

# Farming partnerships: risk of lack of written contracts

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**A complex series of transactions were central to whether a farming partnership existed in a recent tax tribunal case, raising important questions about ownership structure, explain Julie Butler and Libby James, Butler & Co**

Farming is mainly structured through the trading vehicle of the partnership and generally a family farming partnership. However, often nothing is put in writing and there are debates as to whether the partnership ever existed. It is timely therefore to look at a recent tax tribunal case - *SC Properties Limited and R Cooke v HMRC* [2022] (TC 08537).

This is a case about whether or not a partnership existed. A series of transactions were carried out with the intention of transferring a property into a company and deferring any gain until the company made a disposal. The planning depended on a property development partnership existing between husband and wife. Without a partnership the planning permission did not apply.

## Developing a property

The facts were that SC Properties (SCP) and R Cooke (RC) owned a property which they wanted to develop. Mr Cooke claimed that before development work was started, he and his wife created a development partnership, and that the property was appropriated to the partnership's trading stock. Money was borrowed against the value of the property.

Mr and Mrs Cooke granted SCP, a company which they owned, an option to acquire the property for £830,000, its undeveloped market value and the property was acquired by the company with the consideration being taken to a directors loan account.

For the accountant, the double entry would be to debit stock – trading; and credit the directors loan account. The company, SCP, later disposed of the property.

With so many farms trading as a partnership, together with the fact that there can be a lack of clarity within farming family businesses as to not just their existence but also rules regarding decision making, ownership, etc, this makes the case of significance to help decide if a partnership exists and, if so, from when.

## Deferral of the gain

The intention of Mr Cooke was to defer the gain until the company sold the property. This was to be achieved by a TCGA 1992, section 161 election to defer the gain on appropriation to stock and then under ITTOIA 2005, s178 to transfer the stock to the company at acquisition cost.

The crux of the planning permission was that a partnership between Mr Cooke and his wife existed. However, HMRC did not accept that there was a partnership in existence.

We quote para 87 from the tribunal ruling: ‘Even if we accepted that both Mr and Mrs Cooke understood there to be a partnership in existence, the evidence that this partnership existed other than in their minds and in the minds of their professional advisers is extremely thin:

(1) none of the relevant documents to which the partnership was alleged to be a party made reference to the partnership, all were signed only in the name of Mr and Mrs Cooke.

(2) the tax returns and partnership accounts are at best self-serving documents and cannot be treated as independent evidence that the partnership existed. We note the reference in the email of 14 December 2015 to the ‘forms requiring filing in order to create a property development partnership’, suggesting that the forms created, rather than reflected, the existence of the partnership.

In this regard, HMRC pointed to the fact that:

- the partnership was not registered until well after the property transactions in question;
- there was no partnership agreement;
- the partnership had no other commercial dealings;

- it had no bank account;
- no contracts and no invoices; and
- no correspondence.

Everything was conducted by Mr Cooke in his own name. Mrs Cooke gave no evidence and there was nothing to show she had played any part in these activities. So often the evidence to support the existence of a trade is the bank account and basic record keeping which must reflect the partnership.

## Normal formalities are often missing

Despite Mr Cooke's counsel's efforts to show that the normal formalities are often missing in a family partnership, the First Tier Tribunal found that 'no reasonable person would consider that such informality would be appropriate for the significant development activity being undertaken here'.

Para 90 of the ruling stated: 'We agree with HMRC that, other than in the assertions of the appellants, no evidence has been provided that the partnership entered into any of the commercial relationships which would be expected from a partnership carrying on a business.'

The tribunal concluded that the partnership had no legal reality and existed only in the minds of Mr Cooke and his advisers. The elections had no effect and Mr Cooke was chargeable on his share of the gain on the disposal to the company. Stamp duty land tax was also due on the transfer. The Cookes' appeal was dismissed.

The case highlights the important role of the accountant to the business in helping with the books, records, documentation and evidence. The need for evidence has been the headline of a number of recent tribunals. However, the role of the accountant can be difficult as when partners are faced with a number of permutations and combinations that the partners are considering it is difficult to produce the documentation when decisions are still to be made.

## Comparison to farming

The point that 'normal formalities are often missing in a family partnership' is ironically very true of farming family partnerships but even by farming standards this partnership was lacking in detail!

With the lack of 'normal formalities' it is often difficult to decide whether the partnership existed, the start date and the rules that need to be complied with. The case is a timely reminder for farming partnerships to consider that all the basics are in place.

It is also important to consider how the property is owned. Is it as partnership property held in trust and possible registration of the trust?

The commercial fact is that family farming partnerships are the most popular form of trading vehicle in this industry. While companies have their advantages for larger enterprises, even more so following the attractive introduction of the super-deduction capital allowance at 130%, together with the availability of research and development tax credits, the partnership model still tends to be the model adopted by the majority of core farming operations.

Now is therefore a good time to sort out any instances where one partner owns the property on behalf of the partnership.

As general partnerships are not legal entities in their own right the legal title to a property cannot be in the partnership's name. Instead, it is held by some or all of the individual partners as trustees on behalf of the partnership. The position is different for a limited liability partnership which can own land.

Work should also be undertaken to ensure that the partnership land capital accounts are correctly recorded in the accounts, the partnership agreement and understood in the context of succession planning. It might be that there is a trust and this should have been registered with HMRC's Trust Registration Service by 1 September.

In looking at whether a partnership existed, the tribunal said: 'The parties are agreed, as set out in the *Burnett v Barker* decision referred to by both of them, that in order for a partnership to exist three conditions must be satisfied:

- (1) there must be a business;
- (2) the business must be carried on by two or more persons in common; and
- (3) the business must be carried on with a view to profit.

In this regard, most of farming would pass the test.

The tribunal judge concluded: 'While it may be the case the spouses would be happy to enter into relatively small business transactions on the basis of an assumed and unwritten 'partnership' we do not think that any reasonable person would consider that this is appropriate for the significant development activity of the kind undertaken here.'

There are many farming partnerships that are farming high value farms with 'unwritten' arrangements and this case should therefore act as a warning.

### **About the authors**

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