High noon down on the farm?

The tax collectors have the "hobby farmer" in their sights. In the first of a new series, **Julie Butler** looks at Antrobus 2 and the effect the current tax attack will have on the rural property market

There are many who consider that the "lifestyle farmer" was an invention of the 60s – wild parties down on the farm with no neighbours to interrupt the fun. The fact that it was in the 60s that the well-known and well understood tax legislation of "hobby farming" was introduced would support this idea. However, lifestyle farmers are a creation which span centuries of history and tradition. The sole aim of land ownership has not always been commercial return.

A clear example of history repeating itself is the Industrial Revolution and the purchase of landed estates from the vast wealth that this created. While the purpose behind the acquisition might have been more driven by status than lifestyle and tax planning, there are many parallels that can be drawn from that period of history to current times.

So what are the tax reliefs currently available to the lifestyler that make the acquisition of a landed estate, large and small, considered to be so tax driven?

Income Tax

The industry of farming has historically been a 24 hours a day, seven days a week vocation and a number of expenses which might in other industries be seen as private expenditure have for a large number of years justifiably achieved acceptance as a business expense. Examples of these are:

- Farmhouse expenses;
- The cost of vermin control;
- The cost of four-wheel drive vehicles to achieve farm inspections etc; and
- Repairs to cottages occupied by family members living on the farm.

The key issue of vermin control ties into the HM Revenue & Customs letter to the Country landowners' Association (CLA) and representative shooting associations in April 2006. The guide talks of tax irregularities and complying with these.

Farm trading losses can be offset against total income in the year of the loss under s.380 TA 1988 provided there is a profit every sixth year as provided by the "hobby farming" rules. The reality is that tax refunds generally at a 40 per cent rate of income tax help support what is deemed to be the "lifestyle" farming operation.

Capital Gains Tax (CGT)

In the first instance there is the tax advantage of principal

private residence relief on the future disposal of the farmhouse. However, there is also the extremely favourable tax advantage of Business Asset Taper Relief (BATR) at a top rate of 75 per cent on disposals of assets that have been owned for a full two years. With a top rate of income tax of 40 per cent this means a top rate of CGT of 10 per cent (40 per cent x 75 per cent relief =10 per cent).

For many clients acquiring farms and landed estates in recent times this 10 per cent rate of tax can create a new breed of commercial asset stripper. The new lifestyler perhaps does not have the same emotional attachment to the landed estate as perhaps binds those who were born there. The offer of an inflated price for a pony paddock or for a barn or stable block does not have the emotional attachment and barriers of generations of ownership for the lifestyler.

Provided the farming asset has been owned for two years in order to qualify for full BATR, a 10 per cent rate of CGT makes any attempts at asset-stripping very attractive.

So how can the lifestyler be caught out in their quest for CGT heaven? Firstly there must be a genuine business to support the claim for BATR. Secondly the two-year ownership rule must have been strictly complied with. Thirdly the transaction must be safe from attack from the Inland Revenue as the landowner being deemed to be dealing in land under s.776 TA 88 in which case the gain is deemed to be trading profit subject to income tax taxable at a rate of 40 per cent.

So what will give rise to a tax charge under s.776? Clearly if the land or building in question was purchased with a view to selling at a profit at some future date. Is there a concern that many lifestylers would be caught under this section?

VAT

Historically the farm VAT Return has been very straightforward, i.e. agricultural supplies at zero rate and the claim of input VAT at the standard rate. But there have been changes in recent years making this more complicated, e.g. the question of rent received on residential cottages and the review as to partial exemption or the disallowance of certain elements of input VAT such as private usage of the farm shoot etc. Most diversified activities have to charge output VAT at the standard rate.

The new lifestyle farmer tends to have high standards of quality of environment and the improvements and repairs can be very extensive including repairs to the farmhouse. The claim for input VAT can therefore be very high and it is essential that claims can be substantiated by such basic guidelines as commerciality, good documentation and high quality bookkeeping.

Inheritance Tax

It comes as a surprise to many tax advisers who are not farm practitioners that the IHT reliefs for the landed estate are so favourable.

In theory the whole of the landed estate including the farmhouse is capable of achieving 100 per cent IHT relief – s.115 IHTA 1984 refers to such farmhouses in the same sentence as land, cottages and buildings as character appropriate.

It is fascinating to consider that in 1984 (when residential property prices were relatively low) how little attention was paid to the farmhouse. But what of now? Various tax cases have tried to attack the claim for 100 per cent IHT relief on the farmhouse, e.g. *Stark, and Higginson*. Antrobus 1 was considered a relative success for the continued support of the claim for 100 per cent IHT relief on the farmhouse.

However, Antrobus 2 meant that the Land Tribunal would be involved in the "agricultural value" of the farmhouse. Essentially having won the argument for IHT relief on the farmhouse provided certain conditions were achieved, e.g. history, geography etc, there has been an attack on value, insisting that agricultural value is used.

This is the value as if there was a perpetual covenant for the property to be used for agricultural purposes. In Antrobus 2 the market value was reduced by 30 per cent to allow for the restriction of agricultural value. This is not set in stone.

It would be fair to say that the result of Antrobus 2 has caused tremors of doubt throughout the agricultural and tax worlds. With the principles of agricultural value and the possible principle of the working farmer being brought into question, there is lots for the tax adviser to contemplate.

Julie Butler FCA is the author of ***Tax Planning for Farm and Land Diversification*** **and** ***Equine Tax Planning.***
Email j.butler@butler-co.co.uk