

Letting lacuna?

Fred Butler and Malcolm Gunn explain how capital gains tax holdover relief might be obtained on a let cottage.

There is much debate on whether let agricultural cottages can be eligible for holdover relief under TCGA 1992, s 165 so that they can be passed down to the next generation without capital gains tax. To illustrate, let's suppose that Jonty owns a farm, but has retired from farming. Part of the land is now let on a farm business tenancy and part is used for his own diversified non-farming trading activities. The farm is one asset for capital gains tax purposes and includes a farm cottage that is let on an assured shorthold tenancy. Jonty would like to gift the cottage to his daughter, but he cannot obtain holdover on this property alone because it is not used for the trade.

As an aside, remember that the *Balfour* case (*HMRC v AM Brander (Earl of Balfour's Personal Representative)* [2010] STC 2666) relates to inheritance tax business property relief and will not help here. There, the Court of Appeal allowed business property relief on the whole of an estate which included let properties on the basis that the lettings were ancillary to the trading activities of the whole composite estate. That principle cannot however be carried across to the capital gains tax holdover relief provisions. With some exceptions, inheritance tax business property relief relates to assets used in a business and also some shareholdings, but capital gains tax holdover requires the use of the asset for a trade, profession or vocation (s 165(2)(a)). A business that is not one of these will not qualify. However, Jonty is also prepared to transfer some land with the cottage.

Plan A: transfer with land

Let's say that, instead of transferring the cottage on its own, Jonty suggests that he transfers the cottage and some of the adjacent land that is used for his own diversified trading activities. Potentially, in that situation he can obtain capital gains tax holdover because some of the asset transferred is used for the trade. However, the relief is reduced on a 'just and reasonable' basis because the cottage is not being used for the trade (see *TCGA 1992, Sch 7 para 6(1)*). So that approach does not achieve much because, in essence, the proportionate reduction in the eligible asset and the held over gain will leave the gain on the cottage in charge.

Key points

- Generally, let property is not eligible for holdover relief.
- A transfer as one asset with land let on a farm business tenancy should enable relief to be claimed on the whole transfer.



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Plan B: transfer with let farmland

Finally, let's assume that Jonty transfers the cottage as one asset together with farmland let on a farm business tenancy. Perhaps surprisingly, he now can achieve full holdover if it is transferred with some of *that* land. This is because the apportionment rule in Sch 7 para 6(1) applies only to land or property that has some use in the *donor's* trade. However, if it is let agricultural property it is not being used in the donor's trade. Consequently, holdover relief can apply because of the extension of the capital gains tax relief to let agricultural land in s 165(5), which states:

'Part I of Schedule 7 shall have effect for extending the relief provided for by virtue of subsections (1) to (4) above in the case of agricultural property and for applying it in relation to settled property.'

TCGA 1992, Sch 7 para 6(1)

If, in the case of a disposal of an asset, the asset is a building or structure and, over the period of its ownership by the transferor or any substantial part of that period, part of the building or structure was, and part was not, used for the purposes of the trade, profession or vocation referred to in paragraph (a) of the principal provision, there shall be determined the fraction of the unrelieved gain on the disposal which it is just and reasonable to apportion to the part of the asset which was so used, and the amount of the held-over gain (as reduced, if appropriate, under paragraph 5 above) shall be reduced by multiplying it by that fraction.

Note: The expression 'paragraph (a) of the principal provision' refers to s 165(2)(a).

TCGA 1992, Sch 7 Pt 1, paras 1 and 2*Agricultural property*

- (1) This paragraph applies where:
- there is a disposal of an asset which is, or is an interest in, agricultural property within the meaning of IHTA 1984, Pt V ch II (inheritance tax relief for agricultural property); and
 - apart from this paragraph, the disposal would not fall within s 165(1) by reason only that the agricultural property is not used for the purposes of a trade carried on as mentioned in s 165(2)(a).
- (2) Where this paragraph applies, s 165(1) shall apply in relation to the disposal if the circumstances are such that a reduction in respect of the asset:
- is made under IHTA 1984, Pt V ch II in relation to a chargeable transfer taking place on the occasion of the disposal; or
 - would be so made if there were a chargeable transfer on that occasion; or
 - would be so made but for s 124A of that Act (assuming, where there is no chargeable transfer on that occasion, that there were).

So that is how the cottage achieves relief. The land qualifies for agricultural property relief and as long as there is some amount of this relief on the asset gifted, all the asset transferred achieves holdover without any apportionment. This is the effect of *TCGA 1992, Sch 7 Pt 1, paras 1 and 2*.

The land subject to the farm business tenancy is not used for a trade conducted by Jonty. Therefore, at first sight, there is no holdover relief at all under the basic provisions of TCGA 1992, s 165. However, Sch 7 Pt 1 paras 1 and 2 allows full relief if the farmhouse is transferred with some of the let land as a gift and as one asset. There is no reduction by apportionment because that applies only for land used by the donor in their trade, profession or vocation at the time of gift.

See HMRC's *Capital Gains Manual* at CG 71800 for more information on what constitutes a single asset for capital gains tax purposes.

Many are sceptical about this and the lack of the application of the apportionment rules because it confers entitlement to holdover relief on an asset that does not itself qualify as business property and is part of let property – an investment asset. The trick here is the agricultural property qualification.

Conclusion

Advisers have used this legislation for clients who have gifted a cottage (let on an assured shorthold tenancy) at the same time as, say, 20 acres of agricultural land and we have claimed holdover relief in full for capital gains tax purposes. The claims have not been challenged by HMRC.

Planning point

The reduction by apportionment applies only for land used by the donor in their trade, profession or vocation at the time of gift. It does not apply to an asset that would, to some extent, be eligible for agricultural property relief on disposal.

TCGA 1992, s 165 (1), (2) and (4)*Relief for gifts of business assets*

- (1) If:
- an individual ('the transferor') makes a disposal otherwise than under a bargain at arm's length of an asset within subsection (2) below; and
 - a claim for relief under this section is made by the transferor and the person who acquires the asset ('the transferee') or, where the trustees of a settlement are the transferee, by the transferor alone; then, subject to subsection (3) and sections 166, 167, 167A, 169, 169B and 169C, subsection (4) below shall apply in relation to the disposal.
- (2) An asset is within this subsection if:
- it is, or is an interest in, an asset used for the purposes of a trade, profession or vocation carried on by (i) the transferor...
- (4) Where a claim for relief is made under this section in respect of a disposal:
- the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal; and
 - the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset or, as the case may be, the shares or securities;
- shall each be reduced by an amount equal to the held-over gain on the disposal.

The reason is because if a transfer is of an asset or part of an asset where relief is due because of the agricultural property extension (this refers to TCGA 1992, Sch 7 para 1) then no reduction is made for non-trade use and suchlike under either of the apportionment rules, which are contained in Sch 7 Pt 2 para 6. It is let agricultural property.

With the combination of worries over how long inheritance tax agricultural property relief will remain and the new capital gains tax returns, there are many wanting to take advantage of the provision before it disappears. ●

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