

## 'Cleansing' development land using holdover relief

With more development potential now presenting itself for agricultural land, serious tax planning will be needed in order to maximise the after-tax return. One very important tool in the tax planning armoury will be the £5 million limit for entrepreneurs' relief, which needs to be looked at carefully.

### Restrictions and alternatives

Entrepreneurs' relief is an obvious way to reduce the tax bill on sale of development land out of a farm. But the problem is that the restrictions on entrepreneurs' relief are fairly onerous.

In the rural land context in particular, two of the restrictions likely to be relevant are that the asset disposed of:

- cannot be let property; and
- cannot be a mere asset disposal, but must be the whole or part of the business.

Therefore it is likely that the owners of the land will turn to rollover relief as an alternative to entrepreneurs' relief. Unfortunately rollover relief has equal problems in many cases, in that it is restricted via the mixed use or partial use calculations where there has been non-business use for a while. This non-business use could include let property or private use, and this can be restrictive. It can also be difficult to find enough property to meet these criteria.

Guidance in relation to rollover relief is found in TCGA 1992 s152(6) where for the period of ownership, or any substantial part of the period, part of a building structure or area is not used for the purpose of the trade. Where there is mixed business and non-business use of potential development land for rollover relief, there is a restriction and this is covered in TCGA 1992 s152(7). This deals with the situation where at some stage within the ownership period there is no qualifying use whatsoever.

The period of ownership used for qualifying for rollover relief cannot commence earlier than 31 March 1982.

It is generally accepted that the apportionment of costs and disposal proceeds will be

undertaken on a just and reasonable basis for this mixed business use, i.e. between business use and non-business use.

But if entrepreneurs' relief and roll-over relief are restricted or unavailable, at least part of the gain is going to be taxed at the full capital gains tax rate – which is now 28%. Is there any way to avoid that?

Perhaps the twist in the tax planning tail relates to the availability of CGT holdover relief.

### Washing out non-qualifying periods

Fortunately there is a way to get around the onerous provisions of rollover relief and entrepreneurs' relief, where there has been non-qualifying use in the past.

What can be done with the potential development land is to pass it down to the next generation, which can be done free of capital gains tax using the less onerous holdover provisions for agricultural property.

Once the land is in the hands of the next generation, being under new ownership it is automatically wiped clean of those problems of non-qualifying use, i.e. periods when the land was let or periods when it was used for private use. Then in the hands of the next generation one can ensure that it is used purely for qualifying purposes, until it has met the minimum required period - which is now only one year of business use. Once that point has been reached it can be sold, and because it has been used purely for business purposes (whilst under its current owners), entrepreneurs' relief with its attractive 10% rate of capital gains tax can be available.

When this is compared to the much more onerous 28% full rate of capital gains tax, this is very attractive.

By using holdover relief there would obviously be a loss in the uplift of value that one would usually have on a gift, in that the base costs that would have to be used by the next generation disposing of the land would be the original base costs for the family, but then that

would be no different than as if the transferors had disposed of the land themselves.

### Practical example

This method could, for example, be used where some land has become available for development that was part of a main farm, but does not qualify for entrepreneurs' relief, for example because it is let up to the time of transfer.

Instead of selling and paying 28% capital gains tax, the land can instead be transferred to the next generation, using holdover relief to avoid any capital gains tax at the transfer stage.

Under, say, a farm business tenancy the tenant could be given notice before the transfer, with the property transferred at the end of the tenancy so that the property was clear of any non-qualifying use.

The land will then move into new ownership, when it can be farmed directly (using contractors if necessary) so that it qualifies for entrepreneurs' relief, both in terms of business use of the land and as the entirety of their business is conducted on the land (so avoiding any 'part business' issues).

It can then be disposed of after the one year qualifying period.

### Holdover relief

In order to qualify for holdover relief there must be a transfer at undervalue, which would normally be to a family member.

In looking at whether it is agricultural property which is being transferred guidance is given in section 115(2):

*"agricultural land or pasture includes woodland and any building used in conjunction with the intensive rearing of livestock or fish."*

*"If the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture and also includes cottages, farm buildings and farmhouses together with land occupied with them as are of a character appropriate to the property."*

**Taxation of Chargeable Gains Act**

Therefore, in order for potential development land that has been used for agriculture to be passed down to the next generation free of capital gains tax, it simply has to comply with the holdover relief provision of being agricultural property and being used for an agricultural purpose and being occupied in the correct way.

However, it does not have to meet the stringent requirements of say rollover relief where there are restrictions for, as already mentioned, partial business use of development land, i.e. where the land that is part of the rollover relief claim contains areas that qualify for business use and areas not used for the purpose of the trade.

### Potential problems

Obviously transactions of such a large value could cause problems. The inheritance tax considerations must be thought of as must any anti-avoidance procedures that HMRC would be likely to put in the way to challenge such a disposal.

### Income tax treatment

One anti-avoidance danger of using a transfer to the next generation is that the disposal afterwards might be picked upon by HMRC as trading in land and/or a transaction caught under ITA 2007 s756 - which will tax the capital profit as income. Obviously if the sale is taxed as income, then the capital gains tax reliefs will not be available.

The terms of s756 encompass a transaction where land is developed with the sole or main object of realising a gain from disposing of the land when developed, or where land is acquired with the main object of realising a gain from disposing of it. Clearly therefore the motives for passing the property down to the next generation must be thought through.

Arguably one defence to both a charge under s 756 and a suggestion that the land is acquired as trading stock is that the transferees are passive recipients of a gift. As such, most of the badges of trading are absent, and equally a s756 motive to sell quickly at a gain cannot be automatically imputed to them.

In theory it might be more reasonable for the Revenue to apply s759(6), by which the gain can be taxed on a person providing the opportunity for it to be realised (the transferor). However since it is unlikely that the transferor originally acquired the land to realise a gain from it, use of that section would seem unduly harsh.

### Inheritance tax

Another potential pitfall to consider is that of inheritance tax.

Obviously these farming transactions would normally qualify as a transfer of agricultural property, and so would benefit from agricultural property relief.

However consideration must also be given to the fact that a District Valuer would probably try to value this property with a high hope value element. As we have seen in previous issues of *Tax Confidential*, agricultural property relief can only be claimed on the agricultural value of the property, not on the "hope value" (the extra value that comes from the potential to develop the land). Since we are considering potential development land, that hope value could be high.

This means that when the land is transferred as agricultural property from one generation to the next using holdover relief, this would be a lifetime gift for inheritance tax purposes and so taxable if the transferor dies within the next seven years.

It may of course be possible to use business property relief to escape inheritance tax, to cover for the possibility of the transferor not surviving the gift for 7 years. However if the land is, or has recently been, let property (which is likely, given that we are only looking at using this technique where entrepreneur's relief is not available), there would be problems with claiming under the business property relief provisions. Although let land can qualify for agricultural property relief, it is unlikely to qualify for business property relief.

However, this could be where the "Nelson Dance" case would come into play, depending on the full facts, and the provisions of such a transfer being tested by reference to

the transferor's estate. Note also the recapture of BPR and APR on the decease of the transferor after the land has been sold by the transferee, that the relief will be lost when the recipient sells the land unless the proceeds are reinvested in another qualifying asset.

If the current owners were elderly then I suppose it could be argued that an added disadvantage of the lifetime transfer is that it loses the possibility of the CGT uplift on death. However, there would be various concerns as to whether the land would qualify for full inheritance tax relief and what HMRC would do with the hope value.

So that then really rests on the second disposal when entrepreneurs' relief is claimed. Would there in actual fact be an attempt to use section 756 by HMRC? In this regard it is the advantage of life's realities that the development project would probably take a long time and therefore it would be difficult to argue that there were any quick fix advantages to such a transaction.

### Action Plan

Where there is development land which is tainted with criteria which would make it difficult to claim entrepreneurs' relief and difficult to claim rollover relief, there are distinct considerations in using holdover relief to pass to the next generation. It gives a 'clean' product that can then be sold, being able to use rollover relief and entrepreneurs' relief and the advantage of having the gain taxed at the lower 10% rate without the problems of non-qualifying past uses. □

**Julie Butler F.C.A.**

Julie Butler F.C.A. is the author of *Tax Planning for Farm and Land Diversification* ISBN: 0754517691 (1st edition) and ISBN: 0754522180 (2nd edition) and *Equine Tax Planning* ISBN: 0406966540. The third edition of *Tax Planning For Farm and Land Diversification* will be published shortly.  
Butler & Co, Bennett House, The Dean, Alresford, Hampshire, SO24 9BH  
01962 735544  
j.butler@butler-co.co.uk  
www.butler-co.co.uk