

Farming arrangements

Julie Butler explains the tax advantages and disadvantages of contract farming, share farming and grazing agreements.

With so much uncertainty in the farming industry and the future capital taxes legislation that impact on farms, it is essential to look at alternative farming solutions. The need to review contract farming agreements and other alternatives has never been greater amidst all this change. First, there has been the Agriculture Act receiving royal assent on 11 November 2020. This has led to the loss of 'area based' subsidies to be replaced by 'public goods' subsidies to restore the landscape under public products. In addition, there has been the review of inheritance tax by the all-party parliamentary group with the suggestion to move to a flat rate with the possible loss of agricultural property relief and business property relief.

The Tenant Farmers Association and Baroness Rock have also been very critical about what can be considered 'share' farming arrangements and have been pushing for change. However, in spite of the above there were no changes to capital tax reliefs in the 2021 Budget and the consultations announced on tax day. The Department for Environment, Food and Rural Affairs (DEFRA) has announced that 'exit strategies' for farmers will be available in April 2022 (tinyurl.com/j5ymehph) so there is much consideration of alternatives.

In the current farming conditions, there are many commercial reasons that the farmer or landowner might move to a more 'shared' method of farming. Ideally such an arrangement would involve less outlay on equipment together with economies of scale for the operation, as well as the capital tax reliefs associated with 'real' farming and 'real' trading.

Key points

- Revised subsidies under the Agriculture Act 2020, may lead to a review of farming arrangements.
- The advantages of shared farming methods.
- Those involved in contract farming must ensure that a trade is carried on.
- Share farming agreements should reflect the parties contributions.
- Farmers using a joint venture structure should ensure they are not in partnership.



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Advantages of shared farming operations

Fundamental reasons to consider 'shared farming' include:

- tax reliefs associated with 'real' farming and trading;
- old age and difficult to farm at a profit and/or safely;
- commerciality – need to farm with shared overheads to alleviate the impact of the loss of area based subsidies;
- with the new environmental land management (ELM) scheme the shared farming operation could help commerciality; and
- to accommodate new entrants to the farming world, such as a 'rollover buyer'.

Basic choices available to landowners can be:

- contract farming arrangements (CFA);
- share farming agreements (SFA); and
- joint venture farming (JVF).

The advantage of contract or share farming agreements was considered in basic terms in 'The rural lifestyle' (*Taxation*, 4 June 2020, page 20). The shared farming arrangement can also relate to grazing agreements. These can have inheritance tax or capital gains tax problems due to a perceived lack of trade, but in *William Charnley and Maxwell Hodgkinson as executors of the estate of Thomas Gill (deceased)* (TC7425) the First-tier Tribunal granted agricultural and business property relief which came as a surprise and must be considered.

Contract farming arrangements

It is possible for landowners seeking to reduce overheads and achieve more chance of farm profitability to enter into a farming contracting agreement, the tax advantages of which are considered below. The general basis of such an agreement is usually that one party ('the owner') contracts with another ('the contractor') who undertakes to work the farm owned by

the landowner, in accordance with the owner's instructions and policies. In consideration, the contractor receives a flat management fee, and a commission based on the profitability of the enterprise. It is important that the agreement cannot be construed as a tenancy agreement which can have negatives for legal occupation concerns together with business property relief eligibility. The contractor has the advantage of 'economies of scale' through taking on more land in the context of farming.

Annual reviews with regular meetings are essential to promote genuine landowner involvement, commerciality and to reflect all the changes facing farming. In so far as the profits of the farm are to be divided between the landowner and the contractor, it will be important to stipulate the basis on which those profits are to be calculated, when payments are to be made, and how disputes between the parties are to be arbitrated. The landowner paying for the relevant fertilisation cost is considered important for tax purposes to prove the involvement with the basic act of farming for capital taxes purposes.

Normally, it will be the commercial advantages of a CFA which are dominant in decision making. This can be seen, for example, when a tenanted farm has fallen vacant due to the death, retirement or other circumstances of the tenant. The landlord does not wish to farm the land on his own because he lacks the capital and physical strength to do so, but nonetheless wishes to retain vacant possession having in mind that one of his family may wish to pursue a farming career in the future. Many would also consider that the CFA will protect the ability to claim the new the ELM scheme subsidies following the 'agriculture transition plan' with the commercial approach. However, Baroness Rock, on behalf of the Tenant Farmers Association, has made very negative comments about the creditability of the CFA.

Corporation and income tax

It should be at the core of the arrangement that both landowner and contractor will be carrying on separate farming businesses taxable as trading profits. So both will prepare accounts, and make income and corporation tax returns accordingly. As the owner of the land is operating in a trading arrangement there will be the ability to claim genuine farm overhead expenses which can be substantial.

With the likely corporate involvement of the contractor there is scope to take advantage of the tax reliefs of research and development (R&D) at 130% together with the new 'super deduction' for qualifying plant and machinery at the 130% rate for the window announced in the Budget.

High on the list of the priorities is 'capital taxes protection' through correct disclosure. The profit from the CFA should be shown as trading income as this is a trading arrangement and there should be a full disclosure of the transactions including the offsets of income/expenses – this is set out below.

Capital gains tax

If the landowner is treated as a farmer carrying on a trade, he should become entitled to rollover relief and to business asset disposal relief as long as all the conditions are met. This is subject to the review by the Office of Tax Simplification which suggested increases in capital gains tax rates, for example

aligning capital gains tax and income tax, although such considerations were not mentioned in the Budget or tax day.

Inheritance tax

Agricultural property relief should be due on the agricultural activity on the land at the rate of 100%, because the owner should be regarded as farming the land. However, relief depends on whether it can be said that the landowner has the right to vacant possession, which will in turn depend upon the construction of the CFA. For example, in *Arnander (executors of McKenna, deceased)* (SpC 565), a form of CFA did not persuade the tribunal that the landowner was engaged in agriculture to achieve agricultural property relief on the farmhouse.

The specific legislation is in IHTA 1984, s 117 and questions whether the landowner occupies the farmhouse for agriculture. The case is notable in that the executors of the late Mr McKenna did not include the fact that he was a farmer in his obituary.

In general terms HMRC has reviewed the application of the relief to some contract farming scenarios so it can apply to the farming arrangement if the correct conditions exist. Business property relief should also be achieved on the trading operation of the CFA as long as the arrangement achieved the trading status needed to qualify.

Which farming arrangement

The CFAs in general remain the preferred arrangement when the landowner is looking to step back from full day-to-day operations but wants to retain involvement together with their 'farmer' status and occupation of the land for tax, subsidy and lifestyle reasons. Agreements need to be adapted to factor in issues such as changes in farm support, market volatility and the introduction of the ELM scheme which will need careful consideration as more detail emerges.

An attraction of the CFA from a landowner's point of view has always been the lack of the capital outlay and tax advantages of the arrangement. The agreement allows a landowner to release capital tied up in plant and machinery. Because they also retain their active farmer status – as long as there is evidence of such activity – they should also retain qualifying status for agricultural property relief for the farmhouse, as well as the land. It is considered that even if agricultural and business property reliefs were to be lost, the CFA would stand up commercially. However, the all-party parliament group report did not feature in the recent Budget.

Inevitably, after the Covid-19 pandemic, parties to farming arrangements will want to think more carefully about who in the CFA carries the risk, and to what extent, for events such as illness, closure of trade outlets and rises in diesel and other costs. If the ELM scheme becomes one of the main sources of farm support and a large factor in deciding goals, agreements will need to deal carefully with delivery responsibilities and costs, particularly if the farm is part of a larger landscape-delivery scheme.

Detail is still awaited of ELM scheme but many consider the CFA arrangement of the large operation a positive way of coping with the possible changes. There has been much in the farming press about the positivity of 'field trials' for improving productive quality and a focus on innovations for farming which will be needed for the ELM scheme. It can be argued

that the CFA will be in a better position to focus on these areas and the claiming of genuine R&D tax claims. It is important for the farmer within a CFA to be able to show they are bearing the risk of running their business for business property relief and agricultural property relief on the farmhouse, especially as the Budget left these intact.

There has also been much in the tax press about the need for evidenced R&D claims which can work positively for all parties in this scenario.

Share farming agreements

Share farming works where all parties have an active farming input and are willing to take on the risk of the joint operation with ideally economies of scale.

The distinguishing feature of share farming is that the parties respectively providing the land, fixed equipment, machinery, labour and input costs, agree to share the gross output or product arising. In other words, they share the sale proceeds of whatever commodity – milk, grain, meat, and wool – marketed, rather than the net output. The shares of gross output form the basis of a starting point of the separate accounts prepared for the separate independent businesses. The shares will be calculated in the proportions contributed, as determined by an annual budget and the basic agreement. The detail of the commercial transaction must be included in the main farm accounts which will be positive for inheritance tax and capital gains tax.

For capital taxes protection it is imperative that the landowner takes an active part in the share farming business at least to the extent of concerning themselves in the details of farming policy and exercising their right to enter on to the land for some material purposes, even if only for the purpose of inspection and policy making.

Share farming logistics

The following points are strongly recommended for capital tax purposes:

- There should be separate bank accounts for landowner and operator, with no right of access by each party to the other party's accounts regarding other land.
- Separate financial trading accounts should be prepared in a form which would demonstrate that the parties are carrying on their businesses in accordance with the terms of the SFA.
- That agreement should, by its terms and conditions, illustrate the contributions of expertise, working capital and the assumption of risk by the landowner.

If the SFA merely stipulates a guaranteed return for the landowner against their contributions of land and buildings that will not point to a trading activity for the purposes of business property relief and the like.

Planning point

Whether contract, shared or joint venture farming arrangements are used, it is imperative that it must be possible to show that the parties are trading. Without this, important tax reliefs will be lost.

The landowner whose farm is operated under a shared agreement may have difficulty in establishing a trade, particularly if this share farming is not part of a farming operation carried on elsewhere. Much depends on whether their functions as a share farmer extend beyond the functions of a landlord, a fact shown by so many business property relief tribunal cases.

The contributions of expertise, working capital and the assumption of risk point to a trading activity and these must be reflected in the landowner's farm accounts. Contributions of land and buildings against a guaranteed annual return do not reflect trading for business property relief and the aim is always a shared commercial operation with strong tax relief.

Joint ventures

A joint venture can go further than share farming. The concern here is the risk of being deemed to be in a partnership. This must be avoided through careful legal drafting and protection. If there is any potential development value of the land, care will be needed to protect its value and tax reliefs, so strong drafting will be needed on the partnership point.

There is no doubt that all JVs, CFAs and SFAs will need to be reviewed in light of the Budget and with the introduction of a change of subsidy under the Agriculture Act 2020 to make sure that they still work from a commercial, tax and logistics angle. At a practical level it is considered that the large operation of the CFA has more opportunity to maximise the income from ELM scheme.

It will be a very busy time for the tax advisers trying to ensure that capital taxes protection together with R&D, the super deduction and all changes are used to the full.

Accounts presentation and tax relief

The accounts and tax return presentation of the SFA and landowner's farm will be important because they must show a trade. A forensic and holistic approach should provide a complete understanding of the business with advisers working together to maximise tax relief. It is important that tax and accounts advice should be part of the logistics of future arrangements. ●

Author details

Julie Butler FCA is the author of *Tax Planning for Farm and Land Diversification* (Bloomsbury Professional), *Equine Tax Planning* (ISBN 0406966540), *Butler's Equine Tax Planning (second edition)* (Law Brief Publishing) and *Stanley: Taxation of Farmers and Landowners* (LexisNexis) and editor of *Farm Tax Brief*. She can be contacted by phone: 01962 735544 or email: j.butler@butler-co.co.uk.



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