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Tax Impact of FBT

Julie Butler explains Farm Business Tenancies

The introduction of the Farm Business Tenancy (FBT) in September 1995 (under the *Agricultural Tenancies Act 1995*) allowed landowners to let farmland without the 'stranglehold' of the old Agricultural Holdings Act tenancies. But the question that must be asked is: What is the tax position of the Farm Business Tenancy for landowners?

(1) The ease of the FBT

The attraction of the FBT is the administrative simplicity compared to farming 'in hand' or by way of contract or share farming arrangements. For the younger generation, the FBT can release the landowner to earn money elsewhere. However, the average age of the UK farmer is very close to retirement, which makes the FBT very attractive.

Landowners might not want the obligations and aggravations of the contract farming or share farming arrangement in order to qualify as a farmer within section 9, ITTOIA 2005, so they look to the FBT. So what are the tax advantages and disadvantages of the FBT?

(2) Inheritance Tax

Here it is convenient to deal separately with (a) farm land and buildings still used for agricultural purposes; (b) the farmhouse itself; and (c) farm cottages, barns and other buildings put to new uses.

Farm land and buildings

Since 1 September 1995 the FBT has ensured that the relevant land and buildings included within the scope of the FBT qualify for IHT Agricultural Property Relief (APR). The key to the qualification for IHT relief is the clause contained within the FBT, enabling the

landowner to obtain vacant possession within 12 or 24 months.

Consideration must be given to any development or hope value of the land as it is extremely unlikely that Business Property Relief (BPR) will apply.

The farmhouse

The IHT disadvantage of the FBT focuses on the potential loss of IHT relief on the farmhouse (assuming it is to be retained for occupation by the landowner and not included in the FBT). The tax profession accepts that farmhouses are anyway under attack for their eligibility to IHT relief (see, for example, the *Antrobus* case).

With a large number of farms the potential IHT relief on the farmhouse is significant and is at great risk should there be a move from farming 'in hand' or by way of a share or contract farming arrangement. Clearly, how can the IHT relief on the farmhouse be argued if there is no business?

Whilst the recent finding of 'Antrobus 2' dictated that the IHT relief on the farmhouse is restricted to the agricultural value, this is still a significant potential tax saving for those farmers who continue to farm their land as opposed to entering into the FBT.

Farm cottages

Most farms of a significant size have a number of let farm cottages included within the business or enterprise – these are often the cottages where the farm workers used to live when farming was much more labour-intensive. Alternatively, the let property is often farm buildings converted into dwellings available for rental – literally converted pig-sheds, milking parlours and the building where the cart-horses used to stand.

In this Issue

Farm Tenancies 133

Landowners must carefully consider all the tax implications before letting their land under a Farm Business Tenancy – Julie Butler provides a checklist

News in Brief 135

*Finance Bill in Parliament
Manx Tax Reform
Small Companies Relief
Tax & Finance Deadlines*

SBT&F Checklist 137

Our monthly listing of website updates and new publications

Health & Safety 139

Peter Phillips on the confused but important law governing the employment of children and young people

VAT Update 140

VAT relief for memorials and for listed places of worship extended for three years

Published with this Issue

Finance Bill Brief

Contributing Editor

Simon Owen LLB

In order for most farming enterprises to survive in the current commercial environment, there has to be a reliance on a rental income stream. The Special Commissioner's decision in *Farmer* [1999] STC (SCD) 321 gave great hope for IHT relief on the whole farming enterprise. In this case 22 let units (cottages and premises for small businesses) were held to be eligible for IHT Business Property Relief (BPR). Key issues here were the fact that the cottages and small business units were part of the trade – included in the accounts, organised from the same farm office, etc. The farming activity was also greater than the letting activity. In 2006 this might be more difficult to prove.

If an FBT is to be put in place on land which excludes the cottages and other let units, then by definition the rental property cannot be part of the trade. The cottage rental income can be a very valuable income source and the landowner is unlikely to include this within the terms of the FBT, for why would the landowner jeopardise the right to income from lettings unless compensated by additional FBT income, which could become complicated and not necessarily commercial?

In summary, the move to an FBT could mean a potential loss of IHT relief on let cottages and small business units within the enterprise.

(3) Capital Gains Tax

Section 160, *Finance Act 2003* heralded a substantial CGT advantage to landowners taking advantage of the FBT. Under section 160, property let to a trade qualifies for Business Asset Taper Relief (BATR) from 6 April 2004. During the period 6 April 1998 (when BATR replaced indexation relief) to 5 April 2004, land let under an FBT did not count as an asset qualifying for business taper relief.

So if landowners move to an FBT now, will they achieve the 'magical' full BATR which results in the dream rate of 10% CGT? The answer is 'Yes', provided the landowner used the asset for the purposes of farming (or another trade) between 6 April 1998 and 5 April 2004. Tax planners will have to take care in respect of land which was let in the period 6 April 1998 to 5 April 2004. This will result in 'tainted taper relief'. HMRC have now agreed that where an asset has been used partly for purposes that qualify as business use under paragraph 5 and partly for purposes that do not, any apportionment that is needed should be based on area and not on value (or any other basis). There could also be problems with any assets which were subject to any element of private use or where part of the land has been the subject of a previous disposal.

The ability to claim 'untainted' relief is of particular importance with regard to land or buildings which might be sold for development, because of potentially high values.

(4) Income Tax

Farming has been described as a way of life. There are certain 'lifestyle' expenses inherent in the nature of the trade, the location of the farm, historic claims for business expenses, etc. Examples of these types of expenses would be the running costs of the farmhouse and of four-wheel drive vehicles. It is unlikely that the move to an FBT will result in a significant reduction in this expenditure, but will the outlay still qualify for income tax relief?

Whilst 'lifestyle' expenditure would in practice be justified as a Schedule D expense (in the old terminology), it is unlikely that it will be allowed as an expense against the FBT income.

(5) Value Added Tax

As a general rule, the receipt of FBT income is not a taxable supply for VAT purposes. It is an exempt supply unless the landlord has opted to tax the relevant land and buildings and the appropriate notification has been lodged with HMRC.

If the option to tax is not made (and opting to tax is at present unusual for farmland), then there are problems of partial exemption if the FBT is mixed with another trade. Both alternatives – exempt supply (possibly resulting in partial exemption) or opting to tax – can result in complexities. For example, many farmers are surviving commercially with the letting or sale of pony paddocks. The latter activity – with BATR, possibly high March 1982 values for base cost, approximately 105% indexation and the annual exemption – can be very CGT-efficient. Some members of the farming industry have enjoyed these CGT advantages throughout numerous small area disposals, but exercising the option to tax would result in the charging of VAT. Conversely, if the move to a Farm Business Tenancy means VAT deregistration or partial exemption, there will obviously be reduced ability to claim input VAT.

Business Brief 13/2005 (5 July 2005) sets out conditions for the late notification of an option to tax. These conditions are quite restrictive and so the key point is to keep the possibility of opting under review, especially when considering expenditure with a significant VAT cost.

(6) Grazing Agreements

It should be noted that grazing agreements are a trade provided that the landowner is responsible for the hedging, ditching, mowing, topping, fencing and fertilising. Grazing agreements are taxed in the same way as contract farming arrangements. This places them in a different tax category to the FBT with potentially all the tax advantages that attract to a trading as opposed to a letting activity.

(7) Stamp Duty Land Tax (SDLT)

FBTs attract SDLT. Planning issues surround the length of term, the assignment of the lease and the rent reviews.

(8) Conclusion

In summary, with the introduction of the Single Farm Payment scheme, many farming enterprises have been moving away from the complexity of contract or share farming. The Special Edition of HMRC's *Tax Bulletin*, issued in June 2005, set out the tax treatment of the new farm support scheme – the 'Single Payment' for farmers. It is understood that the politically correct terminology for the due payment entitlement is that it is a land management fee and not a subsidy.

Examples of legal entities that can benefit from the FBT are trusts which hold farmland but not farmhouses or cottages. However, the majority of farms owned by the classic sole trader or partnership are less inclined to change to the FBT – and generally when the land in question is just a small area of the total. The move to an FBT is very attractive for areas of land that do not incorporate farmhouses and cottages.

The answer is that any change in the business structure in any farming activity must be reviewed in advance, taking account of all areas of tax planning.

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