

PROTECTING POTENTIAL DEVELOPMENT VALUE FROM IHT AND CGT

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It can be argued that all land and most buildings have a degree of potential development or "hope" value. There will always be some opportunity to "grow" more houses, improve buildings and convert barns etc. What protection can be put in place for both inheritance tax (IHT) and capital gains tax (CGT)?

Risks of the "Do Nothing" Strategy

What action can be taken when potential development land is owned by the 'inheritance tax vulnerable' (IHTV) e.g. the elderly farmer, a landowner with health problems, the widowed etc? There is often no guarantee that the development land or a substantial part of it will be sold during the lifetime of the landowner. The "IHTV" may not just be the elderly, it can be anyone who is about to realise the development in the near future that might die before the development is sold.

If the estimated time for obtaining planning permission is a few years away in relation to a substantial proportion of the development land, then there is a realistic risk that the landowner will still be alive when the development land is sold and the value of his estate for IHT purposes would increase very substantially. With any land there is always a substantial leap in value, which reflects the change from a probability of planning permission to a certainty. Any cash or binding contract for sale would not qualify for Business Property Relief (BPR). There could be a nightmare situation where the farming business holds the cash and is therefore deemed to be an investment business. The change from trading to investment status would be because either the cash or the investment in development land is greater than the trading activity.

Tax protection can be obtained by reinvesting the cash proceeds in other farmland or other businesses, which qualified for BPR.

CGT and IHT battling for importance

There is the substantial risk that if nothing is done with potential development land, there will be an IHT charge at 40% on the full amount of any realised development value to the extent that that realised development value was not reinvested in qualifying assets at the date of death. Such an IHT charge will be more onerous than a CGT charge which is likely to be leviable at a much lower effective rate of charge -- currently at 18%.

The question of 'doing nothing' with development land against gifting during lifetime highlights the downside risk of increasing the effective rate of CGT and weighing this against the upside benefits in terms of reducing IHT as a result of removing the asset from the landowner's estate at a much lower market value. It is assumed that the lifetime gift is at a lower value before the full value is realised.

Conclusion

With regard to IHT planning, if a farming landowner, or general business landowner is holding potential development land within their business with a view to sheltering IHT there are serious risks of 'doing nothing' as the development project approaches. The potential of gifting to the next generation must be reviewed. The complexity and technical concerns of lifetime giving must be given full consideration for all potential development projects.

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Article supplied by Julie Butler F.C.A. 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 F.C.A. 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.

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