

Briefing

'A' is for Agriculture, 'D' is for Diversification, 'E' is for Environmental and 'F' is for Farming and 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 adviser 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 the possible misconception of 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 dependent on farming or agriculture could be lost, which would be very unfortunate.

What are the tax reliefs?

1. 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 by farming, then is the house still a farmhouse? (IHTA 1984 s115);
2. Agricultural Property Relief (APR) on the farmland and buildings (IHTA 1984 s115);
3. Job-related accommodation. It has always been taken for granted that farm workers will live in cottage '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? (ITEPA 2003 s99) Emphasis is on the rules of 'customary and proper performance';
4. Five-year loss rule (hobby farming) (s67 ITA 2007);
5. Farmer's averaging of profits for tax purposes (ITTOIA 2005 Pt Ch16).

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. This 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 farm workers (now employed on diverse activities) could be subject to a benefit kind charge for the use of (what was) the farm cottage;
- The loss claim could be challenged by HMRC before the end of the fifth year; and
- The claim for APR on land, buildings, cottage and farmhouse could be subject to challenge and a claim to BPR would have to succeed where APR failed.

What a complex position for the probate practitioner who could be faced with 'ambush' attacks on IHT 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 IHTA 1984 – the collapse of farm prices and profitability in the 90's, 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 Tax Bulletin Special Edition 2005 introduces the concept of the 'fiscal farmer'. The SFP or single farm payment scheme has introduced the 'environmental steward'.

'A' is for Agriculture

So what is 'agricultural property'? Help is found in IHTM 24041: definition of agricultural property. Agricultural property is defined in IHTA84/S115(2) and is restricted to property in the United Kingdom, the Channel Islands and the Isle of Man, by IHTA/S115(4) means:

- Agricultural land or pasture (IHTM24042) which includes woodland (IHTM24043) and any building used in connection with the intensive rearing of livestock or fish (IHTM24044) if the woodland or building;

- is occupied with agricultural land or pasture (IHTM24111); and
- the occupation is ancillary to that of the agricultural land or pasture.

It also includes such cottages, (IHTM24045) farm buildings (IHTM24046) and farmhouses, (IHTM24047), together with the land occupied with them, as are of a character appropriate (IHTM24036) to the agricultural land or pasture. Dividing the agricultural property into parts stems from the case of *Starke v IRC* [1995] STC 689, which considered the meaning of agricultural land or pasture when parts had been taken away.

APR is only available on death/transfers where there is agricultural land or pasture. It is only once it is established that the subject matter of the transfer contains agricultural land (IHTM24042) or pasture that is occupied for agricultural purposes (IHTM24100) that you can then consider whether any farmhouses (IHTM24047), farm cottages (IHTM24045), or buildings (IHTM24046) qualify for APR. This is why it is essential to identify each part comprised with the agricultural property in order to consider its agricultural value (IHTM24071) against which agricultural relief will apply if the occupation (IHTM24111) or ownership (IHTM2120) conditions are satisfied.

'D' is for diversification

Diversification is the alternative use of land, ie, using the land for a purpose that is not agriculture (farming), for example sporting rights, horse livery, developing agricultural land and buildings into residential dwellings or offices and workshops.

'F' is for farming – what is fiscal farming? – the importance of trade

The question has to be asked as to what farming activities are actually comprised in the definition of agriculture and whether these activities are trading.

There is a special tax regime for the profits of a trade carried on in the UK under ITTOIA 2005 Pt2. 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 ITTOIA 2005 s9(1) farming or market gardening conducted in the UK 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 ITTOIA 2005 s876, '*farming*' means: '*... the occupation of land wholly or mainly for the purpose of husbandry...*'. For corporate taxpayers the definition is somewhat more circuitous in TA1988 s832(1) where '*farm land*' is defined as '*... land in the United Kingdom wholly or mainly occupied for the purposes of husbandry... and "farming" shall be construed accordingly*'. Thus, to be classified as a farmer for tax purposes a person must satisfy two tests: the person must be in occupation of land and the purpose of the 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 (ITTOIA s876(2)).

Short-rotation coppice

There seems to be a natural extension to the farming definition by the specific inclusion of '*short-rotation coppice*' (ITTOIA 2005 s876(3) and FA 1995 s154(1) 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 (ITTOIA s876(6) and FA 1995 s154 (3)).

APR on energy crops

Is APR 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 the IHT Manual indicates that cultivation of land to produce the crop is a key requirement in enabling land to qualify for APR. For example, paragraph 24103 of the Manual cites a rating case concerning reed beds that grew naturally and were then cut for thatching do not qualify. If there is no tilling, sowing or cultivating of the land and all the taxpayers did was to cut reeds then this is 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.

Intensive rearing of livestock for human consumption – is this farming?

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 (ITTOIA 2005 s221 (2)(b)). Averaging also can be applied to trades of market gardening (ITTOIA 2005 s221 (2)(a)). Only farming trades carried on in the UK 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 BIM 73110).

Market gardening v 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' (ITTOIA 2005 s876(5)). 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 growth of hops) and "market gardening" shall be constructed accordingly' (TA1988 s832(1)).

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 (ITTOIA s876(2)(a)). Christmas trees grown on specialist nurseries will be categorised 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 BIM 62601).

Since farming is to be treated as a trade (under ITTOIA 2005 s9(1) for income tax and TA 1988 s53(1) for corporation tax), it is charged to tax under ITTOIA 2005 Pt 2 or Sched D Case I in the ordinary way, provided the land is in the UK. 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 (ITTOIA 2005 s9(2) and (3) for income tax and TA 1988 s53(2) 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 (see 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 in the HMRC Tax Bulletin (June 2005, special edition): as all farming is treated as one trade, it is unclear whether HMRC's interpretation 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 the SFP 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 be in more than one region. 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 role of farmer, husbandry and agriculture? Clearly a simple, unified and clear statutory definition is required to help not just the tax adviser but the taxpayer. The statutory definition

Category	Type consequences	Income tax consequence	Corporation tax
I	Fiscal farmer	Farming income under ITTOIA 2005 s9	Sch D Case I Farming Income
II	Commercial non-farming occupiers	Trading income under ITTOIA 2005 s10	Sch D Case I income under TA 1988 s53(3)
III	Non-traders	Income none otherwise charged under ITTOIA 2005 Pt 5 Ch 8	Sched D Case VI income

should take into account the tasks of land management and a '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 adviser, such as energy crops, some woodland activity etc.

Greater clarity and greater breadth

There are many tax advisers 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 of the claim for IHT reliefs by HMRC (especially re the two year rule and commerciality) that greater clarity and possibly greater breadth of interpretation of farming and agriculture are needed.

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