Do you have the right to tenant?

Historically the definition of a good tenant is one who commits to the type of lease that you require, always pays on time and looks after the property in a very satisfactory way. It has not always been the role of the landlord to consider which tenant is the most tax efficient.

Recent changes to tax law have made this more relevant. Lets look at that in relation to a tenant farmer.

Periods from 5 April 1998 to 5 April 2000

Tenanted farmland will not be a business asset for taper relief purposes for any period from 5 April 1998 to 5 April 2000 unless:

(a) the tenant is a partnership in which the landowner is a partner *(TCGA 1992 A1 Sch 5(2)(a))*, or

(b) the land is used by a company which is a qualifying company in relation to the landowner *(TCGA 1992, A1 Sch 5(2)(b))*, or

(c) the asset is used within a group (51% subsidiary test) where the holding company of that group itself qualifies as a holding company of a trading group *(TCGA 1992, A1 Sch 22)*.

For the company to be a qualifying company in relation to the landowner, it must be a trading company or the holding company of a trading group, and the landowner must either hold shares with 25% of the voting rights, or 5% of the voting rights if he is a full time working officer or employee of the company, or of a company that has a relevant connection with it.

This can be extended to tenants of land and buildings other than of farmland. Let us then look at the position for periods after 5 April 2000.

Periods after 5 April 2000

For periods after 5 April 2000 it is sufficient for the land to be let to any unlisted trading company (or holding company of a trading group) to qualify for business taper relief.

For other unincorporated tenants, for periods after 5 April 2000, the landlord will still have to be in partnership with them, or for a listed company he will need to be employed by the company, or hold 5% of the voting rights in the company.

The relief will not be reduced if the tenant pays a full market rent.

Contrast this position with retirement relief where:

(a) there would be no relief at all if the land was let to either a partnership or a company of which the landlord was neither a partner nor a shareholder, and

(b) there would be a restriction to the relief, and no relief at all, if the land was let to a partnership in which the landlord was a partner, or to a company in which the landlord was a shareholder, and the rent paid was a full market rent.

And contrast the position with rollover relief where there will be a restriction of relief for periods when the

Property valuations and disposals – practical tax planning

Julie Butler **looks at some of the tax problems which may be encountered with farming assets.**

With the current farming crisis combined with the property boom, there are more agricultural properties coming up for sale and estate agents are reporting that they are often being purchased by non-agricultural buyers. There are currently a lot of improvements to property, planning permission applications and disposals of small units taking place.

There is great scope for such buyers with the cash available to try and buy a farm as a complete agricultural unit and then split it up into various lots, rather like corporate asset stripping.

With the move away from farm subsidies and the apparent revival of the rural economy, together with the forthcoming Green Paper on planning, there could be lots of scope for the entrepreneur to buy a farm, get the right planning permission to convert buildings into residential and office lets and to divide these up with the correct acreage if applicable. There are a lot of property speculators, entrepreneurs and some farmers who are very aware of this. This places great emphasis on the valuations placed on property at all levels. When a large unit is purchased, how is the market price arrived at? How is the unit valued on death? How important is this if there is a claim for 100% agricultural property relief (APR)/ business property relief (BPR)?

If 100% agricultural property relief is available, or, with the move away from agriculture to diversification, 100% business property relief, there is apparently not so much importance to be placed on the valuation. However, what about the capital gains tax position? What can the tax planner do?

When reviewing any form of tax planning for farm and landowners it is important that the principle that death is not a chargeable event for capital gains tax be borne in mind. It is generally accepted that values which attract 100% APR or BPR vary enormously due to different circumstances. It is essential that a tax planner is involved in the valuation and that the client's circumstances and, above all, future plans are taken into consideration.

Concerns over future capital gains tax are not so relevant when it is clear that the client wants to hold on to the family property forever. However, if it is obvious that the beneficiaries cannot afford to maintain the estate as it stands and might have to dispose of certain assets, then the whole interaction with capital gains tax and inheritance tax relief is of prime importance.

However, from an inheritance tax point of view, it must be questioned whether the use of lotting will then be given more importance by the Revenue when looking at inheritance tax issues.

Let us therefore look at what the tax principles surrounding lotting are.

The VOA manual CH1B para 9.3 sets out the principles that relate to what is known as lotting, i.e. consideration for the valuation of agricultural property

land is occupied by others (*TCGA 1992 s152(7)*).

The relevance of having 'the right tenant' for tax purpose in this article is to highlight the most tax efficient capital gains tax treatment. However, when considering the position of either landlord or tenant the capital gains tax treatment must not be looked at in isolation and full consideration must also be given to the inheritance tax implications of the situation.

In addition, the change of pre and post 5 April 2000 requirements can restrict the relief available for capital gains and must be considered carefully now rather than just prior to any disposal. Although most practitioners are fully aware of this position, are clients advised so that they may use this information when choosing a tenant?

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Procedural decision on postponement application

Pumahaven Ltd (P) owned the freeholds and superior leaseholders of a number of shops, which were occupied by various group companies. On 18 September 1996 P sold all its businesses and assets to a third party. P drew up its accounts to that date and started a new accounting period on 19 September. On that date P received a one-off payment of rent from one of its former group companies. The Revenue assessed P to corporation tax on the rent. P appealed.

Before the appeal was heard an issue came before the Special Commissioner for decision as to whether P should be allowed to postpone payment of the tax assessed pending the appeal. The postponement was refused. P appealed, contending that two arguments for postponement had been put before the Commissioner, who had dealt with one only. He had not considered the argument that the rent was not taxable as there was no source of income in the relevant accounting period.

The point at issue

The argument that, to be taxable, income must have a source in the relevant accounting period, should have been considered by the Commissioners in deciding whether or not to permit postponement.

The decision

The source doctrine argument was an argument about a principle, which ought not to have been ignored by the Special Commissioner. The decision would be set aside and the matter of postponement remitted to a different Special Commissioner for reconsideration. The appeal was allowed.

Pumahaven Ltd v Williams (Insp of Taxes) – ChD – 4 October 2002

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where different areas would be sold as separate lots. If one or more of the lots is wholly exempt from inheritance tax then it is unnecessary to value that or those lots. However, where a 'lot' is partially exempt this gives rise to an interesting tax planning point with regard to valuations.

When considering valuations it must be assumed that the seller marketed the property in a way which produced the best selling price. If appropriate, it must be divided into lots or assembled into one item for sale as a whole. This can be of importance in relation to farmhouses.

Consideration should be given to the case of *Earl of Ellesmere v IRC* [1918] 2KB735. In the case of *Duke of Buccleuch v IRC* [1967] 1 All ER 129 the general principle is that there is no obligation that there should be lotting into natural units but the property should be marketed in such a way as to produce the largest price provided that it did not involve excessive time or effort.

Where future disposals are intended, it is an essential tax planning point to try to argue high values for IHT and therefore CGT at death. Examples to test the tax planner are:

(i) Hope value, i.e. land used for farming which has planning potential. It is hoped that BPR can be claimed on the difference between the agricultural and hope values.

(ii) The valuation of related property, as defined by *s161(2)*. The rule here is that an artificial assumption can be made in order to determine the value of property for tax purposes. Related property rules are of wide application and must be given consideration by the practitioner in many cases.

(iii) Restrictions on disposal of the asset.

(iv) Unquoted shares and securities.

(v) A lease being treated as a settlement.

(vi) The interaction of debts.

(vii) Farm cottages.

It has often been argued that open market is hypothetical. It is generally considered that the market which is perceived is one where the property is offered for sale to the world at large and that all potential purchasers have an equal opportunity to make an offer and it is widely known it is for sale. Reference can be found in *Lynell v IRC* [1972] AC 680.

These are very interesting times for the estate/land agent and tax planners who act for the property owner whether it be farming or non-farming. With the boom in property prices, the collapse of the farming industry, diversification and property utilisation coming to the fore and with business asset taper relief becoming so favourable from 6 April 2002, the tax planner has got an interesting mine-field of permutations and combinations to consider when advising clients.

With more disposals of land possibly imminent it is very pertinent to look at how tainted taper can be avoided in all these circumstances. The practical tax planning point for all landowning clients is to review the ownership, review the status and to look at future capital gains tax and inheritance tax reliefs, consider the move away from APR to BPR, check for tainted taper and see how lotting could be used to the advantage of the client as opposed to the disadvantage.

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