

'A' is for Agriculture

'D' is for Diversification, 'E' is for Environmental and 'F' is for the Fiscal Farmer

With Blue Tongue and Foot-and-Mouth problems facing the farming industry there will be more and more emphasis on farming and diversification. Well here is an even bigger complication. What is farming?

For the tax advisor it is essential to understand the definition of both 'farming' and 'agriculture' – and a clear understanding of what constitutes 'diversification' is also a distinct advantage. Why? Farming and agriculture are entitled to unique tax reliefs and it would be slightly irritating to claim these tax reliefs in good faith under a possible misconception about the underlying definition and to then 'land' (please excuse the pun!) an unsuspecting client (or their beneficiaries) with a substantial tax bill that was not anticipated. It could also be possible to not claim the maximum reliefs.

Potential loss of agricultural tax reliefs

With many farmers moving away from traditional activities towards the intoxicating (and much needed) profitability of diversification, the tax reliefs dependant on farming or agriculture could be lost, which would be very unfortunate.

What are the tax reliefs?

- Agricultural Property Relief (APR) for inheritance tax (IHT) on the farmhouse. If the farm is no longer surrounded by land in the same ownership that is principally used for farming, then is the house still a farmhouse? (section 115, *Inheritance Tax Act 1984*).
- Agricultural Property Relief (APR) on the farmland and buildings (section 115, *Inheritance Tax Act 1984*).
- Job-related accommodation. It has always been taken for granted that farm workers will live in cottages 'tax-free' due to the advantages of 'job-related accommodation'. Will farm workers who move from carrying out farm duties to non-farm duties still qualify for 'tax-free', job-related accommodation? (section 99, *Income Tax (Earnings and Pensions) Act 2003*). Emphasis is on the rules of 'customary' and 'better performance'.
- Five-year loss rule (hobby farming) (section 67, *Income Tax Act 2007*).
- Farmers' averaging of profits for tax purposes (Part 2, Chapter 16, *Income Tax (Earnings and Pensions) Act 2003*).

In the last few years it can generally be assumed that only a few pure farming activities are profitable and some form of diversification has to take place in order to achieve overall profitability for the farming unit or enterprise, although the summer of 2007 has changed the thinking on arable profitability with corn prices sky high due to the flooded Midlands and no rain in Australia. Diversification might be simply the letting of redundant farm buildings and cottages, or more radical activities.

So what are examples of the problems created if these reliefs are lost?

- The claim for APR on land, buildings, cottages and farmhouse could be subject to challenge: would an alternative claim to Business Property Relief (BPR) succeed where the claim to APR has failed?
- The farm workers (now employed on diverse activities) could be subject to a benefit-in-kind charge for the use of (what were) the farm cottages.
- The loss claim could be challenged by HMRC before the end of the fifth year, on the grounds of commerciality.

What a complex position for the probate practitioner, who could be faced with 'ambush' attacks on inheritance tax reliefs that were perhaps taken for granted!

The changing world of agriculture

Does the definition of 'agriculture' need greater clarification in order for the tax reliefs to be claimed? The problem is that the world of agriculture has changed massively since the introduction of the *Inheritance Tax Act 1984* – the collapse of farm prices and profitability in the 1990s, the vast thrust towards diversification, and the move from production-based subsidies to 'land management' subsidies with the Single Farm Payment (SFP) from January 2005. HMRC's *Tax Bulletin Special Edition* (June 2005) introduces the concept of the 'fiscal farmer'. The Single Farm Payment Scheme has introduced the 'environmental steward'.

'A' is for Agriculture

So what is 'Agricultural Property' for the purposes of the inheritance tax Agricultural Property Relief? Help is found in paragraph 24041 of HMRC's *Inheritance Tax Manual* (IHTM 24041 *Definition of agricultural property*):

'Agricultural property is defined in section 115(2), *Inheritance Tax Act 1984* and is restricted to property in the United Kingdom, the Channel Islands and the Isle of Man, by section 115(4) [in fact, by subsection 115(5)]. It means:

'Agricultural land or pasture (IHTM 24042) which includes woodland (IHTM 24043) and any building used in connection with the intensive rearing of livestock or fish (IHTM 24044) if the woodland or building –

- Is occupied with agricultural land or pasture (IHTM 24111) and
- The occupation is ancillary to that of the agricultural land or pasture.

'It also includes such cottages (IHTM 24045), farm buildings (IHTM 24046) and farmhouses (IHTM 24047),

together with the land occupied with them, as are of a character appropriate (IHTM 24036) to the agricultural land or pasture.

'Dividing the definition of agricultural property into parts stems from the case of *Starke v Inland Revenue Commissioners* [1995] STC 689, which considered the meaning of 'agricultural land or pasture'.

'Agricultural relief is only available on death/transfers where there is agricultural land or pasture. It is only once you have established that the subject matter of the transfer contains agricultural land (IHTM 24042) or pasture that is occupied for agricultural purposes (IHTM 24100) [*in fact*, IHTM 24101] that you can then consider whether any farmhouses (IHTM 24047) farm cottages (IHTM 24045) or buildings (IHTM 24046) qualify for agricultural relief. This is why you need to identify each part comprised within the agricultural property in order to consider its agricultural value (IHTM 24071) against which agricultural relief will apply if the occupation (IHTM 24111) or ownership (IHTM 24120) [*in fact*, IHTM 24121] conditions are satisfied.'

In other words, a building which common sense would tell you is clearly an agricultural building – say a barn used for egg production – will not qualify for Agricultural Property Relief unless it 'is occupied with agricultural land or pasture' and 'the occupation [*of the barn*] is ancillary to that of the agricultural land or pasture'. A question must be asked as to how non-specialist tax advisors can cope with these complexities.

Agricultural Property Relief on energy crops

Is Agricultural Property Relief available where farmers grow crops for fuel? It is generally considered that land cultivated for the growing of energy crops is agricultural land and such use counts as occupation for agricultural purposes. Section 24 of HMRC's *Inheritance Tax Manual* indicates that cultivation of land to produce a crop is a key requirement in enabling land to qualify for Agricultural Property Relief. For example, paragraph 24103 of the *Inheritance Tax Manual* cites a rating case where it was held that reed beds that grew naturally and were then cut for thatching did not qualify as agricultural land. If there was no tilling, sowing or cultivating of the land and all the taxpayers did was to cut reeds, then this was not farming. The absence of tillage meant that the reed beds could not be classed as agricultural land.

Dymond's Capital Taxes, at paragraph 24.863, supports the view that land under cultivation may generally be regarded as being used for the purposes of agriculture.

'D' is for Diversification

Diversification is defined by DEFRA as 'the entrepreneurial use of farm resources for a non-agricultural purpose for commercial gain'. Examples are sporting rights, horse livery and developing agricultural land and buildings as dwellings, offices or workshops.

'F' is for Farming – What is 'fiscal farming'?

From an income / corporation tax point of view, the question has to be asked: 'What farming activities are actually comprised in the definition of agriculture and are these activities trading?'

There is a special tax régime for the profits of a trade carried on in the United Kingdom under Part 2, *Income Tax (Trading*

and Other Income) Act 2005 (ITTOIA). Whether or not a person is carrying on a trade is a question of fact, but the word 'trade' includes the idea of exchanging goods or services for a reward. Although the Courts have indicated what might constitute trading in a large number of cases, these 'badges of trading' need to be considered in relation to farming because under section 9(1), ITTOIA 2005, farming or market gardening conducted in the United Kingdom is treated as the carrying on of a trade for income tax purposes.

So what is the definition of 'farming' for income tax purposes? Under section 996, *Income Tax Act 2007*, 'farming' means 'the occupation of land wholly or mainly for the purpose of husbandry'. For corporate taxpayers the definition is somewhat more circuitous in section 832(1), *Taxes Act 1988*, where 'farm land' is defined as 'land in the United Kingdom wholly or mainly occupied for the purposes of husbandry', the text continuing 'and "farming" shall be construed accordingly'. Thus, to be classified as a farmer for income or corporation tax purposes a person must satisfy two tests: the person must be in occupation of land and the purpose of that occupation must be at least mainly for husbandry. The actual use of the land will normally be indicative of the purpose of occupation, but is not necessarily conclusive. Nor need the occupation be to the exclusion of others (share farming is an example where two persons may occupy land and each be farmers). 'Husbandry' is specifically said to include hop growing and the breeding and rearing of horses and the grazing of horses in connection with those activities (section 996(2), *Income Tax Act 2007*).

Short-rotation coppice

There seems to be a natural extension to the farming definition by the specific inclusion of 'short-rotation coppice' (section 996(3), *Income Tax Act 2007* and section 154(1), *Finance Act 1995* for non-corporate and corporate taxpayers respectively). Short-rotation coppice is defined to be a perennial crop of tree species (normally willow or poplar) planted at high density, the stems of which are harvested above ground at intervals of less than 10 years (subsections 996(6) and 154(3) respectively).

Intensive rearing of livestock for human consumption

For the purposes of averaging relief, 'farming' includes the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption (section 221(2)(b), ITTOIA 2005). Averaging also can be applied to trades of market gardening (section 221(2)(a)). Only farming trades carried on in the United Kingdom may average profits. Also excluded from the definition of 'farming' are farming contractors, because their trade does not involve the occupation of farm land, as are cases where the farming activity is part of a larger trade that includes substantial non-farming activities (see paragraph 73110 of HMRC's *Business Income Manual*).

Market gardening or farming?

The definition of 'farming' for income tax purposes and 'farm land' for corporation tax purposes each excludes, respectively, 'market gardening' and 'market garden land'. 'Market gardening' is defined as:

'the occupation of land as a garden or nursery for the purpose of growing produce for sale' (section 996(5), *Income Tax Act 2007*).

For corporation tax purposes, 'farm land' is expressed to exclude 'market garden land', which means:

'Land in the United Kingdom occupied as a nursery or garden for the sale of produce (other than land used for the growth of hops) and "market gardening" shall be construed accordingly' (section 832(1), *Income and Corporation Taxes Act 1998*).

The mention of hops in the corporation tax formulation does not distinguish the two definitions, as hop growing is regarded as husbandry, and therefore farming for income tax purposes (section 996(2)(a), *Income Tax Act 2007*).

Christmas trees grown on specialist nurseries will be categorized as market gardening. Where, however, Christmas trees are grown on part of a farm, by HMRC practice the activity may be incorporated in the other farming activities conducted (see HMRC's *Business Income Manual*, paragraph 62601).

Since farming is to be treated as a trade (under section 9(1), ITTOIA 2005 for income tax and section 53(1), *Taxes Act 1988* for corporation tax), it is charged to tax under Part 2 of ITTOIA 2005 or Schedule D, Case I in the ordinary way, provided the land is in the United Kingdom. If the land is situated abroad, different problems arise. That also applies to market gardening. The ordinary rules for calculating profits of a trade apply, subject, however, to one major exception.

All the farming carried on by one person, or partnership, or body of persons, is treated as one trade (sections 9(2) and (3), ITTOIA 2005 for income tax and section 53(2), *Taxes Act 1988* for corporation tax). This rule, which does not apply to market gardening, can have major effects on the computation of farming profits and losses and also emphasises the need to have a clear definition of 'farming' and 'agriculture'.

'FF' is for the 'Fiscal Farmer'

The 2005 *Tax Bulletin* mentioned earlier effectively divides farming into three categories, as shown in the table below.

The 'fiscal farmer' will include more than the traditional farmer who continues to farm. As the definition of 'farming' turns upon the purpose behind the occupation of land, HMRC have conceded that those who do not produce anything on the land that franks the SFP will nevertheless be treated as being within this category where other farming takes place elsewhere on the holding. This may not prove to be as simple as stated by HMRC in the June 2005 *Tax Bulletin*: as all farming is treated as one trade, it is unclear whether HMRC's interpret-

ation of 'holding' will be given its normal meaning or the wider one adopted for tax purposes. This may turn upon whether the holding is in the same region for the SFP, so that it can frank and unlock the SFP, though this would be a curious interpretation to adopt in England, where it would be possible for a natural holding to fall partly in one region and partly in another.

The SFP therefore adds another complexity to the definition of farming. Is the farmer effectively just an environmental steward?

'E' is for Environmental Steward

As so many of the agricultural grants and subsidies are for the function of 'environmental stewardship', where does this activity fit with the rôle of farmer and the activities of husbandry and agriculture? Clearly a simple, unified and clear statutory definition is required to help not just the tax advisor but the taxpayer. The statutory definition should take into account the tasks of land management and the landowner's function as 'steward of the environment'.

There are activities that clearly do not count as farming or agriculture, for example 'growing houses', letting out redundant farm cottages, grazing by horses, 'rave concerts', game shooting, letting of sporting facilities, horse livery and long term woodlands. However there are many 'marginal' activities that could confuse the tax advisor, such as energy crops and some woodland activity.

Greater clarity and greater breadth

There are many tax advisors who would argue that, with all the recent changes – including the SFP, the growth of diversification, the greater ownership of land by 'lifestylers' and the greater scrutiny by HMRC of claims for inheritance tax reliefs (especially as regards the two year rule and commerciality) – greater clarity and possibly greater breadth of interpretation of 'farming' and 'agriculture' are needed.

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Taxation of Single Farm Payment Scheme receipts

<i>Land occupied by</i>	<i>Income tax treatment of SFP receipts</i>	<i>Corporation tax treatment of SFP receipts</i>
Fiscal farmer	Farming income under section 9, ITTOIA 2005	Schedule D, Case I farming income
Trader other than a farmer	Trading income under section 10, ITTOIA 2005	Schedule D, Case I income under section 53(3), <i>Taxes Act 1988</i>
Non-trader	Charged as 'income not otherwise charged to income tax' under ITTOIA Part 5, Chapter 8	Schedule D, Case VI income