Country life

With the Office of Tax Simplification's review of lifetime gifts and an ageing farming population, farmers will be considering making lifetime gifts and taking advantage of reliefs while still available. Julie Butler and Fred Butler look at areas of concern for the adviser

Julie Butler *FCA is the author of* Tax Planning for Farm and Land Diversification *and* Equine Tax Planning *(both Bloomsbury Professional), and is the co-author of* Stanley: Taxation of Farmers and Landowners *(LexisNexis)*

Fred Butler *MSc ATT is a tax manager in the farm and equine department of Butler & Co Chartered Accountants*

The farming industry faces much uncertainty at present. Following Brexit, the Tory landslide election win and, more specifically, the proposed changes to the inheritance tax (IHT) lifetime gifting rules, many farmers will be considering passing their farms down to the next generation now to take advantage of the current reliefs available. There is great potential to do this tax-efficiently as part of succession planning, particularly with the possibility that the generous capital tax reliefs currently available might eventually diminish.

However, with a gift comes the risk of a 'failed' potentially exempt transfer (PET), so the scope to achieve IHT relief on farms at death may be more appealing. Yet, with the new Agriculture Bill's requirement for farmers to "deliver environmental public goods" to achieve subsidies, this may conflict with the more traditional activities required for the farm to qualify for agricultural property relief (APR) or business property relief (BPR), neither of which have been updated for some time to reflect modern farming practices.

A solicitor advising a farming family must be aware of the various pitfalls involved in making lifetime gifts, such as loss of probate uplift, gifts with reservation of benefit (GROBs) and transactions in UK land. Forensic analysis of ownership and business structure will be required at the earliest opportunity. A holistic approach with specialist tax advisers is key to ensuring tax and risks are mitigated where possible.

Office of Tax Simplification's review of lifetime gifts

The Office of Tax Simplification (OTS) has proposed a variety of changes as part of a radical review of IHT. Some of the recommendations include:

- combining the various lifetime allowances, the annual exemption, gifts on marriage and regular gifts out of income, and introducing one larger personal gift allowance
- reducing the period it takes for PETs to fall out of the tax net from seven years to five years
- abolishing taper relief, given it is generally misunderstood as applying to the gift as opposed to the tax.

This final proposal is irrelevant to the majority of people who do not make lifetime gifts in excess of the nil-rate band (NRB), but key to those who need to consider succession planning, including farmers. Shortening the lifetime gifting period to five years will assist executors, who often find it difficult to access records more than six years old.

For those advisers currently reviewing farm succession planning and suggesting lifetime transfers to farming clients, consider the timing of the transfer: for example, should one wait for the five-year change to be introduced, or simply start the current seven-year clock ticking now?

Failed potentially exempt transfer

At present, if a PET proves to be a chargeable transfer, this should not be too much of an issue for farmland, given that APR should be available on the part of the value transferred (see section 124A of the Inheritance Act 1984 (IHTA 1984)). Such action will depend, first, on the normal conditions of "occupation for agriculture" in section 117 of the IHTA 1984 being satisfied. The agricultural property must have been either:

- occupied by the transferor for the purposes of agriculture throughout the period of two years prior to the date of transfer, or
- owned by the transferor for the period of seven years prior to the transfer date and occupied throughout that period (by them or another person) for the purposes of agriculture.

As such, where the lifetime gift of the farm achieves APR and BPR, there are strong advantages to gifting the land now, rather than waiting for any OTS recommendations to be implemented by the government.

Probate 'tax-free' uplift

Another key recommendation in the OTS report is to deny the 'tax-free' uplift to market value for assets where a relief or exemption applies, such that no IHT is payable. This proposal reinforces the original intention of APR and BPR – that is, to ensure that businesses can be passed down and continue trading, rather than having to be sold to pay IHT. If this proposal is implemented and the beneficiaries do decide to sell, they will have the historic base cost of the deceased, which will likely result in more capital gains tax (CGT) payable. However, if the spousal exemption applies, the tax-free uplift should still be available.

If this denial of the tax-free uplift came into force, then, in order to prepare, the taxpayer could arguably sell the farm, pay the currently low rate of CGT, and buy a new farm to achieve a higher base cost. However, this is rather laborious, unless it ties into the farm's business strategy.

One consequence of this proposal, should it be implemented, may be that farmers who have held on to their farm and not gifted it – to retain both control of the asset and the current CGT uplift at death – will now be inclined to gift it, mindful that the 'death advantage' of the gift might disappear.

Potential development land

With so much development of farm buildings and farmland currently taking place in the UK, and individuals looking to roll over their gains into more farmland, it is not surprising that farm values remain high. Another reason why land prices are maintaining their value is the beneficial IHT position. Some farmers who are achieving development on their land are looking to buy more farms to roll over their capital gains liability, not just to reduce the tax payable, but to ensure that replacement property relief is available at death for IHT purposes. Obviously, the date of death for generic IHT planning is unknown, but if the farmer is known to be seriously unwell, then rolling over into new business assets becomes more urgent in tax-planning terms.

The practical tax question is whether the landowner should gift before or after the property development. One practical option is to roll over the development gains into new qualifying investments – be it another farm, business or alternative investment market investment – and then gift the resultant asset to non-farming children.

The issue comes from not knowing when the land is going to be developed and when the elderly farmer is going to die. Waiting for the development land to be sold and the resultant cash to be gifted increases the chances of a failed PET, so further consideration should be given to gifting agricultural land at the earliest opportunity, rather than the proceeds of the land. As long as a GROB is avoided (see below), then the value at the date of gifting, rather than the value of the proceeds of the land, is 'locked in'. This could be the difference between £10,000 per acre and £250,000 per acre for some development projects. The market value is not taken into account when holdover relief applies, given the donee simply takes on the historical base cost.

Transactions in land

The biggest issue in gifting land at the moment is that it could come under the scrutiny of HM Revenue & Customs, under the transactions in UK land provisions introduced to catch profits generated from trading in or developing UK land. Their broad aim is to impose an income tax charge where capital gains are made from a disposal of land.

The best way to mitigate the risk of these provisions applying is to prove that the land was not acquired solely to make a profit on disposal. It is therefore key to acquire the land as early as possible and ensure that income is generated from the land via renting, or to have the donee come into the farming business.

For example, if the donee is introduced into the existing partnership as a partner, they are acquiring the land to generate a profit from farming activities. They also help take the strain from the elderly partners, and there is the added advantage of increasing their chance of securing various tax reliefs on the subsequent sale of the development land.

Gifts with reservation of benefit

One of the issues that arises from the gifting of development land is GROBs. This issue is more likely to arise if the donor continues to receive the rent or full partnership profit from the land in question.

The best way to avoid this is to reduce the donor's partnership accordingly if the donees are brought into the partnership. If the donees are not brought in, then a market-value rent must be paid to them for their new ownership of the land, to avoid a GROB.

Where the donees are introduced into the partnership, the most efficient way to record the new ownership of land and profit shares is through the partnership agreement. It is good practice to put notes in the accounts, setting out the position and explaining the exact transfers that have taken place. The permanent files should be updated and the relevant CGT workbooks completed, clearly setting out the tax implications of the gift, including the original base cost, the amount of gains held over and so on.

If there are any GROBs, then the market value as at the date of death, rather than at the date of the gift, is brought into the donor's estate. Note also that if the rules around APR and BPR are met, this can apply to the value brought back into the death estate.

Stamp duty land tax

One further tax that needs to be considered where any land transfer is concerned is the position on stamp duty land tax (SDLT). This will need careful analysis, but often should not be too much of a problem.

Where the land is partnership property, no SDLT is payable where the partners are 'connected' for SDLT purposes. Each partner is connected to their own children, parents and any siblings (plus the spouses of each, if applicable). Uncles / aunts, nephews / nieces and cousins are not connected.

Similarly, there should be no SDLT payable on the gift, even if the land is not partnership property, providing there are no borrowings on the land and there was no consideration.

Incorporation

Given many farms are run through a partnership structure, another option to consider around lifetime gifting is incorporating the business. Where the company issues shares as the consideration for the transfer of the business and its assets, incorporation relief can then be claimed to mitigate the CGT. Subsequent gifts to the next generation are then a lot easier to make, via passing down the shares.

A key advantage with such a strategy relates to the IHT treatment of the gift of shares. If the company continues as a part-trading / part-investment company, BPR will not be clawed back on the death of any of the original shareholders, because it does not matter for BPR purposes if the company ceases to be a mainly trading company.

The bigger issue

Tax aside, arguably one of the more complicated areas is trying to achieve parity between the various children or other family members. This is notoriously tricky within the farming community, where one must take into account who is to remain in the business and who isn't, along with their different tax requirements, besides carrying out the complex exercise of ensuring equal values are achieved. All of this will need careful working through with the family and their other advisers, and may often be more challenging than the tax itself.