

Converting Barns, Selling Development Land – Some of the Implications!

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Whether you have barns suitable for conversion and/or development land the considerations can be similar. The tax implications however, whilst important, should not dictate the personal and commercial angles otherwise the “tail will be wagging the dog”!

NON-TAX CONSIDERATIONS

Firstly the decision will need to be made as to whether the costs should be incurred in the first place in attempting planning or permitted development. For a simple single barn conversion these could be £500 to £2,000, but for development land, costs could easily be in excess of £50,000 depending upon the area and surveys needed! A risk profile on the likely success from a planning consultant is useful before incurring too many costs.

Once a decision has been made as to whether to incur the costs, other non-tax considerations include:-

1. Increase or Decrease In Value to Farm?

It is often “assumed” that value is added by a conversion, but sometimes it will cost more to convert a barn than to build it from a clean site. It is also possible when either building or converting a barn to incur significant costs **and** devalue the farmhouse and farmyard or farm itself – a quaint original high value setting turned into a housing estate is possible!

The decisions are easier if the barns or development site is away from the core of the farm and obtaining advice from a valuer could be very worthwhile before decisions are made.

2. Services

Don't forget to list down the electricity, heating, water, telecom and other services needed and strategise costs and legal implications which can be expensive depending upon layout.

3. Succession Planning Issues

Discussing barn conversions with children often raises succession planning issues, which may or may not be desired. If the farm is being left to one child putting more funds and commitment into it may be the last thing you wish to do if looking to provide for non-farming children? Alternatively a converted barn away from the core could be an attractive asset to leave to a non farming child?

4. **Ownership**

Fragmenting ownership or shared ownership with children may or may not be wanted – it is easy to make decisions generated by the excitement of obtaining ‘planning gains’ that are later considered mistakes.

Neighbours

If you live in a farmhouse on its own do you wish to have children, holiday visitors or tenants as neighbours from a practical point of view - even if you can control who they are?!

5. **Gifting or Retaining**

This is a fundamental decision, but has long-term implications.

If you do gift to children, ensuring you have an option or right to repurchase on sale can be useful or essential - especially if barns are close to the house. Tied in with this life cover can also be essential to ensure cash exists to buy out family members on unfortunate early death. This can give spouses and their children the freedom to move away or be independent if unfortunate disasters happen

6. **Rent or let verses sale**

Before reviewing the tax planning options considering what you will wish to do with the buildings or sale proceeds can help with decision making and of course tax planning. Reviewing the basic options on tax planning may need to be done first however to assess the complete picture!

7. **Age and Health**

If barns or land are eligible for 100% agricultural or business property relief for Inheritance Tax (IHT) purposes and you are elderly and/or unwell, obtaining consents and increasing “chargeable assets” may be an undesirable course of action in any event?

8. **Clocking the Consents**

There is an argument to obtain consent now whilst the rules are relatively relaxed just to ‘clock’ the consent - even if you don’t carry it through. However if there is a high risk of failing with an application you could end up devaluing the farm as the ‘potential’ to convert may be lost!

TAX IMPLICATIONS

These very much depend upon the following factors:-

- A. Whether the barn/land with planning is to be rented out following construction of the house(s), or sold.
- B. What the proceeds will be used for if the property is to be sold, i.e. reinvested in a business asset or not?
- C. Whether gifting to children is to be considered as part of the process, or in the near future.

The main taxes for individuals to consider are as follows:

CAPITAL GAINS TAX

This will only be payable if the barn or land is sold. Annual exemptions of currently £11,300 per person are available each year after which gains over and above cost or the 31st March, 1982 value if later, will be taxed at 10% to the extent that any gain, when added to the total taxable income, falls within the basic rate tax band of £33,500, and 20% thereafter. Subject to an 8% surcharge for residential property. This means that where a basic rate taxpayer has income of at least £10,600

which utilises the personal allowance for income tax purposes, the taxable income and gain in excess of the annual allowance can total £45,000 before capital gains tax is payable at 28%. The tax rate is still relatively low and the cash remaining after paying the tax is yours, but it will then form part of your estate for Inheritance Tax (IHT) purposes as opposed to probably qualifying for 100% agricultural or business property relief prior to disposal.

If you convert a barn and sell it immediately on completion without having used it for any other purpose first there is a risk that the Revenue will assess the profit to income tax rather than capital gains tax with a potential higher rate tax liability subject to the number of owners involved and their taxable income.

To reduce the above capital gains tax rates the following can be considered:-

“Holdover” Relief

If you have owned farmland or buildings that have been used for agricultural purposes for more than 7 years or have traded on them for more than 2 years (and thereby Agricultural Property Relief is available for IHT purposes), or have used them in your trade for the whole period of ownership if less than 2 years, then you can gift barns or development land, or shares of the assets to children or family with no tax. This is done by way of ‘holding over’ the gain under S165 TCGA 1992 - i.e. the recipient takes on your original base value and you avoid the gain. Each recipient can then use their annual exemptions and any spare basic rate tax bands on any subsequent sale subject to any other gains they may have. If they trade with/on the asset rollover relief can be available to them too (see below) or they could just hold the asset. Gifting to family members in this way can save substantial tax but care is needed not to be seen to be deliberately doing so. Such gifts as part of your Inheritance Tax (IHT) planning is however, normal.

A holdover election can be used either before or after planning is obtained, provided the asset is used for business purposes at the time of the gift.

We have a separate leaflet covering holdover relief.

Rollover Relief

If the barns / development land “used” in your trade throughout your period of ownership is to be sold, rollover relief is available under S152 TCGA 1992 against acquisitions of business assets, shares or replacement land in the 12 months before or the 3 years after sale – timing is important here. Extensions of those limits are only permitted at the Revenue’s “discretion”.

In practice if you have evidence to prove you have been trying to rollover (e.g. putting barns / land on the market or actively looking / bidding at auction for replacement assets) the relief has in the past been permitted where you are outside the limits, and retaining evidence of work on finding replacement assets or selling existing assets can be important.

Rollover relief “rolls” over the proceeds, and therefore the gain into the new assets i.e. only postpones it. If you die or emigrate the gain would not crystallise and would no longer be taxable. If you sell the new trading asset the gain is charged at the rate of tax at that point, with a further right to rollover. This can leave you open to future changes in the rules and in some cases it is profitable to pay the tax.

Rollover relief is not permitted into investment assets, i.e. those rented out. It is, however, the initial use that is important. If a gain is rolled into a qualifying furnished holiday letting unit or bed and breakfast unit, which is later rented out or lived in due to a genuine change in circumstances or strategy, the gain does not crystallise at that point. Rollover relief, say, could be claimed and a gain rolled into an asset used by your child in their future business although care would be needed as to who was rolling over the proceeds and who was initially involved in the business. Genuine commercial situations are best – contriving a marginal situation just to save tax can be asking for problems.

Entrepreneurs Relief (ER)

If you cease trading and sell trading assets within 3 years of ceasing to trade then tax is payable at 10% only provided you have been trading for at least 12 months. Ceasing to trade could in practice involve a child continuing or taking over the trade or trading through a company.

In the past worries have existed about losing Agricultural Property Relief for IHT purposes on the house if you were to cease trading, but following the announcement of additional relief in the Budget for lower value houses this may not be significant given the extra £350,000 exemptions for couples that are being introduced on a phased basis from April 2017.

Trading assets are just that! To qualify for ER under S169I TCGA 1992 they must be used in your trade at the time of cessation, or for assets held outside of a partnership they would need to be used for the purposes of the business in the 12 months up to cessation. Care is needed on the wording on any permitted development application – to say they are “totally” redundant would almost certainly deny ER. Can they be redundant for planning purposes, i.e. not in mainstream use, but used for a sheep shelter or storing old machinery and potentially still qualify as used in your trade for tax purposes?

Timing of ceasing to trade and the asset disposals is important for Entrepreneurs Relief.

For rollover relief it is the time apportioned use that counts over the whole period of ownership, not just the last 12 months as for Entrepreneurs Relief and this is easier to qualify for in some cases.

Private Residence Relief

If barns are sold within the ‘curtilage’ of the house and used for private purposes then they may qualify for Principal Private Residence relief and no tax would be payable.

INCOME TAX

Any mortgage or loan interest paid on converting the barns should qualify for relief unless you are a higher rate taxpayer in which case relief could be restricted under the new buy to let rules introduced in the budget if they are to be let out as normal residential lets with a phased reduction in higher rate tax relief coming into effect from April 2017 so that from 6 April 2020 only basic rate tax relief at 20% will be available for the interest. Subject to the possible reduction of interest relief any rental income will be taxed at 20% / 40% or 45%, but not liable to the 9% class 4 NIC charge.

INHERITANCE TAX RELIEF (“IHT”)

If you convert barns for letting units then their value would normally be chargeable to IHT unless they are part and parcel of your business and qualify under the Farmer and Balfour case tests when 100% business relief may continue under s104 & s105 IHTA 1984. The rules are complex here and care is needed. We have a separate leaflet on the ‘whole estate’ concept established by these cases when looking at your tax affairs ‘in the round’.

If you consider your estate is likely to increase in value with the permitted development or planning consent consider gifting before you obtain the permission. At least the gift would be made at a lower value should it then fall back into your estate for IHT purposes on death within 7 years. It may be preferable therefore to gift all or a share of the asset before any sale rather than gifting cash afterwards. Any gift made to individuals would fall outside your estate after 7 years and be exempt from IHT in any event provided you do not reserve a benefit in the gifted asset without paying a market value rent.

VAT

The aspects were well covered here in my attached article in Taxation Magazine of 3rd April, 2014 however these can be very complex and if structured incorrectly, the VAT costs can be substantial.

If a property is to be used by a family member as their main residence, the DIY Scheme may be available to reclaim the VAT incurred on conversion or build. Ensure you are charged the correct rate by builders however as incorrect rates will not be refunded by the scheme – 0% for most new builds and 5% for conversions.

Where the property is used for holiday lets, the business can register for VAT and reclaim the input VAT incurred – though VAT will have to be charged and declared on rental income. Property used for long term residential lets will be exempt for VAT purposes and no reclaim of VAT incurred can be made unless the amounts fall within and qualify under the partial exemption rules.

Planning restrictions can also affect the VAT treatment and care is needed in all cases.

TRADING

If the Revenue consider you are solely interested in making a profit from the consent they may try to tax you to income tax on a profit. They are unlikely to succeed if you can prove you are just realising the value to rollover the gain, or to pay off loans, or to retire. Where trading could be argued successfully by the Revenue is where a child acquired a barn by gift, converts it and sells it in a short period of time! Evidence of intention is important here!

STAMP DUTY

This is generally only a problem when gifting if the borrowings attached to the property exceed £150,000.

SUMMARY

The overall considerations on how to handle barns are significant. Tax is a secondary issue, but a careful analysis of all the taxes are important – circumstances will differ from case to case.

How we can help

We would be happy to discuss this with you. Please contact us if you would like further advice.