Can we all agree for the sake of the business?

There's a lot of tax relief at stake, so why is the farming community avoiding setting out quality partnership agreements, asks *Julie Butler*

For inheritance tax (IHT) purposes, more rural enterprises need business property relief (BPR) for cottages and other areas of alternative land use. They can no longer just rely on achieving agricultural property relief (APR).

The need for BPR was shown in the tax case of *Balfour* [2010]. Assets used in a partnership only attract 50 per cent BPR as opposed to 100 per cent relief for partnership property. For development land, as shown in *McCall v HMRC* [2009], the importance of 100 per cent BPR rather than half that is increasingly important for diversifying farmers and mixed estates with other assets.

Not all diversification projects qualify for APR, so BPR provides some effective back up. With very high land values, the importance between 100 per cent or 50 per cent BPR can be simply shown by a significantly higher IHT bill.

In the UK, the average age of a farmland owner is considered to be over 60 with many still farming well into their 80s. A lot of the older age group have not passed down their farms to the next generation, planning to carry that out on death, when they will therefore need 100 per cent BPR as opposed to 50 per cent.

So much depends on the specific facts in each individual case, i.e. whether the property is a partnership asset in the legal documents, but the big question is: should the farm property be in or out of the partnership accounts?

One way of establishing the structure of the partnership is to have a legally binding deed and to incorporate the trust of the land for the partnership within this document. A simple partnership agreement cannot set out a trust of the land, as trusts must usually be set up by deed. If preferred, the partnership agreement will simply state what the partners' interests in the farming capital are as set out from time to time within the partnership accounts.

This, however, is not all that satisfactory. If one partner does not agree with the accounts in one year, it leaves open what the capital interests are for that specific period. It is also dependent on the partners understanding the partnership property's significance.

Ham dispute

With farmland prices having 'rocketed' in the last decade and development potential returning through recent changes to planning regulations, there is a greater need to protect the tax relief on the land values. It is understood that despite this big worry, very few farming partnerships have undertaken the work and expense of an up-to-date, well thought through partnership agreement. These are integral in disputes as shown in the recent case of *Ham v Ham*.

Husband and wife Ron and Jean Ham started their farming business in 1966 with a modest 5-hectare plot, and continued growing the business. Lower West Barn Farm in Frome (95 hectares) was purchased in 1986. Son John joined the partnership on 1 October 1997, when the family farm covered 178

hectares. Ron described the farm as his "only source of income" and his "legacy to the children", hoping that one day John would take over.

John joined the farm aged 19 and worked with youth and vigour for the next 11 years. But in 2009, the three-way partnership began to encounter differences of opinion. John wanted to drive the farm in one direction, and his parents (now in their early 70s) disagreed and refused to pass over control. He 'retired' from the partnership on 27 February 2009 stating irreconcilable differences with his parents.

Irreconcilable differences

How many farming partnerships are there across the UK where there are differences that cannot be resolved? Likewise, how often is there a partnership agreement that does not provide help or, indeed, no partnership agreement at all?

The resulting dispute over what John Ham was entitled to when leaving the partnership occurred because of the poorly worded partnership agreement – the value being set was thus a matter of interpretation rather than a clearly defined number or basis of calculation specified in the original documentation. One of the appeal court judges expressed sadness that a lack of clarity in the agreement's drafting had caused so much "anxiety and expense" to the family.

As per the terms of the partnership agreement, the other partners would buy out the leaving partner on three months' notice. Here there was a key dispute over the value of the buyout:

- John felt he was entitled to a share of a full market value of the farm; whereas
- Ron and Jean argued that their son's share should be assessed on the book value of the assets – a far more meagre payout as it ignored the soaring land values.

Sad story

With so much at stake, why are quality partnership agreements avoided by the farming community? Is the problem about cost or facing very difficult succession decisions?

Partnerships: take action

- **Ensure there is a robust updated partnership agreement in place from the commencement of every farming partnership.**
- **Review all partnership agreements and ensure details are clear. The Ham case was triggered because the deed of partnership was not clear on the value of the buyout when a partner left the farm.**
- **Some partnership agreements do not provide for an exit strategy, so make sure this is rectified.**
- **Ensure all parties know the quantum of the risks when not sorting out the partnership agreement for disputes and tax reliefs.**
- **Take steps to ensure all potential business disagreements are covered by this partnership 'wonder document'.**
- **Review all partnership property and property used in a partnership to ensure maximum tax relief is achieved.**

In *Ham*, the parents could only afford the payout by selling therefore breaking up the farm. The case asks what the basis is under which partners should be paid out: historic or market value? John appealed the initial decision and the case went before the appeals court in London in October 2013 when three judges ruled that "John was legally in the right and that his parents must be held to the bargain they struck with him 15 years ago".

Lord Justice Lewison said: "I reach this conclusion with some reluctance because, on the particular facts, it may be thought that John will receive a substantial windfall." The other judges also expressed sympathy to Ron and Jean, but concluded that John was entitled to make a market-value claim.

What a difference there has been in farm values between, say, 1986 and 2013 or indeed 1966 and 2013? Could it be that badly drafted farming agreements will result in future problems of a similar nature and unintended windfalls?

Fiscal significance

The potential for dispute is not the only reason for a well-drafted agreement. As mentioned, there is also the need to identify what is 'personal' property and what is 'partnership' property for the availability of 100 per cent as opposed to 50 per cent BPR. The tax facts are straightforward: farmland made available to a partnership only achieves 50 per cent BPR whereas 'partnership' property achieves 100 per cent BPR.

Many family businesses have blurred structures as many members of the family help and lend a hand with the tasks needed. The question of whether an operation is a sole trader or a partnership was looked at in *G Christodoulou* (TC2819). This can be important for all types of tax reliefs, from VAT status for the question of artificial separation, or inheritance, to see who was involved.

After considering the evidence in that case, the tribunal concluded that, on balance, the restaurant was run as a partnership. Many would consider that the taxpayer did well to convince the tribunal that there was a separate legal entity for the restaurant. Evidence pointed both ways so the conclusion had to be reached based on the balance of probabilities.

The important point (see box) is that all businesses must have clarity as to who does what and who controls the operation.

Julie Butler is a partner in Butler & Co. She is the author of *Tax Planning for Farm and Land Diversification, Equine Tax Planning* and *Stanley: Taxation of Farmers and Landowners* (www.butler-co.co.uk)