

Dangerous disclosures

JULIE BUTLER considers the importance of the proper tax return disclosures where land and property are concerned.

When thinking of the self-assessment tax return, immediate word associations for the professional adviser could be “31 January deadline” or “income tax mitigation”. However, also high on the list of the priorities is “capital taxes protection”. A dramatic example of this is the consideration of whether a trade or activity relating to property is shown as self-employed income or on the land and property pages. The disclosure of property income has, by definition, important capital gains tax and inheritance tax considerations.

At some point, it is a certainty that the property will be sold or gifted or the owner will die while in ownership of the property. This might appear over-simplistic, but the tax consequences are significant. What if capital gains tax rollover relief or entrepreneurs’ relief is expected or if business or agricultural property reliefs are needed to mitigate potential inheritance tax liabilities?

An obvious statement is that any income tax return disclosure must not disadvantage any future claim for capital gains or inheritance tax reliefs and the position for capital tax mitigation and planning should (and must) be thought through.

The power of the pages

It can be argued that every entry on the land and property pages must be scrutinised. Once a statement has been made on the tax return that the income is rental it can be argued that there is no further chance of a claim for rollover, entrepreneurs’ or business property reliefs. Further, in terms of agricultural land, a claim for agricultural property relief for the farmhouse could be jeopardised.

Agriculture is perhaps the greyer area because the difference between trading from the land and, say, a grazing agreement is very subtle. Hence the greater need for attention to detail and the recording of expenses.

HMRC’s *Inheritance Tax Manual* at IHTM24073 states: “Where land is let to a third party under a grazing licence or agreement the owner is unlikely to be in occupation for agricultural purposes of that land during the period of the licence. This may have an impact on whether agricultural relief is available on the farmhouse (IHTM24074).”

The farmhouse

The *Inheritance Tax Manual* gives clear guidance that a weak grazing agreement can jeopardise the claim for agricultural property relief on the farmhouse.



At IHTM24074 (“Occupation: Definition of a lease as opposed to a licence”), the manual states: “The terms and practical operation of a grazing licence agreement will determine the fundamental question as to who is the actual occupier of the land for the purposes of assessing compliance with IHTA 1984, s 117. It is therefore important to obtain as much information as possible about the terms and operation of the licence in order to correctly assess their provisions.”

The key time to “obtain as much information as possible” is in the production of the accounts that support the fact that a trade is being carried on, if that is the case, or the simple inclusion of the income on the land and property pages. This is a very clear reminder of the power of the land and property pages and the need to ask: “Is this the right disclosure?”

Practical tip

Review all land and property page entries to ensure that the correct disclosure has been made in respect of the land. Likewise, include a “capital taxes protection” checklist with the preparation of every income tax return that cross references land. The tax return is part of the evidence to support claims for inheritance tax and capital gains tax and the preparation time is the ideal moment for the interactive “fact find”.

A grazing agreement featured in the important *McCall* case (*PN McCall & BJA Keenan (Personal Representatives of Mrs E McClean) v HMRC* [2009] STC 990). It is certain that it will be subject to much HMRC scrutiny in the years ahead. ■

Julie Butler FCA is the author of *Tax Planning for Farm and Land Diversification* (Bloomsbury Professional), *Equine Tax Planning* ISBN: 0406966540, and *Stanley: Taxation of Farmers and Landowners* (LexisNexis). She can be contacted on 01962 735544 or email: j.butler@butler-co.co.uk.

CAPITAL TAXES PROTECTION CHECKLIST

Other income

- 1) *Does any income relate to property?*
The income must be disclosed correctly.
- 2) *Does the property need the protection of trading activity?*
This may be necessary to protect inheritance tax or capital gains tax reliefs.
- 3) *Should disclosure of income be from a trading activity rather than from property?*
In reality, the land may not simply be “let”. There may be indicators that a trade is being carried on and therefore inheritance tax business property relief, capital gains tax entrepreneurs’ relief and rollover relief could be available through the trading activity. Make sure that these aspects are thoroughly researched.

Land and property pages

- 1) *What is the nature of the land and property?*
Different types of land and property – for example, agricultural, commercial or residential – need different protection and disclosures. Ensure that the differences are understood.
- 2) *Has protection of capital gains tax reliefs been considered?*
Rollover relief and entrepreneurs’ relief may be available.
- 3) *Has the protection of inheritance tax reliefs been considered?*
Will business property relief remain available?
- 4) *Should there be disclosure of a trade?*
Let land does not normally attract the reliefs that a trade enjoys and consider whether, in reality, a trade is being carried on. For example, only having a licence rather than tenancy, maintaining the land, boundaries, and waterways, fertilising and checking stock can all indicate that a trade may be present.
- 5) *Are the “badges of trade” present?*
These indicators of a trade being carried out should be supported by the “badges of trade”. Again, research the various “badges” thoroughly.
- 6) *What is the approximate value of the property that needs protecting?*
Higher values are higher risk. It may be necessary to justify to HMRC that a business is being carried on and contemporaneous evidence will be required.
- 7) *Is there clear division between property?*
Combining various properties or different types of property can be a dangerous approach as each property must be clearly defined for added protection.

Trading position

- 1) *Is property ownership involved?*
If the trade only rents the premises from which it operates then there is less need for capital taxes protection. If the trade owns its premises then capital taxes must be considered.
- 2) *Who owns the property; for example, is there joint ownership by spouses or a partnership?*
Assumptions can easily be made when it comes to spouses and there can be a lot of historical unpicking of ownership, especially where farmers are concerned.

- 3) *Is the trading vehicle operated by one party, while the property is in a different ownership, for example where one spouse owns a share of the property, but is not involved in the trade?*
A “marriage” between ownership and trading structure tends to be preferable, where the party or parties carrying on the trade are the same as those owning the property.
- 4) *Is the land and property owned by the partnership or individually?*
Lack of clarity here can result, inadvertently, in business property relief being reduced from 100% to 50%. However, if applied correctly, this ownership structure can mean that capital gains tax entrepreneurs’ relief remains available for an associated disposal.
- 5) *Is the land and property shown in or out of the balance sheet?*
100% business property relief can apply to development land or let cottages on a large estate owned by the business and shown on the balance sheet.
- 6) *Consider the reconciliation of (4) and (5) above.*
Remember that simply having the property on the balance sheet does not instantly mean that 100% business property relief is available.
- 7) *Is a partnership agreement in place to protect property if appropriate?*
Is there a trust deed that confirms that the property is owned by the partnership? Of itself, showing the property on the balance sheet is not enough.
- 8) *Are there disposal plans to protect capital gains tax reliefs and is an entrepreneurs’ relief strategy required?*
The exit strategy is a key part of tax planning.
- 9) *Has inheritance tax relief protection been considered by way of business property or agricultural property relief?*
Every good exit strategy can be prejudiced by unexpected death so both capital gains tax and inheritance tax implications and possible outcomes need to be considered in conjunction with the other.
- 10) *Are the full badges of trade evident for business property relief?*
Because HMRC are continuing to scrutinise the difference between the holding of investments and a trading business and because land values continue to increase, there is an ever-increasing need to defend the trading entity.
- 11) *Is the business profitable?*
Remember that, for inheritance tax business property relief to be available, the business must be carried on for gain (IHTA 1984, s 103(3)).
- 12) *If there is a grazing agreement, where is the basic payment scheme income shown?*
As it is associated with the land, this income should be shown in the trading pages rather than as “other income”. All of the expenses associated with the land, such as fertiliser and maintenance costs, should also be recorded.

Summary

Based on the answers to the above questions, does the tax return disclosure protect the property for:

- capital gains tax relief; and
- inheritance tax relief?