Development land and the 'Zetland' and 'Ramsay' cases

There are many who describe the current development land positions as 'open season', with plenty of opportunities to capitalise on recent planning policy changes to maximise building project potential that was previously unavailable.

The residential development sector has shown signs of recovery and improvement, and this, together with the National Planning Policy Framework (NPPF) encouraging residential construction, will present positive commercial opportunities for both house builders and landowners in the immediate future and in the years ahead. Planning permissions are being fast-tracked for any development sites considered 'sustainable'.

Has tax planning been fully considered?

Whilst many projects have considered and addressed 'planning' concerns, there are many who are of a view that there has been comparatively little thought with regard to tax planning to ensure such strategies are relevant and effective. Key questions such as, have the considerations of BPR for IHT, together with ER or Roll-over Relief for CGT need to be fully considered by all advisers. The tax reliefs are not automatic; they must be thought through in great detail.

In addition, ownership structures and administration must also be identified and actioned – many farmers have complex family arrangements, eg, who owns what is often not clear; and whether there is a 'tax marriage' or not between the land ownership and the trading vehicle frequently needs attention *before* the development project.

Opportunities for building developments

Recent changes to planning regulations have shown a substantial building development opportunity for landowners, as the lack of availability of land and the low build rate since the recession appears to have led to a shortage of new homes, thus creating a significant gap in the market or simply a shortage in the housing supply.

A key requirement of the NPPF is for local authorities to demonstrate that they have at least five years' worth of housing supply available, meaning more projects involving farmland and building are now being considered than before. Councils who have not been meeting government targets will need to show an even longer pipeline of potential housing to ensure that demand can be met.

Applying immediate attention to planning opportunities would appear to be the way forward for the landowners to act with regard to planning permission and tax planning associated with this. In reality, all those owning the prime sites will have been approached by promoters and developers or their agents, and thus should be aware of the potential development gains available, but there are still more sites being looked for.

Neighbourhood Plans

The advent of neighbourhood plans has brought new opportunities for farmers who own parcels of land on the edge of villages or towns. Previously, such sites were unlikely to be considered for development as they were outside the settlement's boundaries; projects were more focused on urban infilling and construction on brownfield sites. Now, however, there is revised potential, provided that there is some level of community support for the development undertaken, ie, infrastructure roads are paid for. Although policy favours employment or leisure uses over residential builds in more rural areas, there are still opportunities for small-scale housing developments.

Whether the development project is large or small, the tax position is a key component of the viability of the project and, therefore, must not be overlooked by the farmers and landowners.

Capital Gains Tax

The recent case of *Russell v HMRC* (2012: TC02299); [2012] UKFTT 623 (TC) has shown the problems of 'material' disposals for ER, the process of avoiding some CGT liability by disposing all or part of a business, ie, ensuring the lower rate of taxation, 10% instead of 18% or 28% is achieved on business disposals. The disposal of 35% of the available farmland by Mr Russell did not match the criteria for all or part of the ER rules, by being a disposal part of the business itself, and thus ER was denied and CGT had to be paid at the higher rate.

In light of this case and the development opportunities, to ensure ER and other business reliefs can be obtained, any farm or FBT, or indeed any farm tenancy, should now be revised to cover such eventualities and there are ways to restructure to maximise the reliefs. ER does not apply to let property or just the sale of a mere asset or sale of a material asset if it does not meet the conditions. In particular, it should be remembered that, for ER purposes, the legislation defines 'business to mean a trade or profession or vocation'.

There will also be large concerns in the agricultural community regarding any 'weak' grazing or contract farming agreement where potential development land is involved. The development could also involve let farm buildings, and questions on whether enough business activity exists to qualify for Roll-over Relief – another CGT respite strategy allowing the gain to be deferred to a later date – will therefore be achieved with the disposal. Roll-over Relief, for investment in land is understood, by many farmers, but it is not the only type of Roll-over Relief. There is also the rollover of a business into a company.

Ramsay and the need to prove degree of service for rollover into a company

Elisabeth Moyne Ramsay v HMRC [2013] UKUT 226 (TCC) (08 May 2013)

The *Ramsay case* highlights some important areas when considering making claims for IHT Relief and ensuring robust evidence to support the claim. So, what are the facts?

In 1987, the taxpayer inherited a one-third share of a block of flats and took over the administration for the whole building in 2002. In February 2003, she gifted one-half of her share to her husband. The couple then spent about 20 hours a week attending to the building, eg, making sure the rent was paid on time, cleaning communal areas, forwarding post to tenants who had left and making sure that the building was insured and complied with fire regulations.

A year later, the taxpayer purchased the rest of the property from her brothers. In September 2004, the taxpayer and her husband transferred the property to TPQ Developments Ltd in exchange for shares in the company. It is this transaction that HMRC tried to argue was a CGT disposal which did not qualify for Roll-over Relief. In August 2005, they made a gift of all their shares in TPQ to their son, R, who became the sole shareholder and director of TPQ. It was this disposal that HMRC tried to argue was a chargeable gain subject to CGT, and that the gain did not qualify for Roll-over Relief, as under s162 TCGA 1992, the property was not a business when the transfer was made.

HMRC questioned the meaning of the business when the transfer was made and turned to the six tests laid out in the *Customs and Excise Commissions v Lord Fisher* [1981] STC 238 VAT case as to what exactly defined a business. For CGT purposes, the service provided was not enough, in their view, to qualify as a business, and thus the relief claim was disallowed.

The taxpayer appealed on the basis that they considered that rollover applied; however the First Tier Tribunal (FTT) initially upheld the HMRC decision. The taxpayer tried again to obtain tax relief, this time appealing to the Upper Tribunal.

The Upper Tribunal held that the word 'business' in the context of s162 should be interpreted broadly. The judge stated that criteria as to what constituted a business in the *Fisher* case were helpful. In this instance, the Upper Tribunal agreed that the work carried out by the taxpayer actually did satisfy the business tests set out in *Fisher*, contrary to HMRC's interpretation. As to the question of degree, the taxpayer's activities in respect to the property did amount to a business for the purposes of s162. The taxpayer's appeal was, therefore, allowed.

The above example demonstrates that, in terms of future development land sales, the degree of services provided by the landowner will be key for proving grazing agreements qualify as a business. *Ramsay* could also help other cases where there are 'blurred boundaries' between the holding of an investment and the operation of a business.

Inheritance Tax Relief

A significant problem facing the farming world today is that the average age of the landowner is very high and IHT planning with current high values of land and development opportunities returning. Young family members are coming back into farming but often not in a land-owning capacity. It is, therefore, increasingly important that agricultural families consider IHT on succession very seriously, and thus more consideration of obtaining IHT reliefs is, therefore, required.

BPR and Hope Value

The primary intention of BPR is to enable businesses to cope with a death in the family or other inheritance tax event without causing the business to have to be sold up. It is meant to be a 'relief'. It is important that BPR is considered in addition to APR as this only covers the agricultural value of land, and not the 'Hope Value' (the difference between agricultural value and market value). BPR, instead, covers the whole market value of the land, including any development potential included in the market value.

Thus, if only APR is claimed by the farming family, there may still be a significant IHT liability arising, whereas a BPR claim would eradicate this extra liability. In general terms, therefore, provided the potential development land is part of a trade and the s105(3) IHTA 1984 tests are met, BPR should be achieved.

However, BPR claims are frequently difficult to defend if the evidence is not robust, as shown by the recent FTT decision in the *The Trustees of David Zetland Settlement v HMRC* [2013] UKFTT 284 (TC). The trustees were appealing a notice of determination issued by HMRC, refusing BPR on the grounds that the trustees were carrying on a business which was excluded because it was one of 'making or holding investments'.

In the *Zetland* case, the Tribunal concluded that the income derived from services was less than 25% of total income received, and thus BPR was denied. However, whilst this guidance is useful, advisers must take the negative approach and assume that the business does not qualify whilst the taxpayer is alive, and then ensure that enough evidence is put in place by the client to validate a potential BPR claim on death. Arguments can be raised that HMRC should take the positive approach.

Nature of the income not the services performed

In order to qualify for BPR, it is essential to understand the nature of the income received as far as the business owner is concerned that determines eligibility for BPR and not the nature of the service being carried out.

In the case of *Zetland*, there were a gym, a café and a hair salon, all of which contributed to the overall integrity of the BPR claim but were entirely separate businesses and not operated by the trustees themselves. The Tribunal was clear that this income must be regarded as investment income, whereas if the businesses were undertaken by the trustees in their own right, it would be viewed as non-investment (trading) income.

Who carries out the service is a key point for others seeking to qualify for BPR, as joint venture arrangements or other types of structuring look unlikely to assist in achieving qualification.

Nature of the service being provided

Henderson J acknowledged during the *Pawson* case that it does not matter how the income is described; it is the nature of what is being provided that actually matters.

There is also the issue of the term 'mainly' used in the IHT legislation (s105(3) IHTA 1984). Tribunals have concluded that 'mainly' trading must be interpreted as 50% and above. This makes sense if a quantitative analysis is being undertaken but is much harder to interpret if a qualitative analysis is utilised. In *Zetland*, the Tribunal concluded that the Revenue derived from services was less than 25% of income, and thus was not eligible to claim the relief.

How do we apply these recent Tribunal rulings of the joint venture of contract farming, and what of a contract farming arrangement (CFA) that is not the trade of farming in practice? All advisers with development land and CFAs must consider bringing the farming back in hand to protect any BPR claim. Where a CFA remains, it is essential to look at the badges of trade, the nature of the income and what is really happening, eg, who fertilises the land.

Practical planning point

McCall v HMRC [2008] STC (SCD) 752 showed that development land needs BPR in order to remain tax-efficient and avoid significant IHT liabilities. Indeed, while APR of £165,000 was claimed in this case, IHT was charged on a value of approximately £5,635,000, the local council having earmarked the site as a development zone, raising the market price of the land to approximately £5,800,000.

With HMRC's continued attack on BPR and services, eg, *McCall*, *Pawson* and now *Zetland*, it is essential for 'intelligent businessmen' to consider bringing all farming activities back in hand. The risk is too great, but hopefully HMRC will assume that the business does qualify for BPR before they launch the next attack.

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