

Common farm tax negligence traps

With farmland prices having increased in excess of 100% between 2005 and 2010 the quantum of potential inheritance tax (IHT) liabilities has therefore also risen should IHT reliefs not be available. If a professional mistake is made with regard to these reliefs on farms and landed estates on IHT matters, the potential liability allocated to errors made by the adviser could also have doubled.

With every tax enquiry, HMRC is trying to secure strong 'tax takes' from their work. When Business Property Relief (BPR) or Agricultural Property Relief (APR) claims fail and there is extra tax to pay (and possible penalties) it can be argued that the professional adviser is partly to blame (why did they make a weak case?) and there will be the threat of a potential negligence claim.

What are the areas of potential professional negligence or worry?

A 'Balfour' failure

Everyone is aware of the success of the *Balfour* case, *HMRC v Brander* [2010] UKUT 300, and how BPR was received on the whole of the estate. The question facing advisers is what happens if BPR is not achieved on a similar enquiry, for example, where there is not enough involvement to convince the Tribunal that this relief applies, or that the rental or investment properties are so great that these activities outweigh the trading activities, leading to BPR being denied by HMRC.

Protection can be achieved via a BPR audit to identify what qualifies for BPR specifically, and what would be classified as 'in the round', taking account of all the activities ancillary to the main farming activity. Problem areas can be where there is automatic assumption that guidance given in *Balfour* will cover all BPR claims and professional advisers have indicated that to be the case, or were specifically advised say several years ago that BPR should be eligible on the estate, and then the estate changes without them fully realising the impact of the changes. For example, with general farm diversification there is a far greater move towards investment activity rather than trading activity.

If the claim for BPR does fail, will there be a claim for bad advice up to the amount of the tax that will be due with possible penalties if the qualification for relief was not thoroughly researched, ie there is no robust evidence for the claim? Clearly a review of all business activities is required, ie the living BPR audit.

Weak contract farming or grazing agreements

The case of *Re Amander v HMRC* [2006] STC 800 highlighted the need for a strong contract farming arrangement. This would mean a contract farming agreement that was drafted correctly and thus was more than just a 'glorified tenancy' with risk for the landowner. It is essential that the terms are carried out in fact, and therefore, this would mean that there was active husbandry being undertaken. The loss of APR on the farmhouse could be a large financial risk. A loss of the claim for BPR is a risk where it is deemed that there is no business, just, say, agricultural occupation – what if the contract is protecting the hope or development value with BPR?

Development value is the difference between the market value and the agricultural value (s115 IHT Act 1984). APR is restricted to agricultural value but hope value needs the protection of BPR. How long is it since the contract farming agreement was reviewed? Whose responsibility is the quality of the agreement – the client, the lawyer who drafted it, the land agents who work with the arrangement in practice or the tax advisers

Farm Tax Brief · April 2012

www.farmtaxbrief.com

who produce the accounts based on the contract farming agreement?

The action plan has to be for all legal documents relating to the farming activity to be reviewed not just by the lawyers, the accountants, tax advisers and land agents but by the clients themselves.

There is the question of whether the clients will be prepared to pay for the cost of the review of legal agreements. If the clients will not pay the answer has to be that a letter must be sent to them warning of possible weaknesses, highlighting the need for a review and pointing out the problems, should tax reliefs be denied. The letter should also try to specify the quantum of the tax liability that is at risk if the reliefs are not achieved.

Inadequate agreements

The generic weakness of grazing agreements to protect BPR was considered in the case of *McCall v HMRC* [2008] STC 752 and [2009] NICA 12. The services that have to be provided by the landowner in order to ensure that there is a trading activity and a business were set out by the landowner in the *McCall* case. What happens if sometime before the *McCall* case a professional adviser was asked whether BPR would be achievable through the grazing agreement, and in good faith the tax adviser considered BPR could be claimed and the adviser hadn't updated that advice for the findings of *McCall*?

It is very interesting that in the *McCall* case the land concerned had an agricultural value of £165,000 but a development value in excess of £4m. This raises the question as to whether the professional advisers were fully aware as to what the grazing agreements were needed for and what tax reliefs they were protecting. Were they aware of all the development and hope value that would be reported on the probate valuation? A practical step to help protect tax advisers is to have an approximate valuation of every farm and estate that is being advised upon on the file so that risk areas can be highlighted. It could be argued that the client should be advised of planning applications and planning intentions. Perhaps clients have informed the tax advisers and the full implications of that have not been realised by the adviser.

Of course, however well drafted the farming contract or grazing agreement is, it will fail to achieve the desired result if it is not operated properly. The contractor or grazier may be a local farmer who just wants to get on with the job, without wasting time in meetings or troubling an elderly landowner with details of fertilizing or weeding the grazing land. An annual or occasional 'living audit' may still be useful where an apparently well-drawn agreement was set up some time ago and seems to have worked successfully with no questions asked.

Income tax and hobby farming

Not all negligence claims by clients against their advisers will rest around inheritance tax. The whole of

farm tax is complicated: for example, farmers averaging, herd-basis, part disposal rules, complexity of the rigidity of entrepreneurs' relief and the hobby farming rules. It could be that a significant period of time has gone by and the tax adviser does not realise what year actually qualifies as the one to be disallowed for hobby farming and claims have been made without realising that they should be disallowed. Perhaps there was insufficient information on transfer by the previous agent. For example, if it is stud farming where the six-year rule is extended by concession to 11 years there can be errors in the calculation and claims going beyond this period.

VAT

Identification of the treatment of VAT is exceptionally complicated in the world of farming and farm diversification.

Agricultural products are zero-rated, ie the supply of food is zero-rated. The farm VAT return was a very simple affair – zero-rated outputs and then claiming back the input VAT on expenses. However, with diversification away from agriculture there are a large amount of VAT complexities. The supply of a right over land is an exempt supply so the renting of cottages is an exempt supply. Most diversification activities, however, are standard-rated but within those areas of diversification there can be a mix, ie do-it-yourself horse livery where there is the supply of a dedicated stable are an exempt supply, whereas full livery, schooling etc, is a standard-rated supply in view of the level of service.

There can be huge complexities within the VAT return for a farm or landed estate. Many farms have not been subject to a VAT inspection for, say, a decade. There can be problems with partial exemption and confusion as to whose responsibility it is to actually check upon the

possible VAT errors. If the accountant looks through the books to produce the accounts they often do not consider it their responsibility to check the VAT, and some engagement letters even state that they have no responsibility for these matters. However, some rather big VAT liabilities can build up through errors on partial exemption etc, and when the liability arises with penalties the farmer can look for a claim for negligence.

Evidence

It is essential that all telephone calls are recorded and all tax advice is undertaken in writing. It is very easy for there to be misunderstandings.

Summary

Professional tax advice around farms and landed estates is very complicated with risks of extra tax upon enquiry by HMRC, leaving some clients wanting to claim for negligence against the original tax adviser.

The basic protection is helped by the checking of all areas of farm tax and to warn clients of concerns and to try to flag up problems. Even if the client is not prepared to pay for the much needed tax planning report they must at least be made aware of the problem. Robust warning letters have to be put in place to provide the protection that is needed to the professional, should a complicated enquiry follow. Strong files must also support all client advice.

Supplied by **Julie Butler** FCA Butler & Co, Bennett House, The Dean, Alresford, Hampshire, SO24 9BH. Tel: 01962 735544, j.butler@butler-co.co.uk, www.butler-co.co.uk

Julie Butler FCA is the author of Tax Planning for Farm and Land Diversification (Bloomsbury Professional), Equine Tax Planning ISBN: 0406966540, and Stanley: Taxation of Farmers and Landowners (LexisNexis).