



is for agriculture

Farming and agriculture present unique problems for the unwary tax adviser, says **Julie Butler**

For tax advisers, it is essential to understand the definition of both farming and agriculture, and having a clear understanding of what constitutes diversification also comes as a distinct advantage. Why? Farming and agriculture are entitled to unique tax reliefs, and it would be slightly irritating to claim these tax reliefs in good faith under the possible misconception of the underlying definition and to then “land” an unsuspecting client (or his or her beneficiaries) with an unanticipated, substantial tax bill. It could also be possible to not claim the maximum reliefs.

Potential loss of agricultural tax reliefs

With many farmers moving away from traditional activities towards the intoxicating (and much needed) profitability of diversification, the tax reliefs dependant on farming or agriculture could be lost, which would be very unfortunate.

What are the tax reliefs?

- Agricultural property relief (APR) for inheritance tax (IHT) on the farmhouse – If the farm is no longer surrounded by land in the same ownership that is principally used by farming, then is the house still a farmhouse? (Inheritance Tax Act 1984 (IHTA) section 115)
- Agricultural property relief on the farmland and buildings (IHTA 1984 section 115)
- Job related accommodation – It has always been taken for granted that farm workers will live in cottages “tax-free” due to the advantages of “job-related accommodation”. Will farm workers who move from carrying out farm duties to non-farm duties still qualify for “tax-free”, job-related accommodation? (Income Tax (Earnings and Pensions) Act 2003 (ITEPA) section 99) Emphasis is on the rules of “customary and proper performance”.
- Five-year loss rule (hobby farming) (Income Tax Act 2007 (ITA) section 67)

- Farmer’s averaging of profits for tax purposes (Income Tax (Trading and Other Income) Act 2005 (ITTOIA) part 2 chapter 16)

In the past few years it can generally be assumed that only a few pure farming activities remain profitable, and some form of diversification must take place to achieve overall profitability for the farming unit or enterprise, although the summer of 2007 changed the thinking on arable profitability, with corn prices sky high due to the flooded Midlands and no rain in Australia. This might be simply the letting of redundant farm buildings and cottages or more radical activities.

So what are examples of the problems created if these reliefs are lost?

- The farm workers (now employed on diverse activities) could be subject to a benefit kind charge for the use of (what was) the farm cottage.
- The loss claim could be challenged by HM Revenue and Customs (HMRC) before the end of the fifth year.
- The claim for APR on land, buildings, cottage and farmhouse could be subject to challenge, and a claim to business property reliefs (BPR) would have to succeed when APR fails.

What a complex position for the probate practitioner who could be faced with “ambush” attacks on IHT reliefs that were perhaps taken for granted.

The changing world of agriculture

Does the definition of agriculture need greater clarification for tax reliefs to be claimed? The problem is that the world of agriculture changed massively since the introduction of IHTA 1984 – the collapse of farm prices and profitability in the 90s, the vast thrust towards diversification and the move from production-based subsidies to “land management” subsidies with the single farm payment (SFP) from January 2005. *HMRC Tax Bulletin Special Edition 2005* introduces the concept of the “fiscal farmer”. The SFP scheme introduced the “environmental steward”.

A is for agriculture

So what is "agricultural property"? Help is found in the HMRC Inheritance Tax Manual (IHTM) 24041: definition of agricultural property:

"Agricultural property is defined in IHTA84/S115(2) and is restricted to property in the United Kingdom, the Channel Islands and the Isle of Man, by IHTA/S115(4) means:

- agricultural land or pasture (IHTM24042) which includes woodland (IHTM24043) and any building used in connection with the intensive rearing of livestock or fish (IHTM24044) if the woodland or building;
- is occupied with agricultural land or pasture (IHTM24111); and
- the occupation is ancillary to that of the agricultural land or pasture.

"It also includes such cottages, (IHTM24045) farm buildings (IHTM24046) and farmhouses, (IHTM24047) together with the land occupied with them, as are of a character appropriate (IHTM24036) to the agricultural land or pasture.

"Dividing the agricultural property into parts stems from the case of *Starke v IRC* (1995) STC 689 which considers the meaning of agricultural land or pasture.

"Agricultural relief is only available on death/transfers where there is agricultural land or pasture. It is only once you have established that the subject matter of the transfer contains agricultural land (IHTM24042) or pasture that is occupied for agricultural purposes (IHTM24100) that you can then consider whether any farmhouses (IHTM24047) farm cottages (IHTM24045) or buildings (IHTM24046) qualify for agricultural relief. This is you need to identify each part comprised with the agricultural property in order to consider its agricultural value (IHTM24071) against which agricultural relief will apply if the occupation (IHTM24111) or ownership (IHTM2120) conditions are satisfied." (See www.hmrc.gov.uk/manuals/ihmanual.)

A question must be asked as to how non-specialist tax advisers can come with these complexities?

D is for diversification?

Diversification is the alternative use of land, for instance, using the land for a purpose that is not agriculture (farming), such as sporting rights, horse livery or developing agricultural land and buildings into residential dwellings or offices and workshops.

F is for farming

The question must be asked: what farming activities are actually comprised in the definition of agriculture, and are these activities trading?

A special tax regime exists for the profits of a trade carried on in the UK under ITTOIA 2005 part 2. Whether or not a person carries on a trade remains a question of fact, but the word "trade" includes the idea of exchanging goods or services for a reward. Although the courts indicate what might constitute trading in a large number of cases, these "badges of trading" should be considered in relation to farming because, under ITTOIA 2005 section 9(1), farming or market gardening conducted in the UK is treated as the carrying on of a trade for income tax purposes.

What is the definition of "farming" for income tax purposes? Under ITA 2007 section 996(2), "farming" means "[...] the occupation of land wholly or mainly for the purpose of husbandry [...]". For corporate taxpayers, the definition is somewhat more circuitous in the Taxes Act (TA) 1988 section 832(1) when "farm land" is defined as "[...] land in the United Kingdom wholly or mainly occupied for the purposes of husbandry [...] and 'farming' shall be construed accordingly".

Thus, to be classified as a farmer for tax purposes, a person must satisfy two tests: the person must be in occupation of land, and the purpose of the occupation must be at least mainly for husbandry. The actual use of the land will normally be indicative of the purpose of occupation, but is not necessarily conclusive. Nor need the occupation be to the exclusion of others (share farming is an example in which two persons may occupy land and each be farmers). "Husbandry" is specifically said to include hop growing and the breeding and rearing of horses and the grazing of horses in connection with those activities (ITA 2007 section 996(2)).

Short-rotation coppice

There seems to be a natural extension to the farming definition by the specific inclusion of "short-rotation coppice" in ITA 2007 section 996(3) and the Finance Act (FA) 1995 section 154(1) for non-corporate and corporate taxpayers, respectively. Short-rotation coppice is defined as a perennial crop of tree species (normally willow or poplar) planted at high density, the stems of which are harvested above ground at intervals of less than 10 years (ITA 2007 section 996(6) and FA 1995 section 154 (3)).

APR on energy crops

Is APR available where farmers grow crops for fuel? It is generally considered that land cultivated for the growing of energy crops is agricultural land, and such use counts as occupation for agricultural purposes. Section 24 of the IHTM indicates that cultivation of land to produce the crop is a key requirement in enabling land to qualify for APR. For example, paragraph 24103 of the IHTM cites a rating case concerning reed beds that grew naturally and were then cut for thatching do not qualify. If there is no tilling, sowing or cultivating of the land, and all the taxpayers did was to cut reeds, then this is not farming. The absence of tillage meant that the reed beds could not be classed as agricultural land.

Dymond's Capital Taxes (Chris Whitehouse and Emma Chamberlain, Sweet & Maxwell, 1985) at paragraph 24.863, supports the view that land under cultivation may generally be regarded as being used for the purposes of agriculture.

Is intensive rearing of livestock for human consumption farming?

For the purposes of averaging relief, "farming" includes the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption (ITTOIA 2005 section 221 (2)(b)). Averaging also can be applied to trades of market gardening (ITTOIA 2005 section 221 (2)(a)). Only farming trades carried on in the UK may average profits. Also >>

<< excluded from the definition of “farming” are farming contractors because their trade does not involve the occupation of farm land, as are cases where the farming activity is part of a larger trade that includes substantial non-farming activities (see the *HMRC Business Income Manual (BIM)* 73110).

Market gardening v farming

The definition of “farming” for income tax purposes and “farm land” for corporation tax purposes each excludes, respectively, “market gardening” and “market garden land”. “Market gardening” is defined as “the occupation of land as a garden or nursery for the purpose of growing produce for sale” (ITA 2007 section 996(5)).

For corporation tax purposes, “farm land” is expressed to exclude “market garden land”, which means: “Land in the United Kingdom occupied as a nursery or garden for the sale of produce (other than land used for growth of hops) and ‘market gardening’ shall be constructed accordingly” (TA 1988 section 832(1)).

Christmas trees grown on specialist nurseries will be categorised as market gardening. When, however, Christmas trees are grown on part of a farm, by HMRC practice the activity may be incorporated in the other farming activities conducted (see BIM 62601).

Since farming is to be treated as a trade (under ITTOIA 2005 section 9(1) for income tax and TA 1988 section 53(1) for corporation tax), it is charged to tax under ITTOIA 2005 part 2 or schedule D case I in the ordinary way, provided the land is in the UK. If the land is situated abroad, different problems arise. That also applies to market gardening. The ordinary rules for calculating profits of a trade apply, subject, however, to one major exception.

All the farming carried out by one person, partnership or body of persons is treated as one trade (ITTOIA 2005 section 9(2) and (3) for income tax and TA 1988 section 53(2) for corporation tax). This rule, which does not apply to market gardening, can have major effects on the computation of farming profits and losses and also emphasises the need to have a clear definition of farming and agriculture.

FF is for the fiscal farmer

HMRC’s *Tax Bulletin* (June 2005, special edition) effectively divides farming into three categories.

Category	Type	Income tax consequences	Corporation tax consequences
I	Fiscal farmer	Farming income under ITTOIA 2005 section 9	schedule D case I Farming income under TA 1988
II	Commercial non-farming occupiers	Trading income under ITTOIA 2005 section 10	schedule D case I non-farming trade under TA 1988
III	Non-traders	Income none otherwise charged under ITTOIA 2005 part 5 chapter 8	schedule D case VI non-trading income under TA 1988



The fiscal farmer will include more than the traditional farmer who continues to farm. As the definition of “farming” turns upon the purpose behind the occupation of land, HMRC conceded that those who do not produce anything on the land that franks the SFP will nevertheless be treated as being within this category when other farming takes place elsewhere on

the holding. This may not prove to be as simple as stated in the *Tax Bulletin*. As all farming is treated as one trade, it is unclear whether HMRC’s interpretation of “holding” will be given its normal meaning or the wider one adopted for tax purposes. This may turn upon whether the holding is in the same region for the SFP so that it can frank the SFP and unlock the SFP, though this would be a curious interpretation to adopt in England, where it would be possible for a natural holding to be in more than one region.

The SFP, therefore, adds another complexity to the definition of farming. Is the farmer effectively just an environmental steward?

E is for environmental steward

As so many of the agricultural grants and subsidies are for the function of “environmental stewardship”, where does this activity fit with the role of farmer, husbandry and agriculture? A simple, unified and clear statutory definition is required to help not just the tax adviser, but also the taxpayer. The statutory definition should take into account the tasks of land management and a “steward of the environment”.

Some activities clearly do not count as farming or agriculture, such as “growing houses”, letting out redundant farm cottages, grazing by horses, “rave concerts”, game shooting, letting of sporting facilities, horse livery and long term woodlands. However, many “marginal” activities could confuse the tax adviser, for example, energy crops or some woodland activities, among others.

Greater clarity and greater breadth

Many tax advisers argue that, with all the recent changes, including the SFP, the growth of diversification, the greater ownership of land by “lifestylers” and the greater scrutiny of the claim for IHT reliefs by HMRC (especially regarding the two-year rule and commerciality), greater clarity and possibly greater breadth of interpretation of farming and agriculture are needed.

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