Development Land – How Can An 'Equalisation Agreement' Help?

Julie Butler provides an insight into equalisation agreements, what they are and their advantages.

It has been said by many land agents that all who own land close to a village stand an exceptional chance of achieving planning permission in the next decade. Such potential development land opportunities can be maximised by the individual landowners cooperating with each other.

Over recent years, the UK has seen a large increase in active development land projects, many involving farmland with several owners. A question that is often raised is how to protect against one landowner benefitting from high value land uses within the project (e.g. the prime residential element) with others stuck with lower values (e.g. infrastructure and low cost housing). Unless action is taken, some landowners may achieve greater reward, despite the fact that all parties own the land integral to the development as a whole.

The solution is to incorporate 'equalisation into any development agreement'.

Equalisation of values

This article looks at active development land projects of a reasonable size where equalisation of values between landowners might be advantageous, and considers some of the potential tax considerations. There are a range of possible solutions, all of which aim, as far as possible, to share the benefit of the higher value land uses across all involved. There can be considerable benefits for all parties if this can be achieved, not least because it means that the neighbouring landowners will not be in competition for the high value use aspects.

How to achieve equalisation

One possibility is demonstrated by the 'Jenkins v Brown pooling arrangement'. This involves all owners 'pooling' their land so that they each own a percentage of the whole site. This is increasingly popular, but it should be noted that there are complexities, particularly when arrangements for farming the land before the development takes place are taken into account; as well as how to untangle the pool if the project is discontinued.

In many cases, a more simplistic approach may be to use a 'gross area basis' whereby the landowners agree that the price they each receive will be calculated by reference to the value of the total site. However, this approach can also be difficult where there are numerous owners, more than one buyer, or where the sale of development land is shared over several years.

There are other arrangements that involve creating a special purpose company vehicle, into which the land is added and the landowners take shares. There is potential for multiple tax considerations around the disposal of the land to a company then extracting the funds, requiring careful planning with emphasis on values to be agreed.

Another potential strategy is to grant cross options, so that if Landowner A sells part of his land, the developer has to pay Landowner B to release his option over the same land. This is a relatively straightforward solution, although it can have disadvantages for both capital gains tax (CGT) and inheritance tax (IHT).

Consideration of the 'big picture' moving forward

Given there are many opportunities for increasing 'property portfolios' the need for the farming community to review all planning permission and tax-planning opportunities around the new permitted development rules must be an immediate priority.

It has been said that with sufficient levels of tax planning, all landowners who are farming (or more importantly should be involved in the trade of farming) can achieve entrepreneurs' relief or rollover relief for CGT purposes, whilst protecting the land for IHT purposes on all land disposals – this is, however, a challenge, especially with equalisation.

Inheritance tax

It is important to consider the tax implications of the landowner predeceasing the completion of the development – the average age of the landowning farmer is near 60 years of age, with a large number in their 70s and 80s. The future IHT position must therefore be considered, as the District Valuer will assess the land on death at market value (IHTA 1984, s 160). The 'hope value' (market value less agricultural value) will need the protection of business property relief (BPR). The availability of BPR and the legal structure must therefore be considered. Where the land is used (but not owned) by a partnership of which the owner is a member, only 50% BPR will be available.

Capital gains tax

The landowner must consider the integration of IHT and CGT in relation to the potential development land. A lawyer must ascertain the exact ownership – often what the landowner understands to be the ownership structure might not be mirrored by the legal interpretation. The available CGT reliefs that can be used must be reviewed at an early stage. If the land is to be passed to the next generation then holdover elections can be considered, but at the potential expense of the 'tax free' uplift on death of the base cost.

The question of the best use of holdover relief, entrepreneurs' relief and rollover relief must be examined. Many advisers are promoting the 'front loading' of entrepreneurs' relief, i.e. take the maximum limit while it still exists, whilst others would advance the rollover option.

Entrepreneurs' relief and partners

Where the farm is operated as a partnership, but the land is owned by one or more partners personally (although this is not normally advisable for IHT purposes), if entrepreneurs' relief is the more immediate goal, it may be helpful to set up this kind of structure in advance. The planning is to structure the sale of the land as an 'associated disposal' where there has been a 'material disposal' of a business.

For a partner, a material disposal is relatively easy to achieve because a reduction in the partner's interest in a partnership share will be recognised as a disposal of part of the business. Finance Act 2015 indicates broadly a 5% reduction in a business interest as being sufficient to qualify as a withdrawal.

This opens the way for the partner to dispose of the land as an 'associated disposal' qualifying for entrepreneurs' relief. The disposal must be made 'as part of the withdrawal of the individual from participation in the business', but HMRC accept that this refers to equity participation and not time spent.

Entrepreneurs' relief is a complicated area of tax and seeking professional advice is to be recommended.

Rollover relief

In order to achieve rollover relief it is essential that the farm is trading and not let. Many argue that the Ramsay case (Elisabeth Moyne Ramsay v HMRC [2013] UKUT 226 (TCC) gives hope for farm property that is let in part but actively managed.

Much has been written about this case. However, seeking professional advice in connection with potential rollover relief claims is always recommended.

Practical Tip :

These are exciting times for potential development projects and it is essential to ensure that tax-planning strategies are in place early, to maximise the potential reliefs available. Such planning should be in place long before the equalisation agreement and/or the planning permission has been obtained.

Landowners with equalisation opportunities are going to have to work with their neighbours, and before they undertake the task of entering into the basic legal agreements, they must:

- ensure all current agreements are in place, and these adequately protect ongoing tax relief (e.g. partnership agreements and wills);
- ensure that overall tax planning takes place before planning permission is obtained and before the equalisation agreement (if any) is agreed upon;
- ensure all new legal agreements provide the required amount of protection; and
- act now – time is running out and tomorrow may be too late!