Bigger slice

JULIE BUTLER considers the income tax and capital gains tax charges that may arise on slice of the action schemes and overage.

Many UK taxpayers are taking advantage of the national housing shortage by selling land for construction and benefiting from the capital gains tax rates that can apply to property developments. One area of attack by HMRC is any arrangements involving the landowner that can be deemed to be "slice of the action" schemes. In general, this is where the vendor receives an agreed percentage of the future development profits. The initial consideration is for the disposal of a capital asset – the land – and will generally be subject to capital gains tax. However, the subsequent consideration is for the later disposal of a new asset – the right to the contingent consideration – the "slice of the action". Such a disposal could be caught under ITA 2007, s 752 and s 756 ("Income treated as arising when gains obtained from some land disposals") because the vendor's rights under the contract were acquired with the sole or main object of realising a gain from the development of the land. The "slice" will therefore run the risk of being taxed at a higher rate as income.

A popular arrangement is for the landowner to receive houses in the development as part of the deal and HMRC will try to capture this element as trading income.

First intention date

It is essential to consider the tax point in these arrangements. When ITA 2007, s 756 applies, the gain is taxed as income arising when the gain is realised. HMRC's authority for this is *Page v Lowther* [1983] STC 799. The effect is that the gain attributable to the period before the intention to develop the land was formed is excluded and is chargeable to capital gains tax in the normal way. It is the future contingent payments that are taxable as trading profit. This requires the land to be valued at "the first intention date". The amount chargeable under s 756 will normally be the difference between the total proceeds (the fixed sum plus the future contingent payments) and the market value of the land at the first intention date. That market value is used as the disposal proceeds in the capital gains tax computation. The first intention date is a question of fact.

A formal HMRC advance clearance procedure is available for transactions potentially falling within s 756. This can be made before or after the relevant transaction. However, it is rarely used in practice because disclosure puts HMRC on notice, and there is a tendency for the department to play safe if there are any doubts, knowing full well that an enquiry can be raised once the tax return has been submitted.

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Overage

Landowners may also sell land that they know could have future development potential in which there should be an "overage provision". This secures a right to future gain in the form of future development value. Overage is about the vendor making a statement in the sale agreement as follows: "You may realise additional value and, if you do, you will pay me for it." It is the responsibility of the beneficiary of the overage, usually the seller, to ensure that the obligation to make that future payment is adequately protected by some form of security.

The tax position must be considered when the overage is realised. This is complex and many advisers assume overage is taxed as a capital gain but, generally, it is assessed to income tax – see the *Capital Gains Manual* at CG72857. Each case must be reviewed carefully and on its own merits. HMRC guidance is in the *Business Income Manual* at BIM60305 "Transaction in land: Overview". The transactions in land rules prevent the avoidance of income tax and corporation tax on land transactions that are, in essence, trading transactions, but where the "profit" emerges in a capital or non-taxable form.

At first glance, overage might appear to apply only to farmland that could be developed in future. It can, however, include a much wider range of property – for example, private dwellings with large gardens or low-key farm and residential property that may, at some stage, enjoy development value.

Practical tip

Approach all potential development plans with care as to the logistics and detail at an early stage. The legal agreements and tax protection must be worked out hand-in-hand, with tax planning being sorted at the heads-of-agreements stage before the legal agreements are finalised.

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