New planning rules – Equalisation of value

It has been said by many land agents that all landowners who own land close to a village, stand a very good chance of achieving planning permission in the next decade. Such potential development land opportunities can be maximised by the individual landowner cooperating with each other.

Over recent years, the UK has seen a large increase in the number of active development land projects. Many of these involve farmland and a multitude of different landowners. A question that is raised in such projects is how to protect against one landowner benefitting from high value land uses within the project (eg, the prime residential element) whilst other landowners are stuck with the low value uses (eg, infrastructure and low cost housing). Unless action is taken, then some landowners may achieve greater reward than others, despite the fact that they all own the land integral to the development as a whole. The solution is to try and incorporate 'equalisation into any development agreement'.

Equalisation of values

This article looks at active development land projects of a reasonable size where equalisation of values between landowners might be considered, and what some of the tax considerations might be. There are a range of possible solutions, all of which aim, in so far as is possible, to share the benefit of the higher value land uses across all landowners involved. There can be considerable benefits for all parties if this can be achieved, not least because it means that the neighbouring landowners will not be in competition for the high value use aspects of the deadline,because the benefit of them will be shared as part of the equalisation strategy.

How to achieve equalisation

One possibility is demonstrated by the *Jenkins v Brown* pooling arrangement. This involves all the owners pooling their land so that they each own a percentage of the whole site. This is proving to be a very popular method of equalisation, but it should be noted that there are complexities, particularly when the arrangements for farming the land before the development takes place are taken into account as well as how to untangle the pool if the development comes to nothing.

In many cases, a more simplistic approach may be to just use a gross area basis whereby the landowners agree that the price they each receive will be calculated by reference to the value of the total site. However, this approach can be difficult where there are numerous owners, more than one buyer, or where the sale of development land is shared over several years. Further to the first two options, there are other arrangements that involve creating a special purpose company vehicle, into which the land is added and the landowners take shares. The tax considerations around the disposal of the land to the limited company, having the gain within the limited company and taking the money out have to be given careful calculation with emphasis on values to be agreed.

Finally, another potential strategy is to grant cross options, so that if Landowner A sells part of his land, the developer has to pay Landowner B to release his option over the same land. This is a relatively straightforward solution, although it can have disadvantages for both Capital Gains Tax (CGT) and Inheritance Tax (IHT).

Consideration of the 'Big Picture' moving forward

Clearly, with all the potential for increased development opportunities, the 'property portfolio' of any farm needs to be reviewed. There is presently so much scope, the need for the farming community to review all planning permission and tax planning opportunities around the new Permitted Development rules must be deemed an immediate priority.

It has been said that with sufficient levels of tax planning, all landowners who are farming (or more importantly should be involved in the trade of farming), can achieve Entrepreneurs' Relief for CGT or indeed roll-over relief for CGT whilst protecting the land for IHT purposes on all land disposals – this is, however, quite a challenge!

Inheritance Tax (IHT)

It is important to consider the tax implications of the landowner predeceasing the completion of the development – the average age of the landowning farmer is apparently near 60 years of age, with a large number of the landowning farmers in their 70 s and 80 s. Care must therefore be taken with regard to IHT. The District Valuer will assess the land on death at market value (s160 IHTA 1984). The 'hope value' (market value less agricultural value) will need the protection of BPR. The eligibility of the farmland for BPR with the legal structure must be considered. Where the land is used (but not owned) by a partnership of which the owner is a member, only 50% BPR will be available. The arrangements discussed above should not result in the land being subject to a 'Binding Contract' for sale so as to cause the loss of APR and BPR until of course the developer is ready to proceed and pay for the and. This is something the draftsman will, however have to bear in mind.

Capital Gains Tax

The landowner must consider the integration of IHT and CGT in relation to the potential development land. The exact ownership of the land must be ascertained by a lawyer – so often what the landowner understands to be the ownership structure might not be mirrored by the legal interpretation of the available documentation. The available CGT reliefs that can be used must be considered at an early stage. If the land is to be passed to the next generation then holdover elections can be considered, but at the potential expense of the 'tax free' uplift on death of the base cost.

The question of the best use of Entrepreneurs Relief (ER) and Rollover Relief must be examined. Many advisers are promoting the 'front loading' of ER, ie, take the maximum limit whilst it still exists, whilst others would advance the rollover option.

Entrepreneurs relief and partners

Where the farm is operated as a partnership, but the land is owned by one or more partners personally (although this is not normally advisable for IHT purposes), if ER is the more immediate goal, it may be helpful to set up this kind of structure in advance. The planning is to structure the sale of the land as an 'associated disposal' where there has been a 'material disposal' of a business. For a partner, a material disposal is relatively easy to achieve because a reduction in the partner's interest in a partnership share will be recognised as a disposal of part of the business by the partner concerned. HMRC offers no guidance as to what classifies as a material disposal, however the the example in CG63995 is a 40% reduction.

This opens the way for the partner to dispose of the land as an 'associated disposal' qualifying for ER. The disposal must be made 'as part of the withdrawal of the individual from participation in the business carried on by the partnership', but HMRC accept that this refers to equity participation and not time spent.

Accordingly, the partner can continue to be a full-time working partner, and as long as there is a reduction in equity interest there is a partial withdrawal from the partnership. This raises the tax planning consideration of the best interaction of the need for partnership property for IHT purposes and the very efficient utilisation of the associated disposals rule for CGT. With the lack of farming Partnership Agreements it is likely that the exact ownership of land is not known.

Rollover relief

In order to achieve roll-over relief it is essential that the farm is trading and not let. Many argue that the *Ramsay* case (*Elisabeth Moyne Ramsay v HMRC* [2013] UKUT 226 (TCC)) gives hope for farm property that is let in part but actively managed.

Ramsay was an Upper Tier Tribunal (UTT) decision and therefore of significant importance in establishing that a let property provided with a large amount of inherent services relating to active management, was sufficient to constitute the carrying on of a business for the purpose of s162 TCGA 1992. Essentially, this case established that where a property is highly actively managed, it can count as a capital asset, which in turn, can be regarded as a business. It should be noted that in the Ramsay case, the owners had spent approximately 20 hours per week carrying out various activities linked to the property, which included meeting and assisting tenants and repairing and maintaining the communal areas. However, the issue before the Tribunal was the roll-over relief for the transfer of a business into a company in exchange for shares.

The UTT looked for evidence of a serious undertaking, earnestly and actively pursued, with reasonable continuity and substance in turnover. There is a need for the activity to be conducted in a regular manner on sound business principles. The UTT was advised that the degree and scope of the activities in the *Ramsay* case far exceeded those usually provided by a normal passive investor, and went much further than the activities that most tenants would normally expect from their landlord. The particular relief being claimed by the taxpayer was, therefore, the relief given by s162 TCGA 1992. However, where land is being sold it is more likely that the owner will be seeking to claim roll-over relief under s152 TCGA 1992, which will require the land to have been used by the owner for a 'trade'. In the Upper tribunal judgment in *Ramsay*, HHJ Berner pointed out that the expression 'Business', as used in s162 TCGA 1992, was somewhat wider than 'trade' which is used in s152 TCGA 1992. Consequently, if the land is let to a tenant it would be wise for even the most active landlord to assume that roll-over relief will not be available for a re-investment of the sale proceeds.

Action plan

These are exciting times for potential development projects and it is essential to ensure that tax planning strategies are in place at an early stage To maximise the potential reliefs available to the taxpayer. Such planning is ideally put in place long before the equalisation agreement and/or the planning permission has been obtained. Landowners with equalisation opportunities are going to have to work with their neighbours, and before they undertake the task of entering into the basic legal agreements, they must:

- Ensure all the current agreements are in place and these adequately protect ongoing tax relief, for example, Partnership Agreements and Wills.
- Ensure that overall tax planning takes place BEFORE planning permission is obtained and before the equalisation agreement (if any) is agreed upon.
- Ensure all new legal agreements provide the required amount of protection.
- Act now – time is running out and tomorrow may be too late!

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Aug 27 2014