

Farmers need to keep trading

Julie Butler considers the Single Payment Scheme

A recent (June 2005) special edition of HMRC's *Tax Bulletin* on the Single Payment Scheme for farmers (the Scheme) has put great emphasis on the need for a farmer to stay trading. The Scheme is the result of the mid-term review of the Common Agricultural Policy (CAP) and it is probably the most fundamental change to farming since the repeal of the Corn Laws.

The Scheme moves farm subsidies away from production, on which they were previously based. It literally decouples the subsidy from production and moves it to 'entitlement'. In broad terms, the subsidy (or 'land management fee', which is the strictly correct term) is based on the area of land owned as opposed to the farm production.

The original hope of the farming community and their associated bodies was that as farmers were being encouraged to give up production/farming, they would still maintain their Inheritance Tax (IHT) advantages as a business (principally, Agricultural Property Relief (APR) or Business Property Relief (BPR)). The theme of the *Tax Bulletin* is that if the recipient is a non-farmer they will still be taxed under what was Schedule D Case I (and is now s 10, ITTOIA 2005) provided that there is a trade, even if it is not a farming trade. However, those who are not seeking to trade at all will have the subsidy taxed under Schedule D Case VI (or as it is now known, Chapter 8 of Part 5 of ITTOIA 2005). Herein lies the problem. If the subsidy is received not just by a 'non-farmer' but by a 'non-trader', then in principle the IHT on the land and the

entitlement will not be eligible for IHT reliefs. So, essentially the IHT treatment will depend on the Schedule D (trading) status.

The good news is that if the farmer continues to farm, then the entitlement to the single farm payment (the entitlement being an asset in its own right, separate from the land) will qualify for IHT relief (BPR), and the farmer will not have to wait as it is deemed to be needed for the future use of the business and therefore escapes the two-year ownership rule for BPR.

The trading versus non-trading theme continues throughout the *Tax Bulletin*, mentioning that obviously if the farmer is not trading then they do not need to be VAT registered and therefore will not be able to make input VAT claims. Land and farmland that needs to be kept in good agricultural and environmental condition does take a lot of looking after, rather like a very, very large garden, and the costs associated therewith would of course have input VAT. In addition, any expenses associated with the receipt of the income would have to be proved to be wholly and necessarily for purposes of the trade in order to achieve income tax reliefs, and if there is not a trade, it could prove to be quite an onerous task for the tax adviser to justify the claim. The key problems here could be 'lifestyle expenses' such as motor expenses, farmhouse costs, etc.

Any tax advisers acting for landowners, farmers and landed estates must be very careful to check the position concerning this establishment of a trading activity,

whether it is farming or some other form of alternative land use which would still qualify as a trade. The tax treatment would be seen to be driving farmers, who can no longer economically farm themselves, to move towards contract farming arrangements or share farming arrangements with local farmers or large contract farming organisations. A carefully-worded contract that protects the Schedule D position can ensure trading status and the preservation of some very important tax reliefs for VAT, income tax, capital gains tax (Business Asset Taper Relief) and IHT (APR/BPR).

For contract or share farming arrangements to pass Schedule D Case I (old terminology) status tests, there must be all the basic 'badges of trade' both within the wording of the contract and in the factual operation thereof. Some farmers are supporting the contract/share farming arrangement with some small element of 'in-hand' farming, eg some livestock rearing, so as to give greater protection of the trading status.

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Note: readers may also be interested in Tech 19/05, issued jointly in May 2005 by the ICAEW and ICAS, which provides guidance on the accounting issues arising from the scheme.