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The Office of Tax Simplification

Capital Gains Tax report

Agriculture commentary

Helping you prosper

Introduction

Anyone from the farming community reading their newspapers this morning will no doubt consider the recommendations for Capital Gains Tax (CGT) reform from the Office of Tax Simplification (OTS) to be just another salvo in a continuing barrage of change facing their industry.

Hot on the heels of the OTS's recent review of Inheritance Tax (IHT), this paper is yet more for farmers to consider against a backdrop of Brexit, the steady erosion of BPS payments (with on-going uncertainty as to what will replace them), and the "once-in-a-generation" industry specific legislation in the form of the Agriculture and Environment Bills currently making their way through Parliament.

Whilst it's tempting to just get out of the office, start work, and try to put it all to the back of your mind (and no-one could blame you), there are important issues here and a failure to consider them now could be costly or even threatening to the future of the family farm.

UHY's analysis of the OTS report

In its 130 pages, the OTS report makes 11 recommendations. Fortunately, our tax specialists have condensed this into a concise summary based around the reports main findings, here.

This shorter document is intended to highlight the areas of specific concern to the farming community.

Objective of the OTS report

The OTS report's stated objective is to address "distortions to behaviour" caused by the current CGT regime. This refers to the perceived preference of those who can, to extract value from their working activities as capital (e.g. shares) rather than income (e.g. wages) because of inherent tax advantages of such a route.

Farmers' interactions with capital taxes (CGT and IHT) are, perhaps, a little different to those of other business owners.

For the farming community, it is the desire to transfer the assets comprising the family farm to the next generation that tends to be the principle concern rather than realising a capital sum through an "exit". In this regard, the recommendations in the report relating to capital transfers would appear to be of most interest to the farming community, and we will start there.

Capital transfers (Recommendations 7 to 9)

Although outside the scope of this OTS report, whether or not Agricultural Property Relief (APR) from IHT is under threat (as a whole or in part) is an issue that should already be in every farmer's thoughts as regards succession planning.

However, what seems clear is that where some form of inheritance tax relief applies on the transfer of assets, e.g. APR in the case of farming assets or Business Property Relief (BPR) in the case of other relevant business assets, the current capital gains uplift on death will be removed.

This means that the current provisions allowing farming assets to be transferred (on death) to the next generation free of IHT and then potentially sold on also without incurring a CGT liability are likely to end.

These recommendations go on to suggest the potential removal of the capital gain uplift on death to all inherited assets, irrespective of whether any IHT relief has been claimed on them.

This potentially means that CGT will be charged on the ultimate disposal of all inherited assets by reference to original cost as opposed to probate value, essentially creating a double charge to both IHT and CGT.

To soften the blow of these changes, it is proposed to allow the deemed costs of assets to be uplifted (re-based) to their year 2000 market value. However, this will be of little comfort to farmers given the 200% to 300% increase in farmland values since the millennium.

In addition, current Gift Holdover Relief provisions may also be extended to a broader range of assets. However, Gift Holdover Relief already applies to farmland and buildings that continue to be used for the purpose of farming.

Rates and boundaries (Recommendations 1 to 4)

These recommendations get to the crux of the "distortion issue" by removing the differential between capital gains and income tax rates.

If the proposals are adopted, as regards the disposal of inherited farming assets, not only will the amount of any capital gain increase (because of the removal of the uplift on death), the rate of tax applicable to those gains will also change from typically 20% to 40% in the case of higher rate tax payers.

As a simplification measure, the proposal also recommends reducing the number of CGT rates, suggesting the removal of the lower rates currently applied to basic rate taxpayers.

In line with harmonising the CGT and income tax rates, the proposals will allow a more flexible use of capital losses but this is of little benefit to farmers who generally own assets such as farmland with large "pregnant" gains.

Finally, it is proposed to negate current taxation advantages conferred to employees via share-based payments as well as potentially taxing (as income) retained earnings left in smaller companies. Whilst concerning for the owners of such businesses, this will not affect the majority of farms trading under non-incorporated models (sole-traders or partnerships).

The Annual Exempt Amount (Recommendations 5 & 6)

It is perhaps no surprise that the proposals support a reduction in the annual exempt amount (AEA) thereby bringing more capital transactions into charge for CGT and increasing the amount of gain chargeable to tax. The report favours reducing the AEA from its current level of in excess of £12,000 to between £2,000 and £4,000.

In line with other current and on-going developments such as Making-Tax-Digital and 30-day CGT reporting for land transactions, the proposals in this section also support the development of systems allowing real-time CGT collection at the time of transaction.

Business Reliefs (Recommendations 10 & 11)

The proposals support the replacement of Business Asset Disposal Relief (BADR), previously Entrepreneurs' Relief (ER), in favour of the return of some sort of retirement relief.

The change to BADR introduced a much-reduced lifetime limit of £1m (previously £10m under ER), significantly reducing the value of this relief to those wanting to simply exit farming activities.

It remains to be seen whether any new form of retirement relief will be more generous. However, it will certainly have an age threshold and will only be available to those approaching retirement age.

well be seen as a politically palatable vehicle by which to reduce fiscal deficits in the post-COVID era.

Although not specifically aimed at farmers and landowners, much of what is proposed will undoubtedly affect the farming community. If succession planning is not currently high on your agenda, our advice is that it should be.

It is likely that at least some of the proposals set out in this document, in addition to possible changes in IHT legislation, may be enacted as early as the next Finance Bill accompanying the Budget in spring 2021.

Any advantages in delaying capital transfers (and related succession planning) until near end of life now seem set to be removed and this practice may prove to be disadvantageous in future.

Please call us to discuss any of the issues raised in this report in more detail.

The next step

If you would like further information on how the report may affect you and to discuss how we might be able to provide guidance and support, please speak to your usual UHY contact or one of our specialists.

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