

FarmTaxBrief

Practical guidance on effective tax planning and the law relating to agricultural land

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Wind farms – tax planning considerations

With the increased number of 'wind farms' and the increased income arising from wind turbines, the question is being asked: What is the income tax, inheritance tax (IHT) and capital gains tax (CGT) position relating to the asset and the income? For IHT purposes the answer has to be that the wind turbines are placed with large distances between each turbine and a lot of business/farming activity can take place around them. An integral IHT point is therefore what is the turbine standing on – is the land part of an agricultural activity or a business? Let's consider alternatives.

Wind farm on a loss making mixed farm at risk of being victim of 'hobby farming' rules
It is assumed that the landowner will grant a lease to the turbine operator, who will sell the electricity generated. The income will be taxed as property income rather than trading income. Even if the landowner enters into a partnership or other arrangements so as to be treated as carrying on an electricity generation trade, this will be separate from the farming trade.

With regard to income tax it will be important for the landowner to allocate the correct amount of overheads and direct expenses against the turbine income. If the correct amount of the farm expenses are (based on fact) allocated against turbine income then there could be greater protection against the landowner falling foul of

the hobby farming rules. Greater commerciality can have huge benefits for a farm that helps the farming profit which in turn will help the claim for business property relief (BPR) on the basis of meeting the trading for gain criteria.

Wind farms and inheritance tax

Assuming that the landowner has leased the site to the operator, the value of the turbines themselves and their site may qualify for BPR on the basis of the one business principle, the net value of the business (s110 IHTA 1984) – of farming incorporating the wind farm. Direction is given from the cases of *Farmer* (*Farmer v IRC* [1999] STC (SCD) 321) and the *Earl of Balfour* (*Brauder (Representative of Fourth Earl of Balfour) v HMRC Commissions* [2009] UK FTT101). HMRC has appealed against the *Balfour* case and we are awaiting the outcome. Concerns would be raised with regard to s105(3) IHTA 1984 (Business consisting wholly or mainly of making or holding investments) if the farm or mixed estate had too many investment business assets, and for example, let property including the wind farm is greater than the trading activity. The criteria when looking at an investment business are the division of turnover, asset value, profit, hours worked etc between trading activities and the investment business activities. If the turbines enjoyed high income, profit and value they could 'tip the

balance' with regard to s105(3), ie, the mixed estate could have greater investment business than trading business caused by the wind turbines and their high value and high rental income. For the established farmer, while the turbines may generate large amounts of income he may carry on his farming business much as before, spending as much time on it.

The concerns of the trading business

If the income and profits from the turbines did 'tip the balance' then consideration would have to be given to considering moving surplus non-trading assets into another legal entity. Would it be easier to transfer the let property etc than the wind turbines? Would the turbines be that easy to transfer? The transfer could include the land they stand on and the land that surrounds them – consideration would have to be given to such matters as access. To review the tax planning there would have to be reasonable forecasts of income and profits from the various sources of the assets on the mixed estate. The case of *Dance (HMRC v Trustees of Nelson Dance Family Settlement [2008] Spc 682)* has possibly helped with the BPR claim for non-business assets. The *Dance* case was further agreed in favour of the taxpayer in the Court of Appeal CA/2008/APP/0434. *Dance* looks at transfers made by the settlor and how they qualify for BPR even if they are a non-business asset leaving the settlor's estate.

Profitable traditional farm

It is assumed that the IHT impact of wind turbines on a traditional farm would be no different to the increase in the number of rental properties on the farm/estate. The impact of the turbines may of course, be less in terms of management time and cost, and amount of land used. The income from turbines will be property income and BPR can be claimed without an attack under s105(3) provided the income etc from the investment in the wind farm does not overshadow the farm trading activity in terms of share of income, profit, value etc. Again projections of future cash flow from both the farm and wind farm activity should be prepared at the point the wind farms are proposed. But how can this be achieved? It can be argued that farm commodity prices and farm production costs have been so variable in recent years so who can predict the farming years ahead? BPR could be achieved as the turbines are part of the farms business as the wind turbine income and value will not 'tip the balance'. Income from the wind turbines must be incorporated into the farm accounts and the ethos of the farm activity must be integrating the wind turbine activity with the main farm account in order to protect BPR.

Profitable mixed farming estate

If the mixed farming estate already contains a number of investment business assets e.g. assets that would not qualify for BPR in their own right as they are not business assets then prior to the arrival of the wind turbines again the introduction of these turbines could 'tip the balance' and evoke s105(3) IHTA 1984 ie, mainly holding investments. This is because the income and value of the turbines is greater than the farm. The question therefore has to be asked should the wind turbines be owned in a separate capacity?

Long-term woodland held as an investment

If the turbines are constructed on areas of cleared commercial woodland within a long-term woodland operation on the assumption that the income from occupying the woodland is 'exempt' and the IHT relief will be 'deferred' under s125-128 IHTA 1984 then the turbine may qualify for BPR. The simple fact is that the turbines are being 'planted' in the middle of property that may not be a business but an investment activity therefore not eligible for BPR. HMRC will often accept that that actively managed commercial woodlands will qualify for BPR as going beyond being mere investments, but the addition of a valuable investment activity may make the entirety 'mainly' an investment business.

What action could be taken to try and ensure the turbines could qualify for BPR? In order to change the long term woodland into a business with trading income and profit greater than the income from the turbines could be a positive step to help BPR on both the woodland and the turbines. If the owner can afford to forego the rental income from the turbines, then the answer may be to gift the land on which they will be erected before it is leased and they are constructed. As the occupation of commercial woodlands is not a 'trade' for income tax purposes, hold-over relief will not be available under s165 TCGA 1992, but the woodlands may nevertheless qualify for BPR so that a gift into settlement, as a chargeable transfer of IHT purposes would secure a CGT hold-over relief under s260 TCGA 1992 without an immediate IHT liability (see *HMRC v Nelson Dance Family Trustees*).

Wasteland not part of a business

On the assumption that the wasteland is not part of business and therefore eligible for BPR then it will not qualify for BPR. The income from the turbine will therefore be income from property let income as it cannot be integrated into a business as there is no business.

How could BPR be achieved? Create a business around the wasteland and turbine – some diversified activity? How about a caravan park with lots of services! But what of planning permission? Perhaps when planning permission is obtained for the wind farms if IHT relief is an important driver in the project then perhaps apply for a permission around the wind turbine so there is a business around the turbines.

Valuing the wind farm

On death of the landowner how will the land agent value the wind turbines for IHT purposes and how might the District Valuer (DV) challenge this? The land with the turbines must be valued at market value s160 IHTA 1984. So what is the market value of land with a wind farm on it – willing buyer and willing seller? As wind farms are relatively new will there be comparable history of sale proceeds? The potential buyer would inspect the lease – so must the valuer, what are the income terms, the liability clauses and risks? A potential buyer would no doubt consider the likelihood of a lease being renewed, and the terms of renewal, an exercise which may require consideration of political as well as technological and meteorological risks. Any taxpayer about to consider the wind farm venture must look at not just the income stream aspect thereof but the impact on value and the possible IHT consequences. The potential value will indicate the future IHT liability that needs to be sheltered.

Capital gains tax (CGT) re disposals

What is the position with regard to future disposal of the land that the wind turbines are constructed on? It could be the complaints of the neighbours are so great that the landowner wants to sell and escape. There are a number of alternatives facing the landowner. He might consider that to comply with the conditions of ER is too complicated. The turbines are rental income and there

not eligible for ER and rollover. How long will the 18% rate be available? If the whole business is sold can ER be obtained on the non-business element? The farmland is being used for a trade and therefore that element should be eligible for rollover relief.

Action plan for wind farms

The clear message with any wind turbine proposal is it is essential to look at the tax planning and 'business bag' (the business into which the turbine arrives) to plant the turbines into to protect potential IHT. Consider the practical tax planning:

1. Taxpayer and adviser to review the wind turbine lease agreement prior to accepting the proposal to consider the impact on the claim for BPR and ER. Consider how the lease agreement interacts with the status of the land on which it is placed.
2. Consider the future plans for the farm, the farming activities and the interaction of the wind turbines in relation to turnover, profit and asset value.
3. Consider disposal of the land prior to the construction of the Turbines when it is a business asset to be to utilise ER. For ER purposes this land disposal cannot be a mere asset.
4. if the wind turbines are used as a valid income stream of the farm or mixed estate then ensure correct expenses allocated against the rental income stream and the rental activity is part of the farming operation to take advantage of the BPR potential of 'Farmer' and 'Balfour'.

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