

Parting ways

Availability of averaging to a farming partnership.

I have a client that is a husband and wife farm partnership and 2018-19 is the first year for their partnership. Before this my clients were trading as a four-partner partnership but due to circumstances they have decided to cease the original partnership and continue their trade as two separate entities.

What I would like to know is whether two or five-year averaging is available to the partners in the final year of the old, four-partner partnership? I am aware that averaging is not available in the year of starting the trade (or joining a partnership) or in the year of cessation of trade (or leaving a partnership). However, it is clear that the farming trade has continued, just within a different legal partnership. My client is farming on part of the same farmland and farming in the same nature as the previous partnership.

Any advice from readers would be appreciated. Obviously, there would be a significant tax saving should averaging be an option.

Query 19,515

- Mrs Giff.

If the volatility tests are met, averaging should be available.

Under ITTOIA 2005, s 221, farmers can average their business profits for income tax purposes if:

- the taxpayer is, or has been, carrying on a qualifying trade, profession or vocation (alone or in partnership); and
- the taxpayer's profits from it fluctuate from one tax year to the next.

This recognises that farming profits can vary hugely from year to year, often due to factors beyond their control – the current wet weather and Brexit uncertainties spring to mind at present. Because the industry experienced more profit volatility over the years, the original option of two-year averaging was updated in FA 2016 to allow for five-year averaging as well. Notably, although many farms now have diversified sources of income such as liverys, barn storage, micro-breweries and even farm contracting, these do not qualify as farming for averaging purposes and should therefore be removed from the calculation.

As always with tax, there are some grey areas and evidenced research on new alternative land use is important to arrive at the correct figure.

Mrs Giff rightly notes that averaging is not available for the tax year in which the taxpayer starts, or permanently ceases, to carry on the trade under ITTOIA 2005, s 222(4)(a). Further guidance can be found in HMRC's *Business Income*

Manual at BIM84115. This includes an example that such a claim could not be made by a partner for the year in which they join the partnership. However, BIM84185 then goes on to say: 'A partnership change does not affect the availability of relief to any individual who was carrying on the trade both before and after the change.' This is because, although two-year and five-year averaging does apply to partnerships, it is not the partnership itself that makes the claim, rather the individual partners based on their respective share of the profits – it does not matter whether the other partners make a claim or not.

As such, and given that the individuals in Mrs Giff's query have been carrying on the same qualifying trade of farming for at least two 'consecutive' tax years, irrespective of which partnership this was under, the averaging rules should apply as long as the other conditions in respect of the volatility tests are met. - Libby James, Butler & Co.