Beware disposals to family members – the 'market value' rule

At first sight, the calculation of a capital gain or loss on the disposal of an asset is relatively straightforward – simply the difference between the amount received for the sale of that asset and the cost of acquiring (and, where relevant) enhancing it, allowing for the incidental costs of acquisition and disposal. However, as with all rules there are exceptions, and particular care needs to be taken when disposing of an asset to other family members.

Spouses and civil partners

The actual consideration, if any, is ignored for transfers of assets between spouses and civil partners. Instead, the consideration is deemed to be that which gives rise to neither a gain nor a loss. The effect of this rule, which is very useful for tax planning purposes, is that the transferee simply assumes the transferors base cost – and the transferor has no capital gain to worry about.

Other connected persons

While the no gain/no loss rules for transfers between spouses and civil partners is useful from a tax perspective, the same cannot be said to be true for market value rule that applies to transfers between connected persons. Where two persons are connected, the actual consideration, if any, is ignored and instead the market value of the asset at the time of the transfer is used to work out any capital gain or loss.

The market value of an asset is the value that asset might reasonably be expected to fetch on sale in the open market.

Who are connected persons?

A person is connected with an individual if that person is:

- the person's spouse or civil partner;
- a relative of the individual;
- the spouse of civil partner of a relative of the individual;
- the relative of the individual's spouse or civil partner;
- the spouse or civil partner of a relative of the individual's spouse or civil partner.

For these purposes, a relative is a brother, sister or ancestor or lineal descendant. Fortunately, the term 'relative' in this context does not embrace all family relationships and excludes, for example, nephews, nieces, aunts, uncles and cousins (and thus the actual consideration is used in calculating any capital gain).

As noted above, the deemed market value rule does not apply to transfers between spouses and civil partners (to which the no gain/no loss rules applies), but it catches those to children, grandchildren, parents, grandparents, siblings – and also to their spouses and civil partners.

Example 1

Barbara has had a flat for many years which she has let out, while living in the family home. Her granddaughter Sophie has recently graduated and started work and is struggling to get on the property ladder. To help Sophie, Barbara sells the flat to her for £150,000. At the time of the sale it is worth £200,000.

As Barbara and Sophie are connected persons, the market value of £200,000 is used to work out Barbara's capital gain rather than the actual consideration of £150,000. If she is unaware of this, the gain will be higher than expected (by £14,000 if Barbara basic rate band has been utilised), and Barbara may find that she is short of funds to pay the tax.

This problem may be exacerbated where the asset is gifted – the gain will be calculated by reference to market value, but there will be no actual consideration from which to pay the tax.