

Transactions between connected persons (S.549)

Part 19-02-09

This document should be read in conjunction with section 549
of the Taxes Consolidation Act 1997

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Introduction

Section 549 of the Taxes Consolidation Act 1997 (“TCA 1997”) provides measures to prevent avoidance of Capital Gains Tax (“CGT”) by the use of arrangements entered into by connected persons. (The rules for determining if persons are connected are set out in **section 10 TCA 1997**.)

9.1 Connected persons definition

Section 10 TCA 1997 provides a definition of the term “connected persons” which appears in various anti-avoidance provisions dealing with transactions not at arm’s length (see, for example, **para 9.9**).

9.2 Connected persons and relative

A person is connected with an individual if that person is the individual’s husband, wife or civil partner, or is a relative, or the husband, wife or civil partner of a relative of the individual or of the individual’s husband, wife or civil partner.

Relative means a brother, sister, ancestor and lineal descendant. For CGT purposes relative also means an aunt, uncle, niece and nephew.

The term “child” (see **section 6 TCA 1997**) includes:

- a stepchild,
- a child adopted under the Adoption Act 2010, or
- a child subject to an inter-country adoption effected outside the State and recognised under the Adoption Act 2010.

9.3 Connected persons and trusts

A person, in acting in a capacity as trustee of a settlement, is connected with:

- any individual who in relation to the settlement is a settlor,
- any person who is connected with such an individual,
- a body corporate which, is deemed to be connected with that settlement (**para 9.4**).

For the purposes of this paragraph, the terms “settlement” and “settlor” have the particular meanings assigned to them by **section 10 TCA 1997**.

9.4 Body corporate and settlements

A body corporate is connected with a settlement in any year if at any time in the year it is a close company (or only not a close company because it is not resident in the State) and the participators then include the trustees of or a beneficiary under the settlement.

9.5 Partnerships

Except in relation to acquisitions or disposals of partnership assets “pursuant to bona fide commercial arrangements”, a person is connected with any person with whom he or she is in partnership, and with the husband or wife or a relative of any individual with whom he or she is in partnership.

In the type of case where the respective interests of the partners in a partnership change without any monetary or other consideration passing (either as a result of the custom of a particular partnership or of partnerships generally in a particular profession or trade), there is a disposal on the transfer of a partnership interest, but no chargeable gain if, under bona fide commercial arrangements, no consideration in money or money’s worth passes. There may, however, be an allowable loss if, in other circumstances, the disposer of the interest acquired it earlier for consideration in that form, i.e., in money or money’s worth.

In practice, **section 10(5) TCA 1997** should be regarded as also applying to a person joining a partnership.

9.6 Connected companies

A company is connected with another company:

- (a) if the same person has control of both, or a person has control of one and persons connected with him or her, have control of the other; or
- (b) if a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by one or more persons with whom he or she is connected.

9.7 Connected companies and persons

A company is connected with another person if that person has control of it, or if that person and persons connected with him or her together have control of it.

9.8 Two or more persons acting together

Any two or more persons acting together to secure or exercise control of a company or to acquire a shareholding in it should be treated in relation to that company as connected with one another and with any person acting on the direction of any of them to secure or exercise control of the company or to acquire a holding in the company.

9.9 Transfers treated as made at market value

Section 549(2) TCA 1997 is directed against certain avoidance devices which may be entered into by connected persons. It applies where a person acquires an asset and the person making the corresponding disposal is connected with him or her, and provides that the person acquiring the asset and the person making the disposal of it shall be treated as parties to a transaction otherwise than by way of a bargain made at arm's length so that the property is deemed to pass at market value (see [Tax and Duty Manual \(TDM\) Part 19-02-06](#)).

9.10 Restriction of losses

A loss which accrues to a person on a disposal to another person with whom he or she is connected may not be deducted from any gain accruing to him or her except on some other disposal by him or her of an asset to the same other person, at a time when they are connected persons.

There is an exception to the above rule in respect of certain gifts made to a settlement (the settlor is connected with the settlement by virtue of **section 10(4) TCA 1997** (see **para 9.3**) if:

- (a) the gift is made to the State, a charity or any of the bodies falling within **section 28(3) of the Finance Act, 1931** (see [TDM Part 19-07-08](#)); or
- (b) the gift and the income derived from it are applied, wholly or primarily, for educational, cultural or recreational purposes for the benefit of members of an association, unless those members are, in the main "connected persons" (see **para 9.1**).

9.11 Options and losses

Section 549(5) TCA 1997 provides that where a person grants an option, to another person with whom he or she is connected, to enter into a sale or other transaction (see [TDM Part 19-01-11](#)), no loss on the disposal of the asset acquired on the exercise of the option is allowable to that other person, unless it accrues on the disposal of the option at arm's length to a person who is not connected with him or her.

9.12 Rights or restrictions over assets

Section 549(6) TCA 1997 provides that restrictive covenants imposed on the disposal of an asset between connected persons are given only limited weight in valuing the asset transferred. As the transaction is between connected persons, the asset is deemed to be transferred at market value. The market value in such a case is, however:

- (a) what its market value would be if it were not subject to the right or restriction, less
- (b) the market value of the right or restriction, or the amount by which its extinction would enhance the value of the asset to its owner, whichever is the less,

so that if the right or restriction is artificial or its exercise would bring only negligible benefit to the person who might exercise it, the adjustment of the market value of the asset would be negligible. For disposals on or after 20 November 2008, **section 43 Finance (No 2) Act 2008**, provides that where the results of (a) and (b) are the same, the market value of the asset should be restricted by the market value of the right or restriction.

9.13 Treating certain rights or restrictions as if they did not exist

Section 549(7) TCA 1997 provides that the market value of an asset should normally be determined, and the amount of the gain accruing on the disposal computed, as if the right or restriction did not exist where the right or restriction referred to in **para 9.12**:

- (a) is of such a nature that its enforcement would or might effectively destroy or substantially impair the value of the asset without bringing any countervailing advantage either to the person making the disposal or to a person connected with him or her,
- (b) is an option or other right to acquire the asset, or
- (c) in the case of incorporeal property, is the right to extinguish the asset in the hands of the person giving the consideration by forfeiture or merger or otherwise.

See, however, **para 9.14** in relation to exceptions to the normal rule.

9.14 Exception to rights or restrictions over assets and losses

Section 43 Finance (No 2) Act 2008 inserted a new subsection (7A) into **section 549 TCA 1997** for disposals, on or after 20 November 2008, between connected persons of an asset which:

- is subject to a right or restriction enforceable by the person making the disposal (or a person connected to that person) and
- the market value of the asset (ignoring the right or restriction) is greater than the consideration given.

This provision counters an avoidance scheme which was intended to generate artificial capital losses for offset against actual chargeable gains. It does so by disapplying the treatment described in **para 9.13** where, on a subsequent disposal of the asset by the person who had acquired it, the effect of that treatment (without taking account of this paragraph) would be to:

- increase a loss, or
- substitute a loss for a gain.

9.15 Anti-avoidance provision to prevent the creation of artificial losses

Section 549(8) TCA 1997 provides that where the seller of an asset is not chargeable to CGT (or Corporation Tax (“CT”) on chargeable gains) in respect of the disposal of an asset subject to an option, the option will **not** be ignored in the tax treatment of a subsequent disposal of the assets by the purchaser. In this way the purchaser will, on a subsequent disposal of the assets in question, be treated as having purchased the assets at their reduced value by virtue of the existence of an option. (This is an anti-avoidance provision to counter schemes to create artificial losses.)

Example 1

A Ltd, which is not liable to CT on chargeable gains, disposes of shares - which are subject to an option - to B (a connected person) for €800,000. But for the option, the market value of the shares would be €1m.

B is treated as having acquired the shares for €800,000 rather than the market value (ignoring the option) of €1m. On a subsequent disposal of the shares by B, the acquisition cost is taken to be €800,000 – not the market value of €1million that would ordinarily be the case in relation to an acquisition from a connected person.

These schemes came to prominence following the decision of the Supreme Court in the case of *McGrath and Others v McDermott* [1988] ITR Vol. 3, p.683.

However, such schemes have been closed off generally by **section 546A TCA 1997**, which was inserted by **section 59 Finance Act 2010**. That section disallows capital losses for CGT or CT purposes where they accrue to a person, directly or indirectly, as a result of arrangements and the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage (as defined).

9.16 Exceptions where subsections (6) and (7) do not apply

Section 549(9) TCA 1997 ensures that subsections (6) and (7) do not apply if the restrictive covenant is also enforceable against the person making the disposal of the asset. In particular, it does not apply to a right of forfeiture or other right exercisable on breach of a covenant contained in a lease of land or other property, nor to any right or restriction under a mortgage or other charge.