GETTING THE LIE OF THE LAND

Julie Butler looks at the tax rules when selling small parcels of farm land

We are constantly asked by clients to explain the tax consequences when a farmer sells a small parcel of land that has potential for housing development, or a 'lifestyler' landowner wants to raise funds from selling land to live the good life.

All situations and operations must be reviewed on a case-by-case basis and full tax planning put in place well in advance. A review for tax planning can also look at the question of commerciality, ie whether assets sold are genuinely used in a business. Many questions focus on the concept of the working farmer and how much involvement there has to be to achieve maximum tax reliefs.

POTENTIAL DEVELOPMENT LAND

There are a variety of types of disposal by landowners for the development of houses, such as an outright sale of the whole property or part of the land owned to a developer. More often an option is granted, exercisable if planning permission is granted. Another arrangement is a promotion agreement where, for a down payment, the developer usually obtains the planning permission and shares in the sale proceeds arising from the end development.

The latter two arrangements allow the tax practitioner time to organise matters so that entrepreneurs' relief (ER) is available on sale. The developers generally do not enter into promotion agreements unless there is a realistic chance of obtaining planning permission.

More difficult capital gains issues arise if the land is held outside the farming partnership. To obtain ER the landowner should take advantage of the 'associated disposal' rules, whereby the land disposal needs to be linked to their "withdrawal from participation in the business" concerned (s169K, Taxation of Chargeable Gains Act 1992 (TCGA 1992)). Following changes in s41, Finance Act 2015 it is generally the case that the landowner need only reduce ownership by a minimum of 5% of the total business to trigger the application of these rules, although usually withdrawal is higher than this.

ENTREPRENEURS' RELIEF

It is whether the land qualifies for ER or rollover relief that causes the advisers to consider whether the asset has been used in a genuine business. Many argue that the business's conduct - good bookkeeping, the badges of trade and making a profit - is more important than the size of the land. Adding other land to the parcel with development potential can help prove that the land is used in a business.

With the 20% rate of capital gains tax (CGT) from 6 April 2016, the desire to 'push the trading boundaries' to achieve the 10% rate of ER has reduced. However, with large development sums, indeed millions, the need to achieve ER or rollover relief still holds a strong financial attraction.

As mentioned, many landowners will not obtain ER unless advance tax planning is undertaken.

WHAT IS A WORKING FARMER?

A landowner can be deemed to be trading without labour or equipment, by entering into a share farming agreement or using contractors. The arrangements are outlined in HMRC's *Business Income Manual* at BIM55070-55090. The trade and accounts may be rigorously reviewed by HMRC, eg to ensure profits are not achieved by excluding expenses. The guidance on testing farming profits in the context of s67, Income Tax Act 2007 (the five-year rule on use of farming losses) is at BIM85650. It must be shown that the landowner shares the risk of the trade and contributes, eg, by buying fertiliser.

Suitability tests regarding the size of potential development land include the ability to make a profit, commerciality, motive and historic evidence of the operation size. With smaller areas of ground, some diversified activity - eg alternative uses of the land - may be easier to demonstrate than traditional farming trades.

EARLIER PERIODS OF OWNERSHIP

Whether the potential development land is large or small, the actual ownership and occupation of the land should be forensically examined regardless of the size, particularly where the land has been let in earlier periods.

Where the land is held as a partnership asset and disposed of within three years of the cessation of trade, relief would be due following s169I(2)(b) and s169I(4), TCGA 1992, with no restriction to take account of earlier periods of letting necessary. This is in contrast to relief under s169K for assets owned outside of the partnership (associated disposals) which has stricter conditions.

ROLLOVER RELIEF

Rollover relief is an alternative to ER for sheltering development land profits and is available when the proceeds from the disposal of the old asset are reinvested into the replacement asset. Both assets must be used for the purposes of a trade. Relief is given by treating the old asset as having been disposed of for no gain/no loss (so long as the proceeds are fully reinvested).

An effective use of rollover relief is a farmer buying farmland after selling farmland for

development and intending to retain the replacement land until death. The next generation will inherit the land at the probate valuation, and the rolled-over gain would fall out of charge. To qualify, the replacement asset must be purchased within one year prior and three years after the old asset was sold. The old asset and replacement asset may be used in different trades. The assets are treated as the same trade for rollover relief purposes, provided there is a gap of only three years between cessation of the old trade and starting the new trade. With these generous tax reliefs available it is sensible to try and make the trading arrangements on small parcels of land as robust as possible.

INVESTMENT BUSINESS

Inheritance tax (IHT) must also be considered with development land. Fundamentally there is a concern that HMRC may argue that the farming business does not exist and that it is essentially a property-based business.

Any diversified activity will predominantly be property-based. A portfolio of evidence will be needed to show which side of the investment line the business falls on and if necessary to challenge HMRC, which can take an aggressive stance to deny IHT reliefs where genuine businesses are trading and operating well into the old age of the proprietor and taxpayer. The tax treatment of the whole diversified activity operation on the land, for example glamping, holiday or wedding operations, must be considered 'in the round'.

GRAZING AGREEMENT

The grazing agreement is a classic use of small farmland areas which can have weaknesses for potential development land. This has recently been scrutinised in the *Allen* case (*Allen v HMRC* TC05100) and generally has been attacked by HMRC.

The critical issue is not just the legal nature of the arrangement between the landowner and the livestock owner, but more importantly, whether what the landowner does on the land amounts to a trade. Particularly, where the landowner seeks to carry on the trade of farming, he or she must show that the grass is being grown as a crop.

It is important to identify who applies fertiliser to the land, as pointed out in 1943 in *CIR v Forsyth Grant* 25 TC 369, and again in 2009 by Girvan LJ in *McCall and Keenan v HMRC* [2009] NICA 12. In *McCall*, the taxpayers' case was fatally damaged by the deceased's son-in-law leaving the graziers to apply the fertiliser. This should be contrasted with the detailed findings in the *Allen* case where, even when the graziers applied fertiliser, it had been supplied to them by the landowner, therefore the grazier was spreading it on behalf of the owner.

Where potential development land is subject to a grazing agreement, the general warning is to change the arrangement to farming in-hand to obtain better tax reliefs. ●

Julie Butler, proprietor of Butler & Co, specialising in farming and equine tax