

Quotas – practical tax planning

Julie Butler looks at the taxation treatment of farming quotas.

Introduced by European Economic Community Regulations in 1984, milk quota is an arrangement which allows wholesale milk producers to produce milk up to the quota threshold without attracting liability to supplementary levy.

A quota is allocated to a particular holding of agricultural land.

Inheritance tax

It has been Inland Revenue practice in the case of dairy farmers to combine the value of quota with the value of the agricultural land for the purposes of agricultural property relief. In any event, agricultural property relief (and business property relief) will not be due on milk quota where dairying activities cease, i.e. the quota is held without a trading activity and leased out. As shown below the practical approach for small disposals is to treat quota as a separate asset.

Capital gains tax

Does milk quota comprise an interest in the underlying land or should it be treated as a separate asset for capital gains tax purposes? The decision in *Faulks v Faulks* [1992], concerned a dispute between a surviving partner and the widow of a deceased former partner over the amount of compensation due to the estate. Comments made by Chadwick J suggested that quota was distinguishable from the underlying land. This approach, if well founded, could imply that the disposal of milk quota should be treated as a part disposal of underlying land, with the need to apportion the acquisition cost. However, the capital gains tax case of *Cottle v Coldicot* (1995) SpC40, where it was held that milk quota was a separate asset, has cast doubt on this treatment.

Quota is a fixed capital asset. The Inspector's Manual describes quotas as follows:

'A farmer holds a quota primarily in order to make a profit from carrying on the particular farming activity which it covers. She or he does not ordinarily buy and sell quota in the course of the farming trade. The quota has the character of an enduring asset of the farmer's business similar to the buildings or farm

machinery. Quota is normally therefore a fixed capital asset of a farmer's business.'

Quotas treated by the Revenue as capital assets are subject to capital gains tax and inheritance tax in the normal way.

Examples are:

- ◆ Suckler cow quota - allowing a producer to claim headage payments on suckler cows.
- ◆ Sheep quota - allowing a producer to claim headage payments on ewes and ewe lambs.

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Quota leasing

All quotas can be leased or sold between farmers. For tax purposes there are two types of transaction - temporary or permanent. 'Back to Back' transactions are increasingly used whereby 'dirty' (used) quota is sold and 'clean' (unused) quota purchased on the same day.

A temporary transaction in quotas is known as leasing. The cost to the purchaser is a trading expense. If the lease is of a temporary surplus then the income will be treated as assessable under Schedule D Case 1. However, if the enterprise has ceased that section of farming then the leasing income is assessable under Schedule D Case VI.

From a tax planning point of view, potato quota now has nil value, therefore a claim

for the capital loss should be considered under *TCGA 1992, s24(2)*. The claim, as in all such claims, should be made, where possible, in a year where there is a taxable gain above the annual exemption for capital gains tax.

Milk quota – as a 'fungible' asset

The following article appeared in *Taxation* on 28 February 2002:

'It is understood that the Revenue takes the not unreasonable view that milk quota is a fungible asset. It is worth considering what benefit this could have to the farmer.

The Capital Gains Manual (at paragraph CG77821) states that a producer primarily holds milk quota to produce and sell milk profitably and not run the risk of financial penalty. The manual states that such producers do not ordinarily buy and sell quota in the course of their day to day trade. Quota is an enduring capital asset of the business in the same way as buildings or farm machinery. Thus, where some of a producer's quota was allocated without cost in 1984 and some was subsequently purchased, the Revenue originally considered that the acquisition cost should be apportioned under *TCGA 1992, s52(4)*, by reference to the total holding.

This could seem unreasonable to the producer who has had to buy and sell quota to reach production targets. The result could be a high sale price matched with a relatively low acquisition cost. The Capital Gains Tax Manual now confirms that milk quotas are regarded as fungible assets, under *TCGA 1992, s104(3)*, and the same identification rules will apply as for shares and securities.

For milk quota disposals before

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6 April 1998, it could be said that the share pooling rules may be analogous with the apportionment rule in s52(4), but disposals on or after that date should be identified with acquisitions under the share identification rules.

It could be argued that the application of s54(4) was unfair on those producers who, from time to time, had to purchase and dispose of quota. The disposal was matched against the much reduced cost due to the inclusion in the apportionment of the 1984 allocation with nil base cost. In these cases the disposal proceeds largely represented the gain, which was produced by what could be said was transitional, and better matched with the purchased quota. It is hoped that applying the current 'fungible asset' rules will help to present a 'fairer' position and also a clearer representation of the correct position.

It could be argued that both methods could be used by the taxpayers. The earlier method could produce gains to offset against any unused annual exemption, whilst keeping the base cost higher for future disposals. However, the latter treatment could produce gains, which would not otherwise have been taxed.

It should be noted that the fungible asset rule does not apply to a limited company. As mentioned above, the tax planning point on quotas is that there are times when both methods have advan-

tages subject to the taxpayer's individual position. An aggressive tax planner could use this to best advantage. However, consistency should be applied.

Where possible the farmer should contact their tax adviser BEFORE the disposal of any quota.

2002 Changes

From 1 April 2002 there is a change in capital gains tax treatment of intangible assets, e.g. quotas. The gain on an intangible asset will only be allowed to be rolled over into another intangible asset. The gain on a tangible asset will not be allowed to be rolled over into an intangible asset. This will obviously affect the practical tax planning on quotas.

On the other hand, from 1 April 2002 new quota owned by a company will qualify for write off against profits either at 4% or at a preferred rate. As the future of quotas is not guaranteed beyond 2008 it could be prudent and tax efficient to write it off over a period to that date. This could have large benefits to farmers trading through a company. There are a number of anti-avoidance provisions including the exclusion of relief on quota purchased from a connected party.

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Sanctions in a tax system

In December 1995, the Swedish tax authority raised assessments for tax and surcharges on undeclared takings and employer's contributions on the proprietor of a taxi firm, J.

J appealed on 8 March 1996 and did not pay the amounts charged. Bankruptcy proceedings were commenced, and J was declared bankrupt in June 1996. In October 1997 he was sentenced to ten months in prison for tax fraud.

In February 1999 the Swedish tax authority rejected the tax appeals filed in March 1996. J appealed to a county court, which dismissed his appeals in December 2001.

The point at issue

J appealed to the European Court of Human Rights on the grounds that the delay in determining the appeals and the bankruptcy proceedings were breaches of Article 6.

The decision

The Court stated that a taxation system based on the provision of information by the taxpayer could not function without sanctions, and, given the number of returns processed, standardised rules. The appeal was dismissed.

Janosecevic v Sweden 23 July 2002

November indexation

The value of the Retail Prices Index for November 2002 is 178.2 (January 1987 = 100).

The table below applies only to

bodies within the charge to corporation tax on their capital gains.

For those within the charge to capital gains tax, the FA 1998 provisions mean

that for assets acquired before April 1998 and disposed of after 5 April 1998, the figures for the indexed rise will be as set out in the April indexation table, shown at TPT 1998, p92. ■

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Jan	-	1.157	1.052	0.954	0.851	0.782	0.725	0.605	0.491	0.369	0.314	0.292	0.261	0.221	0.186	0.154	0.117	0.091	0.070	0.041	0.028
Feb		1.148	1.044	0.938	0.845	0.775	0.718	0.594	0.483	0.361	0.307	0.284	0.254	0.213	0.181	0.150	0.112	0.089	0.064	0.036	0.025
Mar	1.243	1.144	1.037	0.920	0.842	0.771	0.712	0.587	0.468	0.356	0.304	0.279	0.251	0.208	0.176	0.147	0.108	0.086	0.058	0.035	0.021
Apr	1.199	1.114	1.010	0.880	0.825	0.750	0.684	0.559	0.424	0.339	0.284	0.267	0.236	0.196	0.168	0.140	0.096	0.079	0.048	0.029	0.014
May	1.183	1.105	1.003	0.872	0.821	0.749	0.678	0.550	0.412	0.335	0.279	0.263	0.232	0.191	0.165	0.136	0.090	0.076	0.044	0.023	0.011
June	1.177	1.100	0.998	0.868	0.822	0.749	0.672	0.544	0.406	0.329	0.279	0.264	0.232	0.190	0.165	0.131	0.091	0.076	0.041	0.022	0.011
July	1.176	1.089	1.000	0.871	0.827	0.750	0.670	0.543	0.405	0.332	0.284	0.267	0.238	0.195	0.169	0.131	0.093	0.079	0.045	0.028	0.013
Aug	1.176	1.080	0.981	0.866	0.822	0.745	0.652	0.539	0.391	0.329	0.283	0.261	0.232	0.189	0.164	0.124	0.089	0.077	0.045	0.024	0.010
Sept	1.177	1.071	0.977	0.867	0.813	0.740	0.644	0.528	0.378	0.324	0.278	0.256	0.229	0.183	0.159	0.119	0.084	0.072	0.038	0.021	0.003
Oct	1.166	1.063	0.965	0.864	0.810	0.732	0.627	0.517	0.368	0.319	0.274	0.257	0.227	0.190	0.159	0.117	0.083	0.070	0.038	0.022	0.002
Nov	1.156	1.056	0.959	0.858	0.795	0.723	0.620	0.504	0.371	0.314	0.276	0.258	0.226	0.190	0.158	0.117	0.084	0.069	0.035	0.026	-
Dec	1.160	1.051	0.961	0.855	0.789	0.725	0.616	0.500	0.372	0.313	0.280	0.256	0.221	0.182	0.154	0.114	0.084	0.065	0.035	0.028	-