The farmhouse

JULIE BUTLER considers the future of farm residences; new build, renovation or sale.


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With the current elderly profile of farm ownership in the UK, much tax planning is needed around succession and potential sales of the whole farm – or perhaps just the farmhouse – to raise liquid funds. Many UK farms are owned in joint names and this can cause problems on the question of succession or sale. Likewise, many farms have already been on the market and there will be some future sales when one of the joint owners dies. For example, in some cases the beneficiaries cannot afford to 'buy each other out'. If one family member is unable to raise the finances to buy the interests of other members, selling might be the only option. Further, some family members will not want their shares to be bought by other relatives who *can* afford the opportunity due to simple motives such as awkward behaviour. It is essential that such problems are considered well in advance and protected through well-drafted partnership agreements and full, open and honest disclosure of wills and the intentions between the farming partners.

The problem of joint property

If farms are held jointly by the farming partners, the strategy for what happens after one of them dies must be considered from a practical viewpoint. A key problem that will present itself is what to do with any farmhouses. With the recent apparent uncertainty around the rural property market, the worry of the 'large house' market and how the farmhouse is sold or apportioned can be a problem. However, with the potential tax advantage of only or main residence exemption for capital gains tax, this could be attractive.

Currently, many farms are being gifted on death to non-farming siblings and children and such dilemmas can cause complex logistics. Farms are having to be sold after probate as well as during lifetime to realise liquid funds to enable the business to survive. How the farm is owned is important for both capital gains tax and inheritance tax. There may be disadvantages if houses are lived in individually by brothers and sisters but are owned jointly by them and their siblings. There is much tax planning and legal preparation that needs to be undertaken by the family farming business now.

Joint ownership can jeopardise only or main residence relief if farming partners live in different jointly owned properties. A possible solution would be to impose a scheme of partitioning, under which each individual becomes the sole owner of the property they live in. Thus, stamp duty land tax (SDLT) or future capital gains tax can be averted, although schemes of partitioning can become complicated if one or more (not all) of the co-owners live in a jointly owned house while some do not. This can be further complicated with the relatively new 3% extra SDLT charge on the purchase of 'additional property'. This can produce some unfairness if, say, a daughter or son who is not intending to live on the farm is left a share of the farmhouse.

KEY POINTS

- Tax planning around farms and farm properties can be complicated by family relationships.
- Jointly-owned properties can prejudice valuable tax reliefs.
- VAT savings can arise because a new residential property after demolition would be a 'new build' and zero rated.
- Advantage can be taken of the 5% rate if farm residences are unoccupied for two years before the work starts.
- Expenditure on improvements and repairs to a farmhouse should be subject to analysis regarding business and non-business use.

VAT planning on farm residences

When looking at the farmhouse and cottages as part of the succession planning, VAT must be considered. Guidance is given under *VAT Notice 708: building and construction*. Many traditional farmhouses are in a poor state of repair due to recent reductions in farming profits. If the houses are not listed, it might be suggested that the properties could be demolished and rebuilt because this could produce a saving of repair costs and VAT.

The VAT saving arises because the new residential property on a 'knock down' would be a 'new build' and therefore zero rated. On a new build, the contractor will agree to zero-rate the supply of labour and materials because it is a new residential property constructed from bare land. There are many basic problems with knocking down the farmhouse to produce bare land – for example, time delays and the cost of planning permission to rebuild rather than repair. A full cost analysis linked to the assessment of time delay together with tax saving analysis must be produced.

The ability to claim the 20% extra input VAT on the routine repair costs can make a difference on decision-making on the question of whether to demolish or repair. Obviously, some of the input VAT on the repair of the farmhouse can be reclaimed if there is a working farm and a VAT registration. The message is to check the input VAT position as part of the full tax analysis well in advance of the decision-making. Ironically, the VAT position could be the deal-breaker on deciding which route to take regarding the farm repair and improvement strategy ahead of the possible sale or even ahead of the retention.

The 5% reduced rate of VAT is available for many farm residential projects and should be fully reviewed.

VAT and an additional small house

Historically, many larger farmhouses have had smaller residences connected to them for planning permission purposes or to provide accommodation for family members and suchlike. Therefore, other decision-making considerations around the bare land point can be the small house for staff built alongside an existing farmhouse to take advantage of the new build VAT advantage of the additional property. If there is a restriction in the planning consent – for example, that the farmhouse and small house can only be sold together as a single unit, not as separate sales to different buyers, there can be VAT considerations. VATA 1994, Sch 8 Gp 5 Note 2 lists four conditions that must be met for a building to be classed as a 'dwelling'.

The key consideration here is that the 'separate … disposal of the dwelling is not prohibited by the terms of any covenant, statutory planning consent or similar provision'. Since all four conditions must be met to achieve the VAT advantage, an 'and' rather than 'or' situation applies. The advantage of the zero-rate supply of a new build is then lost on the additional property if there is a planning permission restriction of the two houses. The builder is not constructing a new dwelling for VAT purposes and building services and material supplies are standard rated. The dwelling conditions are covered in para 14.2.1 of HMRC *Notice 708*.

If a farmer decides to build a small house next to the farmhouse all taxes must be considered. The practicalities are that the farmer obtains planning permission for the project and then appoints a builder to do the work. As mentioned, the contractor cannot zero-rate his supply of labour and material if there is a planning permission restriction. Although the additional small house is a new residential property being constructed from bare land, the restriction in the planning consent would require the farmhouse and small house to be sold together as a single unit only, not as separate sales to different buyers.

Farmhouses, cottages and repairs

The 5% VAT rate can apply if farm residences are unoccupied for two years before work starts. This could be helpful if property becomes vacant for some reason, perhaps cashflow. On the other hand, as a planning tool a vacant property has its own drawbacks. For example, what is the effect on inheritance tax relief and what happens if, say, the rules change midway.

A farmhouse could be left empty deliberately simply to achieve the 5% VAT rate on renovation, but this obviously comes with worrying concerns for only or main residence relief.

As well as being tax-efficient so far as VAT is concerned, if the decision is made to carry out major repairs to the farmhouse income tax efficiency can also be sought. Can the cost of repairs be allowed against profits? Full spreadsheets should be prepared to help with the decision-making.

There must be a clear analysis between expenditure that counts as improvements and repairs to the farmhouse to justify any repair claim for both income tax and VAT. There should also be a forensic analysis of the farmhouse between business and non-business use to ensure the correct allocation of costs.

Tax strategies need to be decided by farming families when they are buying, selling or apportioning properties and it is essential to review the tax consequences of the advice given by land agents on what they consider will achieve the best price in the market. Alternatively, the tax decisions themselves may determine the strategy to maximise sale proceeds. At present, many land agents are reporting a lack of supply of farms due to market uncertainty. However, it is predicted that many new farms and farmhouses will have to be sold to enable the business to survive or to pay out of estate beneficiaries. The supply of such properties is therefore likely to increase.

Tax planning strategy in advance

The VAT and income tax consequences of all decisions for future farm sales need to be considered as well as inheritance tax reviews to ensure that a tax-efficient trade is maintained. It is fair to say that, with regard to all aspects of farm tax relief, 'keeping trading robustly' has the most generic tax benefits to achieve business reliefs. When any farmer with joint ownerships has a will drafted that leaves farming assets to non-farming beneficiaries it is essential to explain and consider how payments to the beneficiaries will be funded. The 'will file' must show how this matter was considered and explained.

Keep trading

In general, the greater VAT and income tax percentage that can be claimed on the farmhouse will depend on the level of trading activity. It is usually more tax-efficient to maximise trading rather than letting activities. With all the succession dilemmas that face elderly farming families, they must maintain a robust trading activity instead of falling into the trap of letting out property and reducing tax efficiency. Farmers face many problems and logistics – and not only with death planning. The proposed changes to farm subsidies under 'green Brexit' and variable farmland values, which seem confused by some strong development prospects with development proceeds seeking rollover opportunities back into the farmland market, are all concerns that must be factored in to the decision making. ■

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