Active husbandry and involvement for Inheritance Tax

The farming industry has experienced considerable changes in the last decade. Agricultural land values have doubled, development land values have collapsed (and started to recover) and corn prices have been at an all-time high. There are huge opportunities to diversify for a commercial advantage.

The European Commission seem determined to introduce restrictions into the Common Agricultural Policy (CAP). They are threatening to do this by tightening the definition of who is a sufficiently 'active farmer' for the purposes of claiming the Single Farm Payment (SFP). The Commission are concerned that payments are being claimed by people who are not genuine farmers, and so they wish to exclude non-farming beneficiaries such as investors, companies, authorities, and nature conservation organisations.

Profitable farming

The 2010 harvest and recent farming profitability have shown that there is the ability to achieve commerciality in farming, probably far better than has been seen for the last decade. The questions over renewable energy, (eg wind, solar panels, harvesting rainfall), and the UK demand for let property are all pointing towards the vibrancy of diversification. One of the factors that HMRC seem to place a lot of importance on when considering the validity of income tax loss claims and also BPR claims for IHT (where there has been a lack of profitability) is the question of commercial structure. There is always a request for a business plan to be produced by HMRC and for BPR to be achieved it has to be proved that there was a farming business carried on for gain.

Recent tax cases have emphasised active involvement by the landowner in order to argue that s105(3) IHTA 1984 does not apply, ie that the overall enterprise is not an 'Investment Business'.

The case of the Earl of Balfour (*HMRC v Brander (as Executor of the Will of the Late Fourth Earl of Balfour)* [2010] UKUT 300 (TCC)) was not only endorsed by the Upper Tribunal but an appeal to the House of Lords by HMRC was not allowed. This result was considered very good news, in that BPR was granted on a mixed farming estate and the active involvement of the late Earl of Balfour and the areas of turnover, profit etc, were considered. Despite the fact that the capital value of the let property was far in excess of the farming assets, the Upper Tribunal confirmed the findings of the First-Tier Tribunal in that it was not a capital value that was of prime significance here; the question was where the preponderance of business/ farming activities lie.

Tax attack

It would appear that an area of current 'tax attack' by HMRC is the equine industry when it comes to stud farms. The IHT Manual reminds tax inspectors to check that the stud was not just a 'rich man's hobby'. The way forward for farms and stud farms with regard to the claims for both APR and BPR, and also the eligibility for loss claims is commerciality and 'active husbandry'. If the 'active' point is what is needed to help protect future subsidies and tax relief then this is the direction that farms and stud farms must approach moving forward.

Ironically it is easier where there is livestock farming to provide evidence to HMRC of 'involvement' by the landowner as the nature of the activity is so demanding. The big question then rests with active involvement. It has been said that stud farming is not a hobby because the owner would have to be exceedingly wealthy to be able to withstand the damage that can befall a stud farm. There are interesting statistics, for example in Ireland, where the production of foals in 2007 was around 12,000 and yet in 2010 it was less than half of that figure. There has been a reduction in foal production the UK. There is now scope to purchase bargains but the ability for any stud farm to be profitable in the current economic climate is difficult.

Business plans

Business plans must be produced and studied and strategies established as part of 'good housekeeping' and every farm, mixed estate and stud farm in the country must be working to a business plan and a business strategy and this must be available for inspection by HMRC should it be requested. As a planning point, BPR was achieved on the whole of the 'Earl of Balfour' estate as one business: it is key that the business plan is shown as one business with separate subdivisions for each enterprise.

The Office of Tax Simplification (OTS) in March 2011 recommended that IHT as a whole would be subject to review. Is now the time to pass investment elements of the farming business (and elements that would fail the active involvement test) down to the next generation? The case of *Dance* (*Nelson Dance Family Settlement Trustees v HMRC* [2009] STC 802) showed that BPR can be achieved on lifetime transfers that are not business assets when they are disposed of by an individual. There are those who would take that a stage further and say that now is the time to actually pass down to the next generation.

Does the combination of *Balfour* and *Dance* prove that assets can be transferred down to the next generation, and does the recent pre-nuptial case prove that there is a possible strength in a pre-nuptial agreement that can help protect assets once they have been passed down to the next generation? There are arguments to say that 'post-nuptial' agreements could also come into play if passing assets down to the next generation is the way forward.

The interaction of *Dance* and *Balfour* is that *Balfour* showed that there should be caution in order to achieve BPR on the whole of the mixed estate, and there should not be a surplus of investment properties. Therefore, rulings of the surplus investment property can be transferred out of the mixed estates using the benefits of the *Dance* case with regard to BPR and the transfer by an individual.

Action plan

In summary, a lot is happening in the farming industry. BPR has been achieved in a number of recent tax cases and there are arguments to say that all farms and estates should be reviewed for the eligibility of BPR. There should possibly be a BPR 'audit' to review what properties would qualify as business and what would qualify as an investment. It must be determined as to what are the surplus investment properties that can be transferred and to look at how the estate can be protected with the next generation, and also to look at the capital gains tax angles that passing down to the next generation can create should they want to sell any part of those assets. There would also be the claw-back provisions of the Potentially Exempt Transfer if assets were to be transferred down to the next generation and then sold before the seven years to consider. This adds up to a big list of considerations when transferring-out investment assets.

It is clearly the time for active tax planning, active husbandry and active involvement by all those involved in farming.

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