Tax efficient repairs but beware the disputes

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A recent tax tribunal: ***Steadfast Manufacturing & Storage Limited v HMRC* (2020) UKFTT 286 (TC)** tinyurl.com/TX-UKFTT-286 highlights the potential income tax efficiency of undertaking farm repairs. It also highlights the marginal nature between repairs and capital expenditure.

Where a farm has surplus funds, it can be very tax efficient to use spare funds on repairs to the farm. It therefore can be very income tax and inheritance tax (IHT) efficient for elderly farmers to spend surplus funds on their farming operation, i.e. spending monies that possibly would not achieve IHT relief on items that attract such advantages. The expenditure can be extremely tax beneficial with the correct planning and, as a result of the expenditure, the farm should be able to operate more smoothly with improved plant and machinery to work with and a strong repair strategy.

There had been three previous tax tribunal cases where the tax treatment of expenditure by the taxpayer was determined to be ‘revenue’ in nature, i.e. allowable for income tax or corporation tax as opposed to capital expenditure, namely ***Pratt*, *Hopegar* and *Cairnsmill*.**

The HMRC arguments about the resurfacing of the yard in *Steadfast* were that:

1. it provided an enduring advantage for the taxpayer.
2. the works were an improvement to the yard.
3. the work was of sufficient scale and importance to be considered capital expenditure.

The FTT rejected these HMRC viewpoints. The tribunal held that there had not been a renewal of the entirety of the yard because the sub-surface had not been replaced. The tribunal commented that there was also no improvement in the yard compared to its original condition; the building works merely returned the yard to its original condition and did not bring something new into existence. As a result, the expenditure incurred on restoring the yard should be treated as a revenue expense, i.e. allowable for corporation tax relief.

One problem that can arise with spending surplus money or investments on repairs etc is that the correct consideration of the elderly farmer’s Will as to the division of his estate to his children can lead to the final result becoming distorted.

For example, the farmer’s Will could read that one son – perhaps the one who doesn’t stay working on the farm – is due to inherit the outside investments and the son who works on the farm is due to inherit the farm. Perhaps the farming son has, in good faith, persuaded his father to move the investments into farm repairs and machinery. The son who doesn’t stay on the farm then has nothing left to inherit, as all spare funds have been spent on the farm. It could be that everything has been dealt with in good faith and for the positive position of the farm.

The matter could be dealt with by a claim for 'presumed undue influence' by the child who is left nothing in the Will as a result of the actions of the son who stays farming and persuades the father to use surplus funds but this will incur costs; be hard to prove and may shatter family relations for ever.

The cases on repairs of *Pratt*, *Hopegar* and *Cairnsmill* mentioned above have made repairing parts of the farm very attractive in terms of income tax relief and overall tax efficiency for the elderly farmer, and the case of *Steadfast* has endorsed this position.

Farmers who own assets beyond the farm that exceed the nil-rate band for IHT or, for example, cash in the farming balance sheet, could look to repairing and improving the farm for IHT efficiency while taking full advantage of these recent repair income tax cases, but the impact on future succession planning and "family fairness" must also be considered.

There is no doubt that repair and improvement planning to incorporate capital allowances is very beneficial. Any money spent on repairs and new buildings, and generally improving the farm, will fall into one of the following categories of expenditure:

- Repairs
- Capital allowances (AIA £1m 1 January 2019 to 31 December 2020, at £200,000 from 1 January 2021
- Improvements for rollover

Ironically, monies spent on improvements can still be IHT efficient by moving assets that don't achieve IHT exemption into assets that do, such as the farm. Also, where there are capital disposals on the farm, the gain can also be rolled over into the improvements. The whole area of spending monies on the farm for current tax efficiency needs to be reviewed in the context of the forthcoming Spring Budget. There is a window for planning.

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