

ENTREPRENEURS' RELIEF AND FARMING

Julie Butler looks at the disadvantage to the Farm Business Tenancy and commercially let property

From 6 April 2008 the taxpayer can no longer claim Business Asset Taper Relief (BATR) on capital gains and the flat 18% rate applies to all gains. However, Entrepreneurs' relief (ER) is available which allows the effective 10% rate of tax for £1 million of lifetime gains on business disposals. But is ER all it seems? Are we aware of the pitfalls? The aftermath of the CGT reform is that a total review of the tax efficiency of all land holdings should be undertaken by the tax adviser.

Loss of the effective 10% rate of CGT of Farm Business Tenancies.

From 6 April 2004 the farm business tenancy (FBT) achieved the 'magical' effective 10% rate of CGT but this is lost from 6 April 2008 and there is no ER available for gains arising from land sold which is subject to an FBT.

The letting of a commercial property, which previously qualified for BATR will not normally qualify for ER, since commercial property letting is not a trading activity and ER applies only to trading activity. If the property is let to a trading partnership by one of its members or to a trading company by an officer or employee, there may be a measure of relief if the property disposal is associated with a qualifying disposal of the member's interest in the partnership or of the officer/employee's shares in the company.

The CGT and inheritance tax (IHT) relief and the FBT has been a 'yes you can, no you can't, well maybe' ride and in the light of the CGT reform it is essential to review the tax status of all farmland trading structures.

Many areas of farming profitability has been in decline over the last decade and as a result more farming 'in-hand' has been disappearing with a move by the landowner to contract farming and to let land via FBT. However, with increasing food prices and shortages there are different drivers and the recent apparent doubling of agricultural values.

There is another quirk of the ER legislation in that; in order to qualify for ER, there must be a disposal of the

whole or part of the trading business; the sale of an asset in isolation will not qualify for the relief. The criteria relating to retirement relief are discussed in capital gains manual at CG 63530 onwards and will be applied for this purpose. This effectively reintroduces the 'mere asset' point of retirement relief.

Gains on disposals of let residential properties will not qualify for ER, but a business of commercial letting of furnished holiday accommodation in the UK will be treated as trade, so ER will be available provided that all the qualifications are met.

The Birth (and the death) of the FBT

From 1 September 1995 the FBT allowed the landowner to achieve 100% agricultural property relief (APR) for IHT on farmland let for an agricultural purpose.

Let land that achieved APR appeared to be a farming tax revolution. The landowner would achieve a certain financial return on the land and 100% IHT relief. Perfect – or was it?

Problems with the FBT

There were, however, a number of tax disadvantages of the FBT from 1 September 1995, as follows:

- the IHT relief was restricted to the agricultural value not the value above that amount;
- business property relief (BPR) does not apply to the land included in the FBT (eg hope for development) because there is no business;
- there is no ability to claim the lifestyle business expenses associated with farming;
- the farmhouse would not achieve APR as it was not used in the farming operation, as there was no such operation just let land; and
- with diversification, if the use of any land did not qualify as agricultural property then the APR did not apply.

The above disadvantages directed landowners towards contract or share farming arrangements and away from the FBT, but CGT legislation changes in 2004 reignited the FBT attraction.

BATR on commercial lets from 6 April 2004

From 6 April 2004 BATR applied to the FBT. Many landowners decided that as APR and full BATR was applicable to land, then the FBT was preferred to a 'fragile' contract farming arrangement. However, there are some landowners who moved to the farming structure of the FBT when the final CGT advantage came into play from 6 April 2004. They should now reconsider their farming arrangements with the loss of ER eligibility and the IHT disadvantages above.

It would be very easy for landowners to move straight from the security of the FBT to the well drafted contract farming arrangement. However, the recent case of *Arnander (Executors of McKenna Deceased) v HMRC*, Spc 565 23 October 2006 has shown that fragile contract farming arrangements have problems in support of APR on the farmhouse. What is the answer? A genuine robust contract farming arrangement where the landowner has financial risk and is involved in a trade but the contractor absorbs the 'grind' and volume of work, perhaps with some integrated 'in hand farming'?

The 18% rate of CGT

For overall CGT and IHT planning the 18% rate CGT represents a very attractive CGT rate for non-business assets. For IHT planning, with the advantages of both APR and BPR, there could be more scope to sell assets which do not attract APR/BPR and to replace them with business assets that do achieve the potential of IHT relief. But remember that death is not a chargeable event, so there could be some considerable gambling with future tax reliefs taking place.

The role of the District Valuer

On death, when the reality of all the IHT planning often translates to negotiation with HMRC, the role of the District Valuer (DV) has become very important in both the values on which IHT might be paid and also the future base costs for CGT. The land agent and the tax adviser have to think like the DV – to view the values and the farming/trading activity through their eyes. What are the 'hope' and special values that do not qualify for BPR under the FBT? Have these factors been considered?

The CGT and IHT disadvantages of the FBT

The main IHT disadvantage of the FBT is well documented – no BPR on hope value and no APR on the farmhouse but what now with the CGT reform?

To conclude, the FBT does not achieve the advantage of ER as let commercial property is excluded from the ER provisions. ER does not apply to the disposal of 'mere' assets. Like retirement relief, it has to be a disposal of the whole or part of the (farming) business. However, why risk the 18% disadvantage when 10% could be achieved for disposals up to £1 million on a trading status, ie why risk the tax disadvantage of the FBT?

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