

# The Answer Is Blowing In The Wind

JULIE BUTLER considers the tax treatment of wind farms.

**W**IND FARMS ARE a very controversial subject, they have been described as a 'horrendous blot on the landscape'. However, many people consider wind turbines graceful and think that they represent a cleaner sustainable source of energy for the future. This is all very well, but what of the tax position? To date there is no specific direction from case law and there are no clearly presented rules contained within the Revenue manuals. Wind farms are of interest to investor, developer and landowner. Venture capital trusts have been set up to invest in companies that develop, construct and operate wind farms. So what are the facts behind the operation?

- Landowners have the opportunity to receive regular income for up to 25 to 30 years with no additional labour or expense required.
- Depending on size and wind speed, landowners can earn £2,000 to £4,000 a year for each wind turbine.
- Once in place, normal farming can go on around them with no requirement to fence off. The turbines are on concrete slabs 14m x 14m and 2m deep, however they are buried below normal ploughing depth, at least 1m below surface.
- Arable farming can continue right up to the base of the 4m tower. The turbines are connected by cables that are below ploughing depth which will usually run along the boundaries to minimise disruption.
- A developer will choose the site and discuss terms with the landowner. Planning permission can be obtained in six months for small projects and in two to three years for larger projects. In this planning period, the landowner could receive a nominal income of several thousand pounds a year. Once planning permission has been obtained, the landowner is either paid pence per kilowatt hour produced by the wind turbines or a fixed sum a year.
- After a wind farm has been built, over 99% of the land can still be used for farming.

How can the tax planner help his clients? An arrangement/lease/licence with the wind farm operator should not be undertaken lightly. As will be seen, the terms of the lease can have significant tax consequences.

## Loss relief

Essentially, the income from the wind farm lease is Schedule A income from land and property in the hands of the

landowner. Income should be included within the landowner's accounts, but identified separately. With the unprofitable state of many farms, the income will be used to support the farming enterprise and to make the overall operation profitable.

If a farming or market gardening enterprise has sustained losses computed without regard to capital allowances in each of the five preceding years of assessment, TA 1988, s 397 denies the offset of the losses against other income in the current year under 'hobby farming' rules.

The Schedule A income from the wind turbines cannot stop the farm from falling with the hobby farming rules but, with careful structuring, the income could help.

General farm expenses can be allocated against the income from the wind turbines. This will include direct costs and a justifiable proportion of farm overheads that relate to this income. It could be that the s 380 loss relief will not be denied under s 397 due to an accounts profit being achieved.

## Income as capital

Tax planners may set themselves the task of seeking to treat the money received by the landowner for allowing the wind farm on his land as a capital sum derived from the asset. Can the grant of the licence by the landowners to the wind farm developer be treated as a part disposal of land?

The Revenue quotes *Chaloner v Pellipar Investments Ltd* 68 TC 238, which in turn depends upon *Marren v Ingles* 54 TC 76, as authority for the statement that the grant to a right to a profit (*à prendre*) or a licence is not a part disposal of the land. It states that the profit deriving from the granting of the licence arises from the creation of the licence. This is not an asset used in the farming business and as such, business asset taper relief is not due.

Once the developer is interested in the site or indeed once the planning permission is obtained, it could be possible to sell the land to a third party for a value which reflects the potential (as opposed to the actual) income stream. On the assumption that the land qualifies as a business asset and has been farmed up to the date of sale, maximum business asset taper relief should apply and the magical 10% (40% tax rate after 75% business asset taper relief) rate of capital gains tax achieved.

It could be that the landowner would like a right to buy back the land should there be a change of energy policies. A right to buy back documented in writing could be caught under TA 1988, s 36. This section is a further anti-avoidance provision which seeks to tax the difference between the sale price and the lower purchase consideration as a deemed premium. Essentially, the increase in value is taxed as income.

The landowner could sell the land to the wind farm developer/operator and lease back part of the land to farm.





Such a sale could be caught, in part, as income and not capital under TA 1988, s 779 and, therefore, part of the disposal will not be eligible for business asset taper relief.

The landowner might have concerns as to ascertaining the value of the land and the value of future energy generation. Where the land is sold and there are rights to further monies depending on the amount of energy generated, the uplift should be a capital disposal for CGT and eligible for business asset taper relief. The wording of the contract will be of paramount importance.

### Corporation tax

If the land is owned in a limited company, the income should be taxable at the company's marginal rate of corporation tax. In practice, few farms trade through a limited company because of the lack of business asset taper relief, the risk of trapping losses in the company and some potential inheritance tax disadvantages.

Extracting the profits from the limited company via the dividend route will result in the eventual capture of the income in the hands of the individual. There can be a greater spread of the income to family members and shareholders resulting in personal tax savings. Retaining the profit within the company at lower corporate tax rates can be attractive.

Transfer of land into a limited company could be a useful tax planning tool, although consideration of stamp duty land tax and the possible question of TA 1988, s 660 problems with regard to the gifting of shares to family members should be taken into account.

### Pension fund

The purchase of the commercial land by the landowner's pension fund is an interesting tax planning tool, which would require the relevant professional help. The need to sell the land when the beneficiary achieves 75 years of age can have distinct disadvantages.

### Inheritance tax

Land used by the wind farm is subject to a lease and we have to look at a number of issues:

- Does the lease qualify as a farm business tenancy in accordance with the Agricultural Tenancies Act 1995?
- If the lease to the wind farm developer is not a farm

business tenancy, will the land qualify for agricultural or business property relief?

- What are the terms of the lease?
- Can vacant possession be achieved within the required 12 months/24 months?
- Is the activity agriculture?
- Will the wind farm land be an excepted asset under IHTA 1984, s 112 or will relief for the whole enterprise be achieved through the recent case law set by *Farmer (Farmers Executors)* (1999) STC (SCD) 321 or *Marquess of Hertford* (SpC 444)?

For business property relief purposes, the aim is to achieve inheritance tax relief on the whole of the farming activity including the let land. Much will depend on the wording of the lease/licence, as well as on case law as it evolves. There is every possibility that the tax planner should be able to achieve 100% relief on the enterprise. The resultant theme of *Farmer* and the tax planner is that of 'unified management' with all aspects of the business being examined. Where this can be demonstrated, the case for the availability of business property relief will be much stronger.

Key factors will be to ensure:

- that the wind farm is incorporated into the farm as one unit;
- integrated accounts, i.e. treating all the income from farming and wind farms as one integrated business unit; and
- that the business consisted 'mainly of farming'. If the land used for the wind farm is sold so as to capture the advantage of full rollover relief (TCGA 1992, s 155) and reinvested into another business asset, agricultural and business property relief should apply.

### Are wind farms agricultural property?

Agricultural property is defined in IHTA 1984, s 115(2) as follows:

'agricultural land or pasture includes woodlands and any buildings used in connection with the intensive rearing of livestock or fish, if the woodlands or buildings are occupied with agricultural land or



## Wind Farms

pasture and the occupation is ancillary to that of the agricultural land or pastures.'

Agricultural land will include any interest, servitude or right over land.

Agricultural property relief is restricted to agricultural value, this is defined as the value which the property would have if it were subject to a perpetual covenant prohibiting its use other than as agricultural property (IHTA 1984, s 115(3)). Where the claim for agricultural property relief is restricted, then provided the conditions are met (see above), business property relief should apply to any balance not attributable to agricultural value.

### Trust protection

Tax protection might be sought by transfer of the land to a trust. There is no stamp duty land tax on the transfer in and there could be the protection of a holdover relief for CGT on the transfer in or the benefit of full business asset taper relief if the timing of the transfer is correct. Income distributed to beneficiaries could have income tax benefits. This is a very complex area, but should not be overlooked or undertaken lightly.

### Disposal while lease is operational

What is the value of the land and what is the value of the lease on disposal? FA 2003, s 160 now allows land let to qualify for business asset taper relief post-5 April 2004,

but what of the disposal of the lease? This will depend upon the wording of the lease and the arrangement with the third party developer.

### Landowner as developer

Many landowners want to receive regular income without the responsibility for maintaining the turbines, but the landowner can act as developer. There is also scope to have one grid-connected turbine to help provide the farm's own fuel.

If the landowner acts as developer, this is a new trade and has all the complexities of such a course of action, such as what should the trading vehicle be and what is the arrangement between the trading vehicle and landowner. This would give rise to many new tax planning opportunities and the facility to pass income to other family members, whether via a company or a partnership.

### Conclusion

With landowners and farmers looking for financially rewarding diversification projects, wind farms present an interesting alternative. As with all such projects, the tax planning should be looked at in advance and not left blowing in the wind ...

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For more information on wind energy, visit the British Wind Energy Association, [www.bwea.com](http://www.bwea.com).

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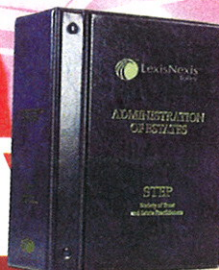
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