Development land tax pitfalls – deferred consideration

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Despite all the news about the housing sector slowing down, the demand for farmland for development has remained strong, with reduced profit margins due to costs. Tax on the sale of land for development can be very complicated. In most cases the gain on the sale of land should be chargeable to capital gains tax (CGT) but in some cases the profit can be charged to income tax and this takes considerable planning in advance.

It is obviously key to try and achieve CGT on development land sales as the rates are lower than income tax but this can be complex and the tax planning should be looked at from the get-go with focus on the heads of terms of the arrangements. There are anti-avoidance provisions known as Transactions in Land (TIL) rules, which are intended to catch profits generated from "trading in or developing land" by taking the profit and charging it to income tax instead of CGT. These rules potentially apply to any disposal of UK land where one of the main purposes of acquiring the land was to realise a gain from its disposal.

The importance of the legal contract

The sale of farm development land can be dealt with under various contracts. Land might often be in an option or promotion agreement, or otherwise a sale and purchase agreement. It's important to understand the tax point of sale and when the tax liability is due, to ensure sufficient proceeds are received to pay the tax. Complexities arise where the disposal proceeds are made over time and where contracts are 'conditional' on certain events taking place.

"Conditional contracts" and arrangements for deferred consideration can be the most complex considerations. They need strong tax planning from the start.

Being caught for income tax

It is quite commonplace for several landowners to 'pool' land under a collaboration agreement to create a suitable development site. This often entitles the landowners to a percentage of the total proceeds, based on the acreage they have contributed. These arrangements are complicated and can result in unintended tax consequences.

It is normal to see 'slice of the action' contracts that enable the landowner to share in developer's future proceeds. In these cases, the landowner typically receives a fixed sum at the time of the land disposal, followed by a percentage of sale proceeds of each building constructed by the purchaser, under an overage clause. While the landowner is not themselves trading, the conditions of TIL can be satisfied in the eyes of HMRC. A number of legal, commercial and tax alternatives will be proposed. One is for the farming client to receive no up-front payment but instead share in any development profit.

It is the share in development land that causes the problem. In the *Business Income Manual* at BIM60650 as a ‘slice of the action’ contract and for individuals reference is made to the income tax legislation in ITA 2007, s 517L. This guidance confirms that the proportion of a gain from a transaction in land that arose before there was an intention to develop it can still be treated as a capital gain rather than subject to income tax under ITA 2007, Pt 9A.

Conditional on planning permission

When the contract for the sale and development of the land will be conditional on planning permission being obtained, the gain should be taxable in the tax year when the contract becomes unconditional. If no payment is to be received from the developer until later, this could cause a cash flow problem, although the tax can be deferred under TCGA 1992, s 280.

Another alternative is whereby the land is sold for a fixed sum, subject to planning, with the consideration being fixed and payable, either in full on planning being obtained or by way of payment as deferred consideration or a combination of the two. In this alternative, the entire gain will be subject to CGT as the amount of the consideration is not variable according to the development profit agreement. This has the advantage of being taxed at CGT rates. HMRC’s *Capital Gains Manual* at CG72580 says: ‘There is an exemption for any gains which are attributable to the period before the intention to develop is formed (ITA 2007, s 517L or CTA 2010, s 356OL) whilst the land functioned as a capital asset…’ Although in practice BADR is less attractive with the drop to £1 million from £10 million and rollover has become the tax planning tool “under pressure”.

Once the contract becomes unconditional, a disposal will take place and this might result in a ‘dry’ tax charge if payment of the monies will not be made until later. TCGA 1992, s 280 may be relevant. When consideration is payable by instalments over a period greater than 18 months, the tax on a chargeable gain can be paid by instalments agreed with HMRC. Note that the instalment period cannot exceed eight years, nor extend beyond the last instalment payment.

This article is aimed at highlighting pitfalls to be aware of. With the sums and risks involved, specialist tax advisers must be used.

VAT and Inheritance Tax

VAT should not be forgotten in development arrangements, as well as the impact of a sale on the landowner’s inheritance tax (IHT) position. From a VAT viewpoint, one of the main considerations is around “opting to tax” and claiming back VAT on the large professional fees involved.

The IHT concerns are if the owner dies BEFORE development and questions have to be asked if tax relief on the “hope value” can be achieved on the land. The case of *Foster v Revenue and Customs* [2019] UKUT 251 (LC) must be considered. This would be through Business Property Relief (BPR) and the need to have the farmland used in the trade right up to development is key and needs protection. 100% BPR is the aim so identification of non-partnership property that only achieves 50% BPR is essential (see the case of Ham v Bell [2016] EWHC 1791 (Ch)).

Development projects can take time as well as being complicated in terms of negotiations and tax planning. It is essential that the landowners have up to date partnership agreements, lasting powers of attorney and Wills to protect the development deal "going live" during a period of illness or probate. The key, as we said from the start, is plan from the beginning, to protect and use specialist help where appropriate (see the case of *Mehjoo v Harben Barker* [2014] EWCA Civ 358).

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