

# Balancing act

A number of recent cases highlight the importance of making sure that tax planning for agricultural businesses is not one-dimensional, and considers both inheritance tax and VAT. **Julie Butler** explains

**T**ax planning and tax compliance issues surrounding farms and landed estates are extremely complicated. Land values doubled between 2005 and 2010, and have held their own, so the tax risks are far greater. Meanwhile, huge diversification from pure farming has, in many instances, put eligibility for agricultural tax reliefs at risk. This article considers these reliefs in light of other tax planning strategies.

## VAT VERSUS IHT MITIGATION

Short-term one-dimensional tax planning work can put other tax reliefs at risk. Take the tax case *RCC v Brander (as executor of the will of the late fourth Earl of Balfour)* [2010] UK UT300 (TCC), inheritance tax (IHT) relief was achieved on a substantial number of let cottages, which made up part of the whole business.

If let property is left in the landed estate, there is the risk of partial exemption for VAT – the rent of the cottages represents an

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exempt supply, whereas the other farming activities are zero- or standard-rated. Many farms and estates have not undergone a VAT inspection in recent years, and this could have some brutal results concerning the application of partial exemption. Where the provision of the let property is an exempt supply, then the input VAT claimed on the whole mixed estate has to be restricted for the element of the exempt supply. There are also concerns that the ruling in *Balfour* could encourage a 'tipping of the balance', leading to estates taking on too much rental property to retain the ability to claim business property relief (BPR), since the investment business is no longer ancillary to the main farming business.

It is extremely complex to ascertain whether the supply in farming businesses is VAT standard-rated, zero-rated or exempt – horse livery and shooting rights are a prime example. Ironically, it is the element of service that is so important in trying to secure agricultural property relief (APR) and BPR. The need for "active husbandry" and establishing a business carried on for gain is key for IHT planning.

With the current increased profitability, many farmers are looking to help mitigate the burden of the 50% income tax rate and

class 4 national insurance (NI) by having a limited company as a partner in the farm, and timing the dividend extraction correctly. Having separate limited companies for dealing with different activities can complicate claims for BPR and APR on the mixed estate. Planning cannot just be at the one dimension of income tax and NI mitigation.

## ACTIVE HUSBANDRY

"Active" husbandry is a prerequisite of claims for BPR. *Balfour and PN McCall & BJA Keenan (PR of Mrs McClean) v HMRC* [2009] STC 990 show how important it is for the deceased to be both involved in the business and active in the farming enterprise. *Arnander v HMRC* [2007] RVR 208 involved the eligibility of a farmhouse for APR and shows the importance of being a farmer who is actively involved in the farming operation; the contract farming agreement was considered weak, and the deceased's farming involvement was not even mentioned in his obituary.

Landowners who have sources of income (and dedication of time) other than farming must document active involvement in the farming operation now and in the future. Photographic evidence, minutes of meetings and, where necessary, diaries of hours worked should be kept.

There are provisions to restrict the claim for income tax losses where the involvement in the business is deemed non-active. The tax loss claim will be capped at £25,000, unless there is evidence of a minimum of 10 hours of active involvement per week. To secure these losses, evidence of work and involvement should be obtained and documented, especially when the taxpayer making the claim has other time-consuming commercial interests that make the 10 hours per week hard to prove. It may be easier to pass the 'actively engaged' test with a livestock operation where the owner lives onsite, than with an arable operation. It can be argued that this 10-hour requirement may help with the eligibility for future claims for IHT relief and the need for active involvement, as they set a minimum 'benchmark' of activity.

## DIVERSIFICATION – EXEMPT SUPPLY

Affixing metal storage containers to land and letting out the space is a common area of diversification for farmers. There is a debate as to whether this is a trading or an investment activity for income and corporation tax purposes. A recent VAT tribunal case, *David Fynamore trading as DA Hanbridge Storage Services* (TC 01081), addressed the VAT treatment of such storage. The company in this case hired its containers out to members of the public. This model presents partial VAT-exemption problems for farmers, but potential commercial advantages if the supply is VAT-exempt, as private

customers will be attracted by not having to pay VAT.

In *Finnamore*, HM Revenue & Customs (HMRC) argued against VAT exemption, on the basis of the VAT Directive's reference to an exemption applying to "the leasing or letting of immovable property" – it argued that the metal containers were, instead, 'movable', since they could be winched into a different location or be used to transport contents, and should therefore be standard-rated for VAT.

The VAT Directive was distinguishing between items that were readily portable (such as a chair) and items that were not. In the context of this case, the metal containers were not movable; they were, by virtue of their own weight, affixed to land, and the lease agreement did not allow them to be moved. The tribunal decided that the supply was therefore exempt as a right over land.

Where the supply is exempt for VAT purposes, it is very easy for HMRC to argue that there is an investment activity for IHT purposes. However, where the metal containers are an integrated part of a mixed farming estate with considerable trading activity, *Balfour* indicates that BPR could be achieved on the whole business enterprise, so this would not necessarily be such a disadvantage for IHT purposes. However, this does show the importance of looking at taxes 'in the round'.

### GRAZING RIGHTS

*McCall* highlights the importance of retaining proof of providing "services", and not just grazing, to achieve BPR. In *Leander International, trading as Arden Grange* (LON/02/0575), the appellant maintained that a supply by a kennels / cattery should be exempt, as any additional services were ancillary to the main supply – in this case, land. A precedent was set by *John Window* (LON/00/0011) that the supply of land was the principal element of the supply, and should determine the liability of that supply. HMRC argued that the supply was one of care, of which the supply of land was a minor element. The tribunal decided in favour of HMRC. The principle is explained in HMRC's *Food Manual (VAT)* at VFOOD3140 ("Animal feeding stuffs: keep of animals"). The simple explanation is that a grazing right grant (the right to allow someone else's animals to graze on your land) is zero-rated. However, the supply of the keep of animals is a standard-rated supply, and this might include an element of care. For example, if it is the landowner's actual responsibility to call in a vet for a sick or injured animal, without reference to its owner, in order to save time, then this is care.

For both IHT- and VAT-planning purposes, a written grazing agreement must be in place defining the arrangement and degree of service. The facts of how the grazing arrangement is operated must follow the agreements, and evidence of that must be kept. Guidance is given in VFOOD3120 ("Items benefiting from the relief: animal feeding stuffs: grazing rights") as to how to ensure the grazing agreement qualifies as a zero-rated supply.

Grants of grazing rights are both the granting of a licence to occupy land and a supply of animal feeding stuffs (that is, grass). In the grazing rights situation, the supply of animal feed takes precedence over the supply of a licence to occupy, and the supply is zero-rated. To identify a grant of grazing rights, examine the contract; it will clearly limit the grantee's rights over the land to grazing only.

If the grazing agreement includes an element of shepherding or oversight, extending to more than once or twice a day, the supply

may be the keep of animals as opposed to grazing (VFOOD3140). If the grazing arrangement is subject to zero-rated VAT (that is, simply the supply of food), it is difficult to see how a claim for BPR can be justified without there being an element of service and care.

### KEEPING RECORDS

*Golding v HMRC* [2011] UK FTT 351 raised very interesting tax planning points, including the need to keep records for longer than the statutory time – ideally, it would seem, from the start of trading. How can the history of the farm business be argued to help the taxpayer unless the accounts, accounting records and other information are available to present that history? In *Golding*, records as far back at the start of the business in 1965 were considered.

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*Balfour and Farmer v IRC* [1999] STC (SCD) 321 both looked at eight years of records to establish the eligibility of a claim for BPR, so HMRC could review capital, profitability, turnover and number of employees, and the split of all these between the investment side of the business (assume exempt supply for VAT) and the trading side (assume standard-rated supply for VAT).

Proper record-keeping will help with other issues, too. For instance, according to HMRC's *Inheritance Tax Manual* (IHTM24068), an essential requirement of eligibility for APR with respect to stud farms "is for an element of horse breeding carried on in a systematic manner with proper record keeping".

In light of these cases, it is important for diversified farming businesses to review their strategy for the recording of business transactions; keeping records in electronic format may be the way forward.

### PRACTICAL PLANNING POINTS

All diversified activities must be reviewed for VAT-compliance and VAT-planning, but this cannot take place in fiscal isolation; all work must consider the ability to claim IHT reliefs. Consideration must be given to the need to register for VAT where this is not in place, and the possible attack by HMRC on artificial business splitting with different diversified activities. All supplies must be reviewed to ensure the correct identification of VAT treatment and the impact on both partial exemption and IHT-planning.

All farm and legal agreements should be reviewed to ensure that they protect all tax angles. Farming contracts, together with the facts supporting the contract, must meet the criteria in both tax-compliance and tax planning terms. With high land values, the risks of errors and the rewards of the correct tax treatment are both significant in tax terms. ■

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