All change

Dramatic changes are approaching for the farming industry, says Julie Butler.


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The Department for Environment, Food and Rural Affairs (Defra) has confirmed that farmers in England will be able to take a lump sum in 2022 instead of receiving their remaining basic payment scheme (BPS) on an annual basis. The BPS is the main rural grant to help the farming industry, with applications between March and May and payments from December (tinyurl.com/ooq5xp3q). Such drastic changes will involve positive and comprehensive tax planning as part of a full succession review. Sadly, the details of how exit payments will work remain unclear because Defra is planning to consult with the farming industry on the offer. This will include eligibility criteria and calculation. The government's objective is to entirely phase out BPS payments by 2028, but the exit payment is intended to accelerate the pace at which new entrants join the industry and adopt the environmental land management scheme (ELMS). It can be argued farmers now know enough to begin planning for both opportunity and change in 2022.

Ownership and commercial viability

One clear action point is to consider the full understanding of the legal ownership of the farming business because there can be misunderstandings. Financial projections must be prepared of the impact of the loss of BPS on finances. Details are still needed about how farmers operating through limited companies, partnerships and other business structures will demonstrate they have left the industry, and this will affect the tax considerations, capital gains tax in particular. With the reduction of the business asset disposal relief (BADR) lifetime limit from £10m to £1m from March 2020 this restricted access to a 10% rate. For farmers whose gains now fall outside this cap, the capital gains tax rate of 20% is still (pending any Budget changes) half the higher rate of income tax, so the capital gains regime should still remain attractive to farmers leaving the industry. Thoughts must then move to the Office of Tax Simplification (OTS) report suggesting the alignment of capital and income tax rates.

Key points

- The basic payment scheme subsidy for farmers will be replaced in the 2020s.
- Effect of the reduced threshold for capital gains tax business asset disposal relief.
- Only or main residence relief for farmhouse.
- The benefits to a tenant and landlord of a tenancy surrender.
- Lifetime transfers may involve a reservation of benefit.

Financial survival for farmers

Ironically, many farmers have been looking towards building houses to compensate for the loss of BPS. Boris Johnson announced in the summer that each local authority in England was to be given a revised target for the number of new homes to be built and told to designate land for preservation or development. Ministers said this would remove uncertainty and lead to new homes being built more quickly, clearing the way for more public spending on towns and cities in the North and Midlands. This recent development (excuse the pun) could take 'rescue money' from rural development. By 2024, farmers will have lost at least half these payments, and by 2028 the government aims to have ended them completely. The BPS will be replaced by subsidies under the 'agricultural transition plan' to restore wilder landscapes and achieve enhanced beauty. All these considerations are against the background of the OTS review and the review by the All Party Parliamentary Group into inheritance tax.

Sale of freehold farm now

Some elderly farmers who perhaps farm as a sole trader or in a partnership where each individual share is relatively low might want to sell before having to cope with all the ELMS change – and take advantage of the £1m BADR and 10% capital gains tax rate and what appear to be current high farm values and a strong demand. Rather than wait for 2022 they could also sell the BPS which would be subject to capital gains tax.

Main residence relief should be available on the farmhouse, but the trap of farmhouses held as partnership property should be considered. Many farm sales are private and the agents have waiting lists of 'rollover buyers' and the like, so establishing current value with land agents may be delayed. Farm splitting with possible retention by one partner or a partner rolling over into a smaller farm could be the result.

Surrender of tenancy now

Some tenants might want to surrender the tenancy now to negotiate with their landlord which, as part of a landed estate, might be planning to cope with ELMS through economies of scale. Again, this might take advantage of current high values (which do vary dramatically depending on area) and the sale of the BPS. Some arrangements might involve the retention of the farmhouse and a few acres. Again, if tenants are considering surrender or have been asked to surrender, the capital gains tax position of both tenant and landlord must be considered urgently as part of the negotiations.

Lifetime transfers – reservation of benefit

Some advisers are suggesting taking advantage of current beneficial capital gains and inheritance tax rates with the lifetime transfer of the whole or part of a farm. The OTS has suggested that the trading to investment percentage is increased to 80% to establish entitlement to business property relief. In that event, if the relief stays the criteria of being able to qualify for trading status and the relief itself will be much harder. Many farms have taken on increased investment activity such as letting cottages and offices, and receiving income from phone masts, wind turbines and solar panels.

The problem of lifetime transfers on farms is that there can be some reservation of benefit. Unfortunately, due to the operation of the 'gift with reservation of benefit' (GROB) anti-avoidance rules, if the donor were to die while they continued to occupy the property or house in question, they will have failed to remove its value from their death estate for inheritance tax purposes.

Farming is notorious for marginal cases of retained benefit and retained occupation. The GROB rules in FA 1986, Pt 5 address the issue of individuals avoiding an inheritance tax charge by gifting assets thereby removing them from their death estate while continuing to use or benefit from those assets during their lifetime. In short, the rules provide that a donor who disposes of an asset must be genuinely or virtually excluded from all benefits of owning the asset in question and the donee must assume bona fide possession and enjoyment of it. The rules apply to gifts of all assets and include transfers made into trusts as well as to individuals. Many might think that the current capital gains tax and inheritance tax advantages outweigh any exit payment.

If the gifts of qualifying land and buildings are within a partnership structure and are generally intergenerational, reducing the donor's and increasing the donee's profit shares, this should result in the GROB being avoided.

The issue with such intergenerational transfers is that the ever increasing amount of 'investment' or diversified activities on the farm means these assets can no longer benefit from holdover relief in the same way that agricultural or trading assets do. This makes strategic tax planning challenging.

Another area being considered by advisers is to bring the older generation's estate below the £2m threshold to secure the higher tax free allowance of the residential nil rate band (RNRB). Clearly, transfers using TCGA 1992, s 165 ('Relief for gifts of business assets') means the recipient takes on the lower base cost and the probate uplift is lost, so this must be factored in as part of the long-term succession planning although there is consideration in the above-mentioned reports that the probate uplift may be removed.

Despite the recent shift in Boris's 'build, build, build' statements, farms will try to replace the BPS drop with the development of some farm buildings, so capital gains tax planning will remain in focus.

Planning point

Capital gains tax and inheritance tax changes may particularly affect those in the farming industry. Further, advisers should also be aware of planning and subsidy changes that may impact on business and succession plans.

Tenant farmers

Many would argue that the tax position on tenant farmers is more certain. Under current rates of inheritance tax most farmers would seek to take back farmland 'in hand'. Many tenant farmers worried about profitability would prefer to be paid to give up an Agriculture Holding Act (AHA) 1986 tenancy and receive compensation and the potential BPS exit payment. The tax planning around the timing of the surrender of the tenancy is critical. Some tenants might risk the current favourable rates over the exit payment at higher tax rates.

Certainties and uncertainties

With the detail of the agricultural transition plan (tinyurl.com/186wpaa1) together with the housing policy still awaited, and with the background of uncertainties of the capital gains tax and inheritance tax reform, there has to be an element of 'gambling' as to the best route for farmers to take. For those who plan to wait until more details are known it is important to ensure that all the fact finding is in place ready to move forward with succession planning. The certainty is that the key forensic analysis for tax planning is the legal ownership, legal understanding, and protection, together with the plans for the family members. Everything must be in place regarding ownership and strategy so that when the details are released full succession tax planning can be put in place.

Another certainty is that all farm tax advisers must keep updated with all the detail of the changes that farmers face while considering the tax implications on an ongoing basis.

The general consensus for tax advisers is to maintain awareness of the Defra proposals, but action will depend on both the Budget on 3 March and the much awaited detail of the scheme. A hectic time lies ahead.

Author details

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