



FARMING AND RURAL BUSINESS GROUP NEWSLETTER

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Accounting for profit on property disposals captured at 50% income tax

The last few years have seen shifts and changes in the interaction of income tax and capital gains tax. Prior to the major reform of capital gains tax (CGT) effective from 6 April 2008, business asset taper relief (BATR) allowed business capital disposals to be taxed at a 10% rate of tax where the land sold had previously been part of the farm or business assets.

This meant that property development profits could be taxed at this low tax rate of 10%. When the highest rate of income tax was 40%, this meant a potential tax saving advantage of 30% when capturing the profit in the business CGT regime as opposed to the income tax regime.

From 6 April 2010, the highest income tax rate increased to 50%. As the standard CGT rate is 18% from 6 April 2008, this now means that there is a potential tax saving advantage of 32% between capturing property disposals as CGT instead of income tax.

Unless the sale of the property is in conjunction with the disposal of the whole business, it is unlikely that Entrepreneurs' Relief will apply. Moreover, even if the whole business were being sold, the property itself would have to have been owned for a period in excess of 12 months. It is therefore attractive for HMRC to try to capture any profits on property disposals as income and for the taxpayer to try to ensure that the gain is taxed under the CGT regime.

It is possible for a gain arising on the disposal of land and property to be taxed under one of three headings:

- Capital gains tax
- Trading in land
- Artificial transactions in land – Income Tax Act 2007 s 756.

Capital gains tax (CGT)

A gain on the disposal of land will be taxed as capital where it can be demonstrated that the taxpayer is not dealing in land. Likewise, it will be taxed under the CGT provisions provided that the anti-avoidance legislation of Income Tax Act 2007 (ITA 2007) s 756 'Income treated as arising when gains obtained from some land disposals' does not come into play.

Trading in land

It can be argued that if the farmer or landowner carries out any work to the property to promote its development or sale other than by just obtaining planning permission, then he is trading in land. It is possible that if a farmer/landowner makes frequent disposals or buys to sell on, he could be caught under the 'trading in land' provisions. Trading is defined in the taxes act as including 'every trade, manufacture, adventure or concern in the nature of trade'. Since this does not really define trading at all, the so-called 'badges of trade' have been formulated. It is not necessary to show that all badges of trade are present for an activity to be assessed as a trade. The following comprise the trading emblems known as 'the badges of trade'.

1. **Motive:** illustrated where land has been acquired for the purposes of resale. The land has not been acquired as fixed capital but rather as stock in trade, which will usually be confirmed if there is a short interval of time between the acquisition and sale. File notes and documentation should support the capital disposal motive, not the trading motive, and that the land has been used for dedicated farm purposes or diversification purposes.

2. **Similar trading interests:** is the taxpayer involved in similar ventures that have been admitted as trading or do other capital disposals in the light of the current disposal connect the transactions as trading after taking account of the other badges?
3. **Frequency of transactions:** a number of similar transactions may indicate a continuous activity. Transactions normally treated as of a capital nature in isolation acquire the characteristic of trading income due to the frequency of the transactions.
4. **Circumstances of acquisition:** it is difficult for HMRC to demonstrate that the sale of land acquired by gift or inheritance amounts to an adventure in the nature of trade, as intention of resale will not necessarily be in mind at the time of acquisition.
5. **Subject matter:** is it genuine farmland? Has it be farmed or stored for resale? This badge of trade tends to be unhelpful in land cases since land can be acquired as an investment, own occupation and resale.
6. **Time interval:** holding the land for a number of years may point to a lack of profit-motive when the land was acquired. However, the factor is not considered conclusive by HMRC. In *Cooksey and Bibbey v Rednall* (1949) 30 TC 514, the taxpayer successfully argued that there was a lack of profit-motive, but the case still went to the High Court even though the land in question had been held for 15 years.
7. **Supplementary work:** this applies where work is done to the property to make it more marketable, or where the taxpayer actively takes steps to find purchasers. However, there may be circumstances where cash needs to be raised as soon as possible. The more development work carried out the more likely the trading clarification.
8. **Method of finance:** the purchaser may have purchased the land with the assistance of a loan that has been made on terms requiring repayment upon resale. This gives a clear indication of intention, as demonstrated in *Turner v Last* (1965) 42 TC 517.

The tax planner must ascertain what the intention is on acquisition. Of crucial importance is the acquirer's intention at the moment of the acquisition of the land: see *Simmons (as liquidator of Lionel Simmons Properties Ltd) v IRC* [1980] STC 350.

Artificial transactions in land

Further to the consideration of farmland sales not being caught as capital gains, developers are usually caught under the terms of ITA 2007 s 756, which encompasses cases where: 'land is developed with the sole or main object of realising a gain from disposing of the land when developed.' The purpose is to prevent property-dealing profits from being disguised as capital. The circumstances are clear and likely to be kept to two situations:

- the disposal of shares in a property company (*Yuill v Wilson* [1980] STC 460); or
- where a UK resident passes the opportunity to make a trading profit on UK land to an overseas company.

The scope of ITA 2007 s 756 is broad and catches transactions that have little or no element of artificiality; therefore, the avoidance can be accidental or unwitting by the landowner.

The rules apply in the following circumstances:

- land is developed with the sole or main object of realising a gain from disposal later;
- land is held as trading stock; or
- the land or any interest that has its value derived from it (eg, shares in a landowning company, interests in partnerships, etc) is acquired with the sole or main object of realising a gain on disposal.

In order for ITA 2007 s 756 to apply, a gain of a capital nature must result. A farmer who sells land confident that any tax will be calculated under the provisions of CGT could be caught for the 50% income tax rate as opposed to the 18% tax rate of CGT.

'Slice of the action' schemes

One of the most common applications of ITA 2007 s 756 involves 'slice of the action' schemes. These schemes involve the landowner selling surplus land to a developer, receiving a fixed sum, followed by future contingent payments based upon the success of the development. The receipt will be of a capital nature in the landowner's hands and accordingly will be caught by ITA 2007 s 756 as a trading profit has emerged in a

capital form. HMRC's authority for treating additional payments in this way can be found in *Page v Lowther* [1983] STC 61. The fixed sum, however, will remain chargeable to CGT. It is the contingent payments that must be taxable as trading profit.

ITA 2007 s 756 cannot be invoked where the landowner could be charged under trading profit – refer to the 'badges of trade' to see if it is pure trading.

ITA 2007 s 756 cannot apply in respect of the disposal of a main residence that is exempt from CGT (Taxation of Chargeable Gains Act 1992 s 222) or would be if it were not for Taxation of Chargeable Gains Act 1992 s 224(3).

Advance clearance procedures

A formal HMRC advance clearance procedure is available in respect of transactions potentially falling within ITA 2007 s 756. This can be made before or after the relevant transaction. The action plan has to be to make sure that tax planning is carried out in advance of disposals; that the motives for the sale (and original purchase) are considered; and that full warnings are made to the client.

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