

# Landed Estates Update

DRIVING LIFELONG PROSPERITY

Summer 2016

Welcome to the current edition of Landed Estates Update, our publication for landowners and those advising on Landed Estates. As estates look to generate income from different sources, the choice of business structure and ownership for a new venture may have wide ranging tax implications. In this issue we consider a number of options for the choice of structure and the potential tax implications.

To illustrate the tax issues a case study runs throughout this update. The Whiteacre Estate is considering letting 100 acres for a solar development, with annual rent of £1,000 per acre, index-linked for 25 years. The estate is currently owned by Mr and Mrs Green and trades as a partnership. They have children and grandchildren.

## THE STRUCTURING OPTIONS

The options available to the Greens include retaining the land in the existing partnership, transferring it to a limited company, transferring it to a trust or gifting it to the next generation. A decision as to which is best will depend on the specific circumstances of the Greens and what is most important for them. e.g. do they want income or are they more worried about inheritance tax; would they be happy with an outright gift or do they want to retain control of the land?

## TAX ON PROFITS

The solar farm will generate circa £100,000 income per annum. Within the partnership the income is taxed on the Greens at tax rates of 20%, 40% and 45% depending on other income. If instead of rental income the activity generated trading profits, they would also have to pay National Insurance (NI) at 9% or 2%.

If the Greens decided to use a limited company, profits are subject to corporation tax, currently at 20%, but dropping to 19% from April 2017 and 17% from April 2020.

If the business is looking to retain profits the corporation tax rates are clearly more attractive. However, if profit is extracted from the company because the funds are needed

elsewhere at Whiteacre, further tax will be payable. There are a number of options for doing this but typically it will be by way of salary and/or dividend.

Salary is tax deductible in the company and is taxed on the recipient at the income tax rates given above, with employee NI at 12% or 2%. In addition, the company has to pay employers NI at 13.8%.

Dividends are paid out after deduction of corporation tax with the current tax rates being 7.5%, 32.5% and 38.1% once the £5,000 0% dividend band has been exceeded. When looking at both corporation tax and income tax the effective total tax rates are 26%, 46% or 50.48%, depending on income levels. This is higher than the income tax rates so, if all profit is being extracted, may not be desirable. The Greens could give shares to their children or grandchildren to utilise a number of £5,000 0% bands, and this may make a company more attractive as it allows income to pass around the family.

A similar result can be obtained by setting up a trust with children and grandchildren among the class of beneficiaries. The trustees would have to pay tax at 45%, but the grandchildren would be able to reclaim tax if income distributions are made to them and it is covered by their personal allowance.

If the new business is likely to be loss making in the early years, it may be beneficial to be unincorporated. If other areas of the estate are profitable the losses can be set against that income, subject to the allowable limits, reducing the total tax payable. If the losses arise in a company they have to be carried forward against future profits.

## CAPITAL GAINS

For most new ventures capital gains are unlikely to be a major concern. However, if the Greens want to pass the land down a generation, timing may be critical to ensure that holdover relief is available. The availability of the relief can ensure that the land can be transferred with the gain being deferred. If they decided to transfer the land to a trust the relief would also be available. If a company is going to be used, the land will be sold to the company giving rise to a gain.

If the Greens were looking to sell land for development, careful planning would be needed if they wanted to try and secure Entrepreneurs' Relief (ER) and a 10% capital gains tax rate on the sale. In broad terms ER only applies to the disposal of a business and not assets used in a business, although there are circumstances where the latter is possible. With a minimum twelve months qualifying period, planning is essential.

If the Greens are considering transferring the land to a company, thought should be given as to what happens when the solar lease expires. If they want to extract the land from the company, gains within a company are subject to corporation tax and there will also be a further tax charge on the shareholders. This potentially results in tax payable at up to 50.48% compared to a maximum 28% if gains are realised by individuals.

## INHERITANCE TAX

Securing Business property Relief (BPR), which gives 100% relief from Inheritance Tax (IHT), is key for many estates. The relief is



**NICHOLAS SMAIL**

Partner

01242 680000

nicholas.smil@hazlewoods.co.uk

available providing the business is wholly or mainly trading and, providing it applies, both the trading and investment (non-trading) assets qualify. For an estate the trading element is typically the farming operation and the investment activity is the let cottages. To determine if an estate is wholly or mainly trading it is necessary to consider turnover, profit, capital employed and time spent between trade and non trade. An overall view is then taken by standing back and looking at the business in the round.

A new business venture could change the balance of the estate as a whole, switching it from trading to non-trading. The position may not change on day one, but over time as the new venture grows and other factors also change e.g. the fall in farming profitability. If the new income stream risks the IHT position of the estate as a whole, a separate entity may be the best course of action.

As the land is being let for solar the income will be investment income, increasing both non-trading turnover and profit. The land will cease to be used for farming and so will shift, say, £1million of value from trading to investment when looking at the capital employed. Depending on the overall size of Whiteacre, and the nature of the business, the solar development could tip the business as a whole from trading to investment, with the loss of BPR. From an IHT perspective it would then be best to put it into a separate entity.

Shares in an unquoted company qualify for BPR, providing the company is wholly or mainly trading and the other criteria are met. The solar letting would not be regarded as trading so the shares would not qualify for BPR. By moving the land to a company the Greens could be increasing the exposure to IHT unless they gift shares to the next generation.

If the land is being transferred to the next generation timing will be important. Once planning permission for the solar park has been granted, the value of the site will increase. Not only does this increase the value of the gift, but it is also likely that APR will not be available on the full market value. If the transfer is to a trust this could result in an immediate IHT charge.

## VAT

VAT can be an unwanted burden and sometimes a business will want to avoid charging it, whilst in other cases the priority

will be the recovery of VAT on expenditure. Adding a new business venture to an existing VAT registered business may mean that VAT has to be charged on sales, which can be detrimental e.g. with furnished holiday lets. Alternatively it may be beneficial; for example, including residential lets, which are an exempt supply, within a trading business may enable VAT on expenses to be recovered under the partial exemption rules. The rules may also enable VAT on the conversion of a barn to a dwelling, on which VAT should be charged at 5%, to be recovered on expenditure up to £150,000.

## STAMP DUTY LAND TAX (SDLT)

SDLT is unlikely to be an issue on an ongoing basis. However, care needs to be taken if land or buildings are being moved into a different entity as part of the business structuring. As the Greens are trading in a partnership, relief could be available if they decided to transfer land to a company.

## NON TAX ISSUES

As well as the tax issues there are a number of non tax issues to consider. A company gives the benefit of limited liability and the nature of the business venture may make this attractive. However, details about the company, including shareholders, directors and company accounts have to be filed at Companies House and are on the public record. Funding requirements and the ability to secure funds may point in a particular direction.

If asset protection is the driving factor, the use of a trust may be desirable as the trustees retain control of the assets, although future generations can benefit from the income.

## CONCLUSION

When looking at a new business venture there are a number of options to consider. Which is the best will depend on the needs of the family, but careful consideration of all the taxes is required to ensure that there are no unintended consequences arising from the choice. It may be that the structure will need to change as the business evolves and the initial choice should be reviewed periodically to ensure it remains the best.

Staverton Court, Staverton, Cheltenham, GL51 0UX  
Tel. 01242 680000 Fax. 01242 680857

[www.hazlewoods.co.uk](http://www.hazlewoods.co.uk) / @HazlewoodsAgri

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