Passing down the family farm: CAP reform

by Julie Butler

On 4 July the reform of the Common Agricultural Policy (CAP) was at last agreed. The National Farmers' Union (NFU) President, Sir Ben Gill, has stated that as ever the devil is in the detail. Broadly it means that the European Union (EU) Agricultural Council has agreed to break the link between support payments and production, known as 'de-coupling'. This will enable farmers to focus more clearly on the needs of the market.

There has been a radical shift in policy and attitude towards farmers in the United Kingdom (UK). The government no longer looks to British farmers to grow and supply the food that is eaten in this country. The approach seems to be that if the right quality of food can be produced at the right price then there is a chance in the market place. If not, the UK food will come from abroad and UK farmers will have to find other sources of income. The government while seeking to phase out production subsidies is, however, prepared to support farmers for maintaining the landscape.

Current beneficial tax advantages

These reforms will change a lot of tax focus. The whole definition of agriculture for agricultural property relief (APR) for inheritance tax (IHT) and the complex farming rules such as averaging the profits due to fluctuations in productivity could be reconsidered. Questions have been raised for some time now on the tax definition of agriculture and farming. Tax practitioners have been very focused on the fact that there have been few pure farm profits in recent years and the need to review the income tax computation to identify the difference between farming and non-farming has been quite an onerous task. Concerns over farming clients being caught under the hobby farming rules, which could mean a potential loss of valuable IHT and capital gains tax (CGT) reliefs through no longer having business status, has been high on the tax planning agenda.

The relative collapse of the farming industry combined with the forthcoming CAP reform has caused a lot of families to look to pass the farm down to the next generation to take advantage of young fresh ideas and the fact that generally the IHT reliefs surrounding the family farm are untouched since John Major declared that his aim was to let wealth pass down the generations. There are those that would argue that because the current IHT reliefs are so good why not just leave everything in place?

Will the tax advantages stay?

There are cynics who say that the key is to pass the farm down now before the reliefs are removed or attacked further. Examples of these attacks by the Revenue are those questions being asked about APR and the farmhouse (see *Lloyds TSB (personal representative of Antrobus (deceased)) v I R Commrs* [2002] STC 465. (Reference to this case can also be found under new developments in the British Tax Reporter, para. 954-121 and 954-122.)

Under the CAP reform with greater emphasis on diversification and farmers being paid to maintain the landscape will there still be strong arguments to claim APR on the farmhouse? With the current farming crisis there are many buildings on the farm which are currently redundant and would continue to be so or would even fail to be eligible for APR due to the infrequently used rule.

While there are many uncertainties about the extensive detail of the reform of CAP there is still clarity over the IHT and CGT reliefs available on the passing down of the family farm.

Tax marriage between trading vehicle and land ownership

At a practical level one of the biggest problems is that the trading vehicle that farms the land, i.e. runs the activity of the farming business, and the members of the family who own the land are not the same. There should clearly be a tax efficient lease between the owners and the traders or work should be put in place to try and achieve uniformity of owners and business relationships.

This is often not that easy in practice. Examples are clearly where parents still own the land and they have invited two sons into the partnership, but the sons do not own the land and the partnership of four should have a lease with the ownership of two.

To give the children the protection, the parents might have a rather long lease which could prove IHT and CGT inefficient. Changes in the trading arrangement could of course evoke tainted taper and therefore reduce the availability of business asset taper relief (BATR) (*Taxes of Chargeable Gains Act* 1992 (TCGA 1992), Sch. A1, para. 9).

Capital gains tax

The passing down of the farm will of course trigger a CGT disposal which would not only need recording on the tax return, but calculating, reviewing and protecting against an unnecessary liability. Protection via the holdover route can be achieved (TCGA 1992, s. 165). However, in most cases on pure agricultural values there are rarely CGT liabilities as there has been little uplift in value to give charge to CGT. For land held since March 1982 there is indexation relief at 104 per cent and in most cases this covers any uplift.

Clearly the problem areas are buildings which have increased considerably in value or land with development potential. Regarding the latter, it is likely that the proactive tax adviser has already looked at ways of sheltering the potential capital gain.

Ironically one of the most obvious and easiest current reliefs to shelter a development gain is through BATR (TCGA 1992, Sch. A1) on the farming asset or the ability to rollover, and this status must be protected when looking at passing down to the next generation.

Worry over failed PET

Having established that the ownership of the land qualifies for APR or BPR and the gift to the next generation takes place due consideration will be given as to outright ownership or whether a trust vehicle is contemplated.

One of the key concerns has to be the potential for a failed potentially exempt transfer (PET), i.e. the gift will be a PET and if the donor dies within seven years of the gift and the gift is no longer a business asset (*Inheritance Tax Act* 1984 (IHTA 1984), s. 113A) or is no longer a business asset with the same value there could be a liability to IHT (IHTA 1984, s. 113B. See also IHTA 1984, s. 124A and s.124B for similar rules for APR).

This obviously has problems what will have happened to the family farm in seven years time? It is assumed that the move away from production by some farms towards maintaining the landscape and countryside will still qualify as a business. Other triggers of a failed PET could be the sale of the farm soon after the gift, or a sale of the farm into a replacement asset which does not continue with business status.

Clearly the donor and donee must be made aware by the tax adviser of the need to preserve conditions for seven years and of providing for this within the legal document.

Limited company

Many farms own their land in the limited company or trade the land in a limited company. This has some tax problems:

(1) the trapping of losses within the limited company;

(2) the lack of BATR if the asset is held within the limited company (Inland Revenue CGT Reform, TCGA 1992, s. 2A);

(3) the problems over the loss of principal private property relief (PPR) for a farmhouse owned by a limited company; and

(4) the problem over benefits in kind and risks to trading status for IHT.

The passing down of company shares will have to be compared to the advantages of actually removing the limited company to remove the tax problems mentioned. The family farm that is owned within the structure of a limited company is currently very vulnerable from loss of IHT reliefs under the mainly holding investment rule (IHTA 1984, s. 105) as it is very easy for more than 50 per cent of the farm assets to be deemed to be of investment status rather than trading status.

In summary, it is a key time for the tax adviser to review the tax status of all farm assets. The announcements of the CAP reform combined with the current favourable IHT and CGT reliefs invite and excite the possibility for proactive tax planning and the possibility of passing to the next generation.

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