Mineral Royalties

JULIE BUTLER FCA discusses the merits of gravel extraction tax planning.

NOT EVERYONE MAY be aware of the taxation of mineral royalties which is still half income tax and half capital gains tax. Mineral royalties are not eligible for taper relief, which is significant from 6 April 2002 when full taper relief became available. The review of the taxation of mineral royalties has become even more relevant with the introduction of aggregates levy from 1 April 2002.

One of the most common commercial minerals is gravel, and there are a number of ways of trying to have the extraction taxed as efficiently as possible.

Outright sale

One could sell the land containing the pit. It is to be hoped that this has the advantage of capital gains tax classification with all the business relief associated therewith, such as rollover relief, business taper and indexation up to 5 April 1998. This assumes that business status can be shown, *i.e.* farmed in hand. The disadvantage is that many landowners do not want to lose ownership, and this leads to the next point.

Buyback option

One could sell the land containing the pit with an option to buy back the land afterwards. The sale of a gravel pit with the option to buy it back after exhaustion means that the extracted proceeds will be liable to income tax (section 36, Taxes Act 1988). This forgoes any advantage of capital gains tax relief.

Sale of gravel

Capital tranches of gravel may be sold without selling the land itself. The problem is that the Inland Revenue claims that unless the surface is sold, the tranche of gravel will not be a business asset for taper relief purposes.

The treasury route

The treasury route is a well-tried method where the landowner sells a capital tranche of gravel with a licence for the aggregates company to enter the land for purposes of extraction. The key is to establish a capital gain in-house, for instance put the land into settlement or gift it to a member of the family. This should result in ten per cent capital gains tax (assuming full taper relief is available) which is funded out of the first tranche sale to the aggregates company. If the calculation is correct, there should be no further tax. It is a good idea to put a restrictive covenant on the number of cubic metres. The downside is that for the aggregates company under section 418, Capital Allowances Act 2001, capital tranches are subject to capital allowances at only ten per cent a year. However, when the tranche is exhausted, the company is entitled to claim a balancing allowance for the balance amount spent (section 428 of that Act), *i.e.* the aggregates company will not receive 100 per cent relief until the end of the tranche.

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