

# FarmTaxBrief

March 2010

Volume 25 • Number 2

## Briefing

### Profit on property disposals captured at 50% income tax

The last few years have seen changes and shifts in the interaction of income tax and capital gains tax (CGT).

Prior to the reform effective from 6 April 2008 business asset taper relief (BATR) allowed business capital disposals to be taxed at 10% rate of tax where the land sold had previously been part of the farm or business assets. This meant that property development profits could be taxed at this low tax rate of 10%.

When the highest rate of income tax was 40% this meant a potential tax saving advantage of 30% when capturing the profit in the business CGT regime as opposed to the income tax regime.

From 6 April 2010 the highest income tax rate increases to 50% and as the standard CGT rate is 18% from 6 April 2008 this now means there is a potential tax saving advantage of 32% between capturing property disposals as CGT instead of income tax.

Unless the sale of the property is in conjunction with the disposal of the whole business it is unlikely that entrepreneurs' relief will apply – if it were to apply the tax advantage would be 40%. In addition, even if the whole business was being sold the property itself would have to have been owned for a period in excess of 12 months and in property development this may not always be the case if there is a quick turnover of properties. It is therefore more and more attractive for HMRC to try and capture any profits on property disposals as income and for the taxpayer to try and ensure that the gain is taxed under the CGT regime.

It is possible for a gain arising on the disposal of land and property to be taxed under one of three headings:

- 1) CGT;
- 2) 'Trading in land'; and
- 3) ITA 2007 s756 – 'artificial transactions in land'.

### Capital gains tax (CGT)

A gain on the disposal of land will be taxed as capital where it can be demonstrated that the taxpayer is not dealing in land. Likewise, it will be taxed under the CGT provisions provided that the anti-avoidance legislation of ITA 2007 s756 does not come into play.

### Trading in land

It can be argued that if the farmer/landowner carries out any work to the property to promote the development/sale other than by just obtaining planning permission, then he is trading in land. It is

possible that if a farmer/landowner makes frequent disposals or buys to sell-on he could be caught under the trading in land provisions. Trading is defined in the Taxes Act as including 'every trade, manufacture, adventure or concern in the nature of trade'. This does not really define trading at all and, therefore, the so-called 'badges of trade' have been formulated. It is not necessary to show that all badges of trade are present for an activity to be assessed as a trade; however, a profit-seeking motive at the time of acquisition is the most persuasive, which is often confirmed by the existence of other badges.

Let us look at what makes up the trading emblems known as the badges of trade.

- 1) Motive: this is classically illustrated where land has been acquired for the purposes of resale. The land has not been acquired as fixed capital but rather as stock in trade and will usually be confirmed if there is a short interval of time between the acquisition and sale. File notes and documentation should support the capital disposal motive, not the trading motive. Document also that the land has been used for dedicated farm purposes or diversification purposes.
- 2) Trading interests in a similar field (please excuse the pun): is the taxpayer involved in similar ventures that have been admitted as trading or do other capital disposals in the light of the current disposal connect the transactions as trading after taking account of the other badges?
- 3) Frequency of transactions: a number of similar transactions may indicate a continuous activity. Transactions normally treated as of a capital nature in isolation, acquire the characteristic of trading income due to the frequency of the transactions. This would apply to a farmer who sells a number of areas of land over a short period of time. Again, it would be looked at 'in the round'. Was this merely a disposal of long held farmland in a number of transactions or was it frequent disposals of newly acquired sites which scarcely saw a farm animal or a plough?
- 4) Circumstances of acquisition: it is difficult for HMRC to demonstrate that the sale of land acquired by gift or inheritance amounts to an adventure in the nature of trade, as intention of resale will not necessarily be in mind at the time of acquisition. Again, can it be shown it was acquired to improve the farming trade?
- 5) Subject matter: is it genuine farmland? Has it been farmed or stored for resale? This badge of trade tends

to be unhelpful in land cases since land can be acquired as an investment, own occupation and resale. Links to motive are relevant here. Was it bought as farmland as well as being farmland?

- 6) Time interval: holding the land for a number of years may point to a lack of profit-motive when the land was acquired. However, the factor is not considered conclusive by HMRC. In *Cooksey and Bibbey v Rednall* (1949) 30 TC 514, the taxpayer successfully argued that there was a lack of profit-motive, but the case still went to the High Court even though the land in question had been held for 15 years.
- 7) Supplementary work: this applies where work is done to the property to make it more marketable (eg, in cases of development) or where the taxpayer actively takes steps to find purchasers. However, there may be circumstances where cash needs to be raised as soon as possible. The more development work carried out the more likely the trading classification.
- 8) Method of finance: the purchaser may have purchased the land with the assistance of a loan that has been made on terms requiring repayment upon resale. This gives a clear indication of intention as demonstrated in *Turner v Last* (1965) 42 TC 517. It is one point among a large number of others.

The tax planner must ascertain what the intention is on acquisition. Of crucial importance is the acquirer's intention at the moment of the acquisition of the land: see *Simmons (as liquidator of Lionel Simmons Properties Ltd) v IRC* [1980] STC 350, in which Lord Wilberforce said: 'Trading requires an intention to trade; normally the question to be asked is whether this intention existed at the time of the acquisition of the asset.' In land transactions, the moment of acquisition is defined as the moment of exchange of contracts for purchase and not the moment of completion. The simple task of obtaining planning permission does not constitute development but buying farmland with a view to development profits could.

### Artificial transactions in land

Further to the consideration of farmland sales not being caught as capital gains, developers are usually caught under the terms of ITA 2007 s756, which encompasses cases where 'land is developed with the sole or main object of realising a gain from disposing of the land when developed'. The aim of this section is for

HMRC to prevent property dealing profits being treated as capital.

It has been said that some farmers and landowners enjoy 'growing houses' more than growing crops and after one genuine disposal they start to 'trade' in land. The purpose is to prevent property-dealing profits being disguised as capital. The circumstances are clear and likely to be kept to two situations:

- The disposal of shares in a property company (*Yuill v Wilson* [1980] STC 460); or
- Where a UK resident passes the opportunity to make a trading profit on UK land to an overseas company.

The scope of ITA 2007 s756 is broad and catches transactions which have little or no element of artificiality; therefore the avoidance can be accidental or unwitting by the landowner. With the current shortage of houses, there could be farmers and landowners who are caught in these provisions.

The rules apply in the following circumstances:

- Land is developed with the sole or main object of realising a gain from disposal later;
- Land is held as trading stock; or
- The land or any interest that has its value derived from it (eg, shares in a landowning company, interests in partnerships, etc) is acquired with the sole or main object of realising a gain on disposal.

In order for ITA 2007 s756 to apply, a gain of a capital nature must result. Section 756 means that the gain could not be chargeable as income under any of the Taxes Acts if it is trade. If a trade exists, the sale will be caught in the trading in land provisions.

A farmer who sells land confident that any tax will be calculated under the provisions of CGT could be caught for the 50% income tax rate as opposed to the 18% tax rate of CGT.

In summary, the disposal of land by a farmer can fall into three taxable activities:

- a genuine capital gain;
- trading in the development of house; and
- a capital gain that is developed with the sole purpose of realising a gain and is therefore an 'artificial transaction in land'.

### 'Slice of the action' schemes

One of the most common applications of ITA 2007 s756 arises involving 'slice of the action' schemes. These schemes involve the landowner selling surplus land to a developer, receiving a fixed sum, followed by

future contingent payments based upon the success of the development. The developer himself will be trading and will, in effect, be passing some of the trading profits on to the former landowner. The receipt will be of a capital nature in the landowner's hands and accordingly will be caught by ITA 2007 s756 as a trading profit has emerged in a capital form. HMRC's authority for treating additional payments in this way can be found in *Page v Louther* [1983] STC 61. The fixed sum, however, will remain chargeable to CGT. It is the contingent payments that must be taxable as trading profit. ITA 2007 s756 cannot be invoked where the landowner could be charged under trading profit – refer to the 'badges of trade' to see if it is pure trading.

ITA 2007 s756 cannot apply in respect of the disposal of a main residence, which is exempt from CGT [TCGA 1992 s222] or would be if it were not for TCGA 1992 s224(3), regarding residences acquired wholly or partly for the purpose of realising a gain from the disposal.

### **Advance clearance procedures**

A formal HMRC advance clearance procedure is available in respect of transactions potentially falling within ITA 2007 s756. This can be made before or after the relevant transaction. However, it is rarely used in practice since disclosure puts HMRC on notice, and there is a tendency for HMRC to 'play safe' if there are any doubts, knowing full well that an enquiry can be raised once the tax return has been submitted.

The action plan has to be to make sure that tax planning is carried out in advance of disposals, that the motives for the sale (and original purchase) are considered and the full warnings are made to the client.

---

*Article supplied by Julie Butler FCA Butler & Co, Bowland House, West Street, Alresford, Hampshire, SO24 9AT Tel: 01962 735544. Email: j.butler@butler-co.co.uk, Website: www.butler-co.co.uk*  
*Julie Butler FCA is the author of Tax Planning for Farm and Land Diversification ISBN: 0754517691 (1st edition) and ISBN: 0754522180 (2nd edition) and Equine Tax Planning ISBN: 0406966540. The third edition of Tax Planning For Farm and Land Diversification will be published shortly.*