Land required

Julie Butler, Libby James and Fred Butler review tax planning around compulsory purchase orders.

Let's look at compulsory purchase orders (CPO). It is a very busy time for compulsory purchase reform. The government started 2025 by taking forward some of the work from the previous government on compulsory purchase change, as well as introducing consultations on additional measures. It is clear that it wants progress.

While compensation for a compulsory purchase is a single sum in legal terms, for tax purposes this sum is split up into 'income' and 'capital' with different tax treatments for each. This can then be further complicated given that the total compensation payable will often comprise a sum for the land itself, as well as a sum for disturbance, severance and injurious affection.

Disturbance, severance and injurious affection

Compensation for disturbance covers the impact on the landowner's business as a result of the compulsory purchase of their land. The most common elements of disturbance compensation are:

- compensation for losses on stock and profits – subject to income tax as part of normal trading results;
- compensation for loss of goodwill – subject to capital gains tax; and
- compensation for expenses incurred – offset against said expenses.

All the above and disturbance payments generally cannot be rolled over (see later). Any remaining amounts are then chargeable to CGT to the extent they derive from capital assets.

Compensation for severance and injurious affection is paid to landowners to account for the fall in value of their remaining land caused by the CPO and subsequent construction and use of the acquiring authority's scheme. For tax purposes any severance award is treated as a part disposal of the landowner's remaining land and liable to CGT in the normal way, subject to the special rules for small part-disposals. Tax planning around compulsory purchase with or without the loss of hope value must be carefully considered as each situation is different.

Key points

- Compensation under a compulsory purchase order (CPO) is split into income and capital for tax purposes.
- Disturbance compensation covers the impact on a landowner's business.
- Authorities can now apply to remove hope value (ie the future worth of land if it were developed) from CPO compensation.
- Rollover relief may be available when compensation proceeds are reinvested in other land or property under specified conditions.
- Where a landowner has opted to tax their land, compensation is treated on a VAT-inclusive basis.

Hope value loss and compulsory purchase

In practical terms, hope value refers to the potential future worth of land if it were to be developed. When land is compulsorily purchased by public authorities for projects such as roads, housing or infrastructure, owners are usually compensated based on both its current value and its hope value – the potential it holds for future development. It is the hope value of such developments that has aided the survival of many farms.

Recently, the government introduced a change via the Planning and Infrastructure Bill that removes hope value in cases where land is acquired for affordable housing, healthcare or education. As such, landowners may now receive compensation based only on the value of its current use, rather than what it could be worth in years to come.

In these difficult times for farmers this is yet another financial blow in what would be an already distressing and seemingly unfair situation. Sentimental feelings aside, the compulsory purchase process can often be a huge administrative burden and this amendment potentially makes it harder for those affected to ensure they are adequately compensated.

Leading rural organisations such as the Country Landowners Association (CLA) have met government officials and proposed amendments to ensure fair compensation, clearer processes and better consultation, but these attempts are yet to be successful. If a farmer's land is at risk of compulsory purchase, it is important to stay informed of any changes given the major financial impact it may have. While farming bodies continuing to challenge this change, understanding the landowner's rights and the potential fallout will help the farmer understand the process should the worst happen. Tax planning should also be carried out on the potential alternatives.

Practical time delays and safeguards

At a practical level farmers and landowners are unhappy at losing the land and this is only worsened by losing the hope value. Often compensation will not be agreed for a significant time after the acquisition of the land, due to the individual elements that make up the payment. In many cases this process can take years and may often end up in the Land Tribunal to adjudicate.

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The government has produced a document explaining the removal of hope value in CPOs entitled *Compulsory purchase compensation: Power to remove hope value* (tinyurl.com/govcpcompfactsheet) This factsheet incudes guidance on how acquiring authorities can apply for the removal of hope value by including a direction in a CPO when it is submitted for confirmation either to the secretary of state for land in England or the Welsh ministers for land in Wales. It states that there must be compelling reasons as to why the non-payment of hope value would be justified in the public interest and they must fully evidence the public benefits that would result from this, taking the impact on affected landowners into account and how a fair balance between public and private interests would be reached.

While safeguards exist, the process for appealing these decisions remains unclear like so many of the problems facing farmers (full tax guidance for 'planning for the environment' and the legislation for changes to agricultural and business property relief to name just two).

Capital gains tax

In addition to the loss of hope value, a compulsory purchase triggers a disposal for CGT purposes, with CGT broadly charged on the difference between the payment received and the cost of the land.

The exact date of the disposal will be determined by the precise terms of the CPO and whether any conditions are attached. The receipt of a compensation payment may trigger a part disposal of the land in question for CGT purposes, with the cost of the land apportioned between the compensation payment and the value of the remaining interest in the land. Any compensation for the temporary loss of profits will be treated as trading income as set out above.

Following the October 2024 Budget, CGT will normally be charged at 24% for both residential and non-residential property, subject to the seller's available annual exemption and basic rate band, together with any brought forward CGT losses.

Rollover relief for CPOs

It may however be possible to obtain relief from an immediate CGT liability provided the sums under the CPO or compensation scheme are re-invested in other land or property. TCGA 1992, s 247 allows rollover relief to apply where land is disposed of to an authority exercising or having compulsory powers and further land or property is then acquired, subject to certain conditions being met.

Much like rollover relief for the replacement of business assets, the re-investment must be made within one year prior to the disposal of the land compulsorily purchased or within three years after it, and the relief is available only where the proceeds are rolled into the purchase of other land or property.

Crucially, however, the proceeds do not have to be reinvested into land to be used as a business asset, although any new property purchased must not be used as a main residence by the taxpayer. Relief will be withdrawn if the use of the property changes to that of a main residence within a six-year time frame.

Rollover relief is usually only available for the disposal and acquisition of specific assets used in a trade – for example when in-hand farmland is sold and further land to be used in the farming trade is acquired. However, when land is sold by CPO the rollover rules are extended to cover the following:

- Proceeds must be invested in new land (this means improvements to existing land or buildings do not qualify).
- The date of disposal is when the amount of compensation is agreed, not when the asset is disposed of.
- The consideration for the disposal of the old land may include 'severance'.
- The new asset does not have to be used for business purposes.
- A dwelling house can qualify for relief but not if it is or becomes the landowner's main residence within six years after acquisition.
- The landowner must not have taken any steps to dispose of the land or made their willingness to sell known to the body with compulsory purchase powers.

It is important to reiterate that it is only the capital elements of compensation that can benefit from rollover relief. As set out above, disturbance payments will likely be subject to income tax, but severance payments will not.

Extension to rollover time limits

The usual time limits for rollover relief still apply, but HMRC has outlined in statement of practice D6 that these time limits may be extended where land that has been compulsorily purchased is let back to the previous owner until such a time as the new owner actually requires the land.

In these instances, HMRC accepts that the time limits for reinvestment are extended, such that the three-year period does not commence until the land ceases to be used by the previous owner in their trade, so when the new owner is ready to occupy or develop the land. Clearly, there are advantages and disadvantages of the income tax and CGT treatment with rollover relief so payments must be clearly identified and all tax planning tailor made.

VAT

Where a landowner has opted to tax their land, ie they have waived the VAT exemption over the land, HMRC will consider the compensation received to be on a VAT-inclusive basis.

The VAT treatment of 'disturbance' elements of compensation will follow the underlying treatment of the land itself and VAT will also apply on the disturbance elements. This may mean that landowners who have opted to tax their land could find themselves receiving less compensation than envisaged.

As an option to tax cannot be revoked until a period of 20 years has elapsed, some landowners may find this unwanted tax burden unavoidable. This raises a very strong point on the 'opt to tax'. With general potential development land, the option to tax is considered at an early stage. The compulsory purchase must also be reviewed for opt to tax advantages and disadvantages.

Inheritance tax

Farm succession planning is essential for all farmers. Following the October 2024 Budget on which slashed agricultural property relief (APR) and business property relief (BPR) to 50% from April 2026, the valuation of 'hope value' is critical. It will be essential to understand life expectancy of those concerned where possible as well as the potential hope value and the interaction of compulsory purchase. Wills will need to be updated and calculations performed to account for these new IHT liabilities, but the valuation can be complex given the difficulty to quantify the potential development amount.

Hope value can suffer if it is to achieve only 50% BPR. The end result is that the mix of potential compulsory purchase, hope value and reduced BPR could make IHT calculations and predictions for planning very complicated. The pressure on the probate value and valuer is intense and events post death will have to be considered, as well as the full impact of the proposals. ●

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