The rural lifestyle

Julie Butler and Fred Butler discuss the various tax advantages and potential problem areas for clients who are considering the purchase, sale or disposal of a 'lifestyle farm'.


© iStockphoto/D-Keine

There have been many negatives written about the 'lifestyle farmer' (or 'lifestyler' as they are known) by the farming press. The generic advantages are considered to be providing employment, investing capital into agriculture, helping improve farms and the like. But what are the particular tax advantages of buying a farm in the UK since the Agriculture Bill 2020, the Tory landslide, the 'Boris budget' 2020 and now the Covid-19 lockdown. Back in 2004, the article 'What future lies ahead?', looked at the effect of tax legislation on the future of farming in the UK (*Taxation*, 15 July 2004, page 399). Since then, one impact on the industry is the increase in these lifestyle farmers who have been 'basking' in the positive tax reliefs and farm subsidies.

Many might argue that, when the UK is in recovery post-coronavirus, the lifestyler could be a welcome addition to the local community, supporting local employment with staff working on improvements and farm projects. Wealthy clients may think, therefore, that it is a good time to look at buying farms with the property market opening again.

Inheritance tax

An obvious tax advantage (and all references in this section are to IHTA 1984) of the farm purchase is the ability for a large amount of wealth to escape the inheritance tax regime through business property relief (BPR) and agricultural property relief (APR). The all-party parliamentary group on inheritance tax and intergenerational fairness is calling for inheritance tax to be cut from 40% to 10%, and 20% for estates worth more than £2m (tinyurl.com/uxfobq4). We are assuming that the inheritance tax reliefs continue. Many argue that HMRC looks more favourably on the 'working farmer' when reviewing BPR claims. Support for such status can be helped by the use of a contract farming arrangement (CFA) or, going one stage further, by 'farming with contractors'; in other words, buying in the contract work when needed. Despite much speculation, the inheritance tax reliefs of farm ownership were not altered after the Budget on 11 March 2020.

Key points

- Will there be farm purchase opportunities after the Covid-19 outbreak?
- Despite suggestions, inheritance tax advantages for farms remain unchanged.
- Remember that agricultural property relief is restricted to agricultural value.
- Rollover relief has become more attractive since the changes to entrepreneurs' relief.
- The 25% of total income cap on losses does not apply if relief is given against capital gains.
- The stamp duty land tax mixed-use rate can be advantageous.

IHTA 1984, Pt V ch 1 deals with business property relief and s 105(3) states: 'A business or interest in a business, or shares in or securities of a company, are not relevant business property if the business or, as the case may be, the business carried on by the company consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments.'

There have been many challenges under s 105(3) by HMRC arguing that the diversified farm activities are investments rather than trading – see *HMRC v The Personal Representative of Maureen Vigne (Deceased)* [2018] UKUT 0357), *The Personal Representatives of Graham Deceased* (TC6536) and *Charnley & Anor (Estate of Gill)* (TC7425). All these cases – relating to a livery yard, holiday accommodation, and a grazing agreement – were successful for the taxpayer. And all these tribunal decisions can affect the diversified farm that is owned by the working farmer as well as the lifestyler.

The investment angle takes on further meaning with the *Balfour* case *(HMRC v AM Brander (as executor of the will of the late fourth Earl of Balfour)* [2010] UKUT 300 (TCC)) and the suggestion by the Office of Tax Simplification (OTS) that the trading activity should exceed the investment activity by 80:20. This suggestion is in its report, *Simplifying the design of Inheritance Tax*, section 5.22 (tinyurl.com/r9xank5); in other words, in the same ratio as capital gains tax. The report says:

'For capital gains tax purposes, where a business is given away as a gift or sold to a third party, gift holdover relief or entrepreneurs' relief may apply. For these reliefs, the test for eligibility in relation to companies is not the "wholly or mainly" test but whether there is "substantial" trading activity in the business. HMRC guidance suggests that this will generally involve an 80:20 split of trading versus investment, with several indicators to look at, including assets, income, expenses, time spent by officers or employees, and the history of the business.'

The current accepted ratio for inheritance tax BPR is simply that trading activity must exceed investment activity by more than 50%. The criteria that are under scrutiny are capital employed, hours worked, turnover, profit, and the overall view. The farm accounts are therefore important in helping to arrive at this analysis along with the probate valuation and logs of hours spent. Obviously, there is subjectivity around some of these areas as to whether they are a trade or an investment. Again, despite being promoted by the OTS, no change was made in the Finance Bill but there is speculation about this autumn.

The importance of trading

As indicated above, among the various tax targets farmers have to hit is that they achieve trading as opposed to investment status and the services of diversified activities, for example liveries (see *Vigne*) and storage, must be taken into account. To ensure the trading percentage is robust there must be strong action points. For example, these might be to replace farm business tenancies (FBTs) with arrangements such as CFAs or farming in hand – in other words, with the owner being involved directly in activities and day-to-day farm management.

The *Gill* case (tinyurl.com/yb537brx) was a positive for the grazing licence but it must be remembered that Mr Gill had a history of being a working farmer and, in the round, was *not* a lifestyler. See also the case of *Golding's Executors* (TC1211) where farming, no matter how small, was seen as a way of life.

Under s 103(3) the farm must be carried on for a profit and from the outset there must be business plans, a close review of the proposed expenditure between repairs and improvements, and a total understanding of the profit motive. While a profit only has to be made every sixth year (ITA 2007, s 67 for income tax and CTA 2010, s 48 for corporation tax) to limit the relief available for 'hobby farming', there must be an approach to profitability in the business projections and ethics.

In practical terms, there is a history among lifestylers of buying stud farms because horse breeding qualifies as agriculture (IHTA 1984, s 115). Business plans and commerciality are key here because breeding can take a long time to produce a profit. The Thoroughbred Breeders Association (TBA) agreed with HMRC in 1982 that, by concession, the six-year hobby farm rule could be extended to eleven years (tinyurl.com/ydd8983a).

The purchaser of a stud farm who is relying on APR should remember that this relief is restricted to agricultural value (s 115(3)) and does not qualify for market value (s 160), with the potential for development considered in accordance with the decision of the Upper Tribunal Lands Chamber in *Foster v CRC* UKUT0251 (LC) – see case report at tinyurl.com/ya2q89kl.

The understanding of the advantages of BPR and what does and does not qualify for inheritance tax relief is paramount. An obvious risk for the tax adviser would be potential development land that does require BPR. The farmhouse can achieve APR but HMRC have a natural dislike of the 'mansion house', although the restriction to agricultural value and occupied for agriculture (s 117) can help here. See *Arnander (executors of McKenna, dec'd) v HMRC* [2006] STC 800.

Capital gains tax and the rollover buyer

With the capital gains tax changes, it can be argued that there are more advantages of the lifestyler who wants to rollover a gain into a farm purchase. Several reliefs are available here:

- Rollover relief – 0% rate of capital gains tax.
- Entrepreneurs' relief – now renamed business asset disposal relief (BADR) – 10% rate of capital gains tax.
- Non-residential property – 20% rate of capital gains tax.
- Residential property – 28% rate of capital gains tax.

Rollover relief has huge attraction to the lifestyler who is funding the purchase of a farm from, say, the sale of a business. The relief can also lead to the advantages of replacement relief for inheritance tax (s 107), although the OTS have suggested that the 'tax-free uplift on death' should be abolished. Such a move did not happen in the 2020 Budget.

> "The annual investment allowance is capped at £1m until 31 December 2020 and can create an income tax loss."

The lifestyler can also choose to sell parts of the farm in a tax-efficient manner. For example, the sale of one or more pony paddocks could be eligible for BADR or rollover relief.

That said, and in practice, buying more land could be more common nowadays. The capital gains tax advantages are useful. However, in the 2020 Budget the entrepreneurs' relief lifetime limit was reduced from £10m to £1m, and in FA 2020 we have BADR. Rollover relief has therefore become more attractive since 11 March 2020. A new player in the farm market has emerged – the 'rollover buyer'.

It could be that, to reduce the investment percentage and increase the trading elements of a farming business, some let cottages are sold by the lifestyler and the new obligation to declare capital gains from 6 April 2020 must be considered.

Selling cottages and using the funds to buy more trading assets such as a grain store *(S May and Others* (TC6928)) can have overall tax advantages, not just to improve the trading percentage but to increase capital allowances entitlement.

The annual investment allowance is capped at £1m until 31 December 2020 and this can create an income tax loss to offset against the lifestyler's total income and capital gains. However, Covid-19 has caused problems for the residential property market.

Income tax losses

Lifestyle farming can create income tax losses and sideways loss relief can be an advantage. This is capped at 25% of total income but is *not* restricted if set against capital gains so could be used to offset these. Business plans are essential, and the timing of repair expenditure can be a tax planning tool.

With the Agriculture Bill proposing to replace lucrative area subsidies for public products, profitability is predicted to become more difficult for lifestylers. There is the risk of a 'money pit' scenario for the lifestyler and working with good contractors and staff is essential with cost control being key.

As proven by a large number of tribunal cases, tax loss claims are scrutinised – see *Henderson* and *Naghshineh* (TC6631) and the 17-year loss claim. The *Naghshineh* case has recently been overturned in the Upper Tribunal and HMRC's appeal was allowed ([2020] UKUT 0030 (TCC)). Tax advisers may have lifestyler clients who sold their businesses some time ago and need to meet a rollover relief deadline and are hoping for some bargain farms on the market post-Covid-19.

Input VAT claims

Work on newly acquired farm cottages and farmhouse by the lifestyler will attract input VAT and debate as to whether the expenditure is repair, improvement or personal. It is likely that early VAT returns will show large repayments and HMRC will be keen to see invoices, business plans and profit motive from the start. The input VAT claims on the farmhouse are potentially generous but evidence of its use for agriculture must be readily available. The VAT strategy needs to be thought through carefully with all taxes in the round. The added value to the local community in difficult Covid-19 times has already been discussed.

SDLT and mixed use

The stamp duty land tax (SDLT) business and mixed-use rate can be used to advantage and can make farm purchases attractive (FA 2003, s 55, table B). For small lifestyle purchases mixed use can be attractive but HMRC is scrutinising abuse in this area – see *Pensfold* (TC7609), *Dr David Hyman and another* (TC7271) and *Myles-Till* (TC7633). Ensure that evidence of the business operation on the non-residential property is maintained. Likewise, when selling cottages (see capital gains tax section) with some land the mixed-use rate can be a selling advantage. Obviously, the property market needs professional assessment at the point of purchase.

Lifestyle advantages

The lifestyle tax and social advantages of the farm, farming estate or country retreat can be seen by many to be endless. The attraction of the mile long driveway, shooting and fishing rights and space for horses are all an advantage. Some could see the farm as the UK holiday home with a large but expensive garden. It can be argued that not much has changed at the top end of the agricultural market since the industrial revolution and the purchases of landed estates to display wealth by industrialists.

Planning point

The stamp duty land tax business and mixed-use rates can make farm purchases attractive, but remember that HMRC is scrutinising abuse of the differential between these and residential rates.

The private use calculation for all these taxes must be considered with diligent and honest recording which can help towards greater profitability. As shown, when handled correctly the inheritance tax, capital gains tax, income tax and VAT advantages can be rewarding with a farm purchase and nothing in this year's Budget has dented this. Farmland values have stayed high, especially when there is more than one interested buyer – particularly a 'rollover buyer' with development profits to shelter if a bidding war starts. However, exactly what happens after the property market lockdown is subject to speculation. The amount of inheritance tax and capital gains tax are likely to be high and beware of tax greed over the smaller private use matters. Capital taxes savings will often far outweigh the income tax advantages over claiming private expenses.

The tree hugger

Planting trees has potential for subsidies on the environment issues, especially in Scotland. There is scope for woodland investors and agroforestry together with rewilding considerations. Using a land agent who understands the post-Agriculture Bill subsidies together with the lifestyler's goals will be paramount. Work in the UK forests and woods was not banned during the lockdown because they were an essential supply. With high prices available for hard and softwood, increased work in the woods could be attractive following the coronavirus pandemic to create positive healthy employment.

When buying a farm, all taxes must be considered in the round and the adviser needs to understand which tax reliefs are relevant to the lifestyle buyer; each is different with different tax and commercial motives. The essential first point is to understand what the client wants commercially and which tax reliefs are more important than others.

There is no doubt that some lifestylers will want to take advantage of tax reliefs and possibly find some tax-efficient farm bargains. We await with interest, as we did in 2004, to see what happens regarding tax issues as the farming industry moves into the future following the present Covid-19 crisis.

Author details

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

Fred Butler MSc ATT is tax manager in the Farm & Equine Department at Butler & Co.
Fred can be contacted on 01962 735544 or email: fred@butler-co.co.uk.

FIND OUT MORE
On Taxation.co.uk

- Succession planning for the farming sector: tinyurl.com/y86wx7wb
- *Gill* decision on agricultural property relief and business property relief: tinyurl.com/sept9lx
- HMRC's approach to mixed-use claims for SDLT: tinyurl.com/y5mdqjko