

The Rebirth of Contract Farming

JULIE BUTLER discusses the effect of stamp duty land tax on farm business tenancies.

STAMP DUTY LAND tax was introduced on 1 December 2003 and applies to leases. It has been said that it is not the amount of the tax that will kill the farm business tenancy, but the administration involved in the calculation of the potential stamp duty land tax liability. The net present value has to be calculated. This is in principle the total rent payable over the term of lease subject to a slight discount. The easiest way to deal with the calculation is to use the calculator on the Stamp Office website <http://sdcalculator.inlandrevenue.gov.uk>.

The stamp duty land tax is paid at one per cent of the difference between the threshold and the net present value. The thresholds are:

Residential	£60,000
Commercial	£150,000

Rent reviews

If there are rent reviews in less than five years, and the common cycle for agricultural tenancies is three years, the tenant or his agent must make a reasonable estimate for use in the calculation of the net present value. It has been promoted that the farm business tenancy cycle should be extended to five years for tax administration purposes.

Where the farm business tenancy includes a mixture of farmland and cottages, these are treated as commercial for the calculation of the above threshold.

History of farm business tenancies

Farm business tenancies were introduced from 1 September 1995 under the Agricultural Tenancies Act 1995. At the time of introduction, large areas of farming were profitable and the property boom had not yet been enjoyed. Farm business tenancies were heralded with great enthusiasm, as they gave 100 per cent agricultural property relief (section 116(2)(k), Inheritance Tax Act 1984, and as extended under section 116[5A-5B]) for inheritance tax, and so much greater freedom and flexibility for the landlord.

The farm business tenancy did present some problems with regard to capital gains tax. It did not embrace the tax benefits of business asset taper relief from 6 April 1998. The impact of this deficiency was really felt when, from 6 April 2002, the effective capital gains tax rate for land

disposals (especially development land disposals) dropped to ten per cent (40 per cent top rate of tax with 75 per cent reduction for business assets).

Capital gains tax problems

Many landowners held land in a farm business tenancy arrangement that was capable of achieving rewarding development gains, e.g. pony paddocks, development land close to towns and villages, redundant farm buildings in prime positions, etc. The capital gains tax advantages of business asset taper relief were not to be enjoyed under the farm business tenancy arrangement. As an alternative, a contract farming arrangement could give this capital gains tax advantage as well as the 100 per cent agricultural property relief.

Other problems with farm business tenancies for the landowner revolved around the agricultural property relief on the farmhouse. If a farm or estate lets its land under a farm business tenancy, there could be no claim for the farmhouse.

Tenants have also experienced problems under farm business tenancy arrangements. In January 2002, the report of the Policy Commission on the Future of Farming and Food (the Curry Report) was published. This set out the Government's agenda for the farming industry generally. While welcoming the farm business tenancy, it expressed concern about the tenant's ability to diversify under the terms of the tenancy legislation. It recommended that the Department for Environment, Food and Rural Affairs, and the Treasury should conduct a review of the tax position of farm business tenancies to see how changes could encourage sensible diversification and longer lets. This review is still evolving.

Section 160, Finance Act 2003

From 6 April 2004, farm business tenancies qualify for business asset taper relief. The land must be let for a trade. Is this, however, the solution to all the farm business tenancy's problems?

The Paymaster-General certainly announced that the Finance Act 2003 change to the definition of business asset was intended to bring about behavioural change, claiming section 160 had the purpose of changing 'the behaviour' of landlords when they let in future (Standing Committee B, fourteenth sitting, 17 June 2003).

There is a curious anomaly which will remain under section 160 which discriminates against letting to quoted companies and charities which are not business assets for business asset taper relief. Another anomaly which exists is woodlands. The Paymaster-General said that the lack of



business asset taper relief for woodlands would 'receive serious consideration from the government in due course'.

There is a complexity for farm business tenancy land that is due to be sold post 6 April 2004.

Mixed use for business asset taper relief

The farm business tenancy will not qualify for full business asset taper relief where there is mixed use since 6 April 1998. This includes circumstances where the land and building were let to unlisted companies from 6 April 2000 (sections 66 and 67, Finance Act 2000). For sales of land and building after 6 April 2004, there will have to be a tainted taper relief calculation which will reduce the taper relief and not ensure the target capital gains tax rate of ten per cent (40 per cent less 75 per cent business asset taper relief). Long term planning would point towards a new farm business tenancy being drafted to achieve clean taper relief to fully enjoy section 160.

But what is the case regarding stamp duty land tax? Would it be more tax efficient to look at a contract farming arrangement to avoid all the aggravation? What will be the impact of the Mid-Term Review?

Mid-Term Review

Margaret Beckett received a very heated response in the House of Commons to her announcement about the Mid-Term Review of the Common Agricultural Policy Reform on 12 February 2004. This follows the single farm payment scheme introduced on 29 September 2003 by Council Regulation 1782/2002. This has been heralded one of the most dramatic changes to agriculture since the entry into the European Union.

All farmers must embrace modulation, e.g. the progressive siphoning of direct payments to fund agri-environmental schemes and rural development initiatives. In order to receive the single farm payment, cross compliance conditions must be met to ensure the land is kept in good agricultural and environmental condition.

What is the best trading vehicle to achieve this? Is it the farm business tenancy or farming land in hand through a contract farming arrangement? How will all the tax points raised above effect this decision?

Contract farming

Contract farming is an arrangement under which a landowner, who would not otherwise be carrying on a

business, puts himself into the position of doing so by virtue of a special agreement conferring rights and obligation which he does so with an individual who might have become a tenant. The arrangement has all the benefits, and risks, of Schedule D status, as well as the ability to claim any losses that might arise under sections 380 and 381, Taxes Act 1988. There is also a greater opportunity to claim expenses.

Contract and share farming arrangements were effectively born before the farm business tenancy when landowners, who might have let their land, were led to become owner-occupiers, and other landowners to set up partnerships and joint ventures with those who might have become tenants. The farm business tenancy gave the landowner hope to let the land with strong commercial return, flexibility and tax efficiency, but what now?

The definition of contract farming and share farming can be found at *Business Income Manual*, paragraphs BIM55090 and BIM55070 respectively. Will the complexity of stamp duty land tax and the Mid-Term Review force the landowner to look for clean taper relief for the future to try and protect agricultural property relief on the farmhouse?

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So many farmers are dependent on their land agents for advice and they have never had such a complex time, e.g. the Mid-Term Review, Single Farm Payment Entitlements, stamp duty land tax, net present value drafting farm business tenancies for Mid-Term Review changes and to top it all, the Royal Institute of Chartered Surveyors say they now have to carry out valuations (including capital gains tax base values in 1982) in a formal structure under the Red Book.

The summary of potential advantages of a contract farming arrangement is as follows:

- Schedule D, Case I status;
- no worries over stamp duty land tax on the farm business tenancy lease;
- less worries over Mid-Term Review entitlement;
- ability to use sections 380 and 381 with full claim for expenses;
- greater chance of increased inheritance tax reliefs, e.g. farmhouse.

Whatever happened to simple discussions and decisions across a farmer's kitchen table? Those times have gone, and the complexities are too great.

Tax advisers must be prepared to look at farm tax planning in the round and to work with land agents and solicitors in these very trying times. ■

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