate the two acres to the village hall. She did not particularly need another eight acres for her farm, although she will use it to grow wheat.

Mrs Jackson can claim relief under section 431 of ITA for the two acres donated to the charity. New section 437(1B) of ITA will apply because the land has been purchased and donated within four years and was purchased so she could donate the two acres to the village hall and claim the tax relief available. Therefore the amount of relief is limited under new section 438A of ITA to a "just and reasonable" apportionment of the acquisition cost of £40,000. Given 2/10ths of the land has been donated then a similar proportion of the acquisition costs would qualify for relief - £8,000.

If the situation had been a little more complex, say half of the 10 acres had just been re-zoned by the local Council for housing and so the cost of the 10 acre parcel was £5 million, then in apportioning how much of the £5 million relates to the two acres given to the village hall would be more complex. For example if the two acres were not within the re-zoned area the cost would probably still be £8,000 as the vast majority of the £5 million cost will relate to the five acres which can now have housing built on it. Such a case may require valuations to be agreed with HM Revenue & Customs to determine the amount of relief due under section 431 of ITA.