Valuation of farm freehold property

Many farms and estates were purchased or inherited several decades ago. As a result the figure used for the freehold property shown on numerous balance sheets is seriously understated.

Understatement

With increases in farm values of over 100% from 2005 to 2010 and a large increase in values over the previous decades, in some instances this understatement could be as much as several million pounds.

It is quite normal for a freehold farm to have been inherited or purchased at say £2,000 in the 1970s and to be worth over £2 million today.

In addition, the improvements to freehold property can look out of balance because of this historical difference. It is quite easy for a modest modern improvement to have cost more, in cash terms, than the original acquisition value of the land.

FRS15

Most UK accounts should be prepared on the historical cost basis, which would mean valuing land and buildings at their initial acquisition cost.

However, Financial Reporting Standard 15 (FRS15) allows assets to be shown in the accounts at their modern valuation instead of their original cost, in certain circumstances.

The revaluation profit should not be recognised in the profit and loss account but in a separate revaluation reserve, as it is unrecognised at the balance sheet date.

Advantages of revaluation

There are many who would consider that to show the freehold property at valuation in the accounts would be so much more reflective of the "true and fair position".

With many farms wanting to borrow money for expansion, unless the freehold property is included at market value the result is a distorted and strange looking balance sheet.

Restricted to a "class of assets"

The rules of FRS15 allow for revaluations but they must be in respect of an entire "class of assets":

> *"Where a tangible fixed asset is revalued, all tangible fixed assets of the same class should be revalued"*
>
> ***FRS15***

The separate classes of tangible fixed assets are:

a) land and buildings;
b) plant and machinery; and
c) fixtures, fittings and equipment.

The result is that if some of the freehold property is to be revalued, then this policy must be applied to all the freehold property included in the business accounts, without exception.

Also the notes to the accounts should be clearly drafted to show that the accounting policy has changed.

Once revalued always revalued

The consideration is then to the future - what happens once a revaluation has taken place? Do a few more decades go past without valuing it again?

The answer is no. Under FRS15 (which was introduced in 1999), once you start revaluing then there should be a valuation at least every 5 years, with an interim valuation after 3 years.

Cost of regular revaluations

This regular revaluation cycle can be quite an onerous and expensive operation.

Many farming businesses would like their accounts to show a true and fair view but are very cautious about the cost of having to revalue the freehold property on a regular basis.

Revaluation process

The full (5-yearly) and the interim (year 3) revaluations must, under FRS15, be carried out by a "qualified valuer".

The interim valuation is a much simpler process, based on "market transactions in similar properties" and "market trends". An interim valuation by the same valuer that carried out the last full valuation usually need not require an inspection visit to the property unless there have been "recent changes to the property or the locality".

However the full five-yearly valuation requires, as well as the usual research and questioning:

- Detailed inspection of the interior and exterior of the property;
- Inspection of the locality;
- Inquiries of the planning authorities.

Clearly this is not a process to be undertaken lightly, but there are commercial and tax advantages of going through with it.

Advantages of regular revaluations

However it can be argued that most farms need valuations for other purposes, for example to obtain borrowings secured on freehold property.

In addition regular valuations are essential for accurate capital tax planning moving forward, particularly inheritance tax planning and capital gains tax planning.

To operate a revaluation policy on the class of fixed assets "land and buildings" is therefore something that most farming enterprises will have to consider.

The revaluation process

A farm revaluation is not something that can be undertaken lightly.

There are a lot of complex issues and it can be difficult to arrive at market value on certain areas of the farm, for example where there are both ongoing and potential planning applications.

There is also hope value (the difference between market value and agricultural value under section 115) to consider, which is essential information for successful inheritance tax planning.

Tax planning considerations

Farm tax is exceptionally complicated – the farm values are high and the risks of claims for tax reliefs being denied is a real worry.

Revaluations every five years (with interim values at three years) could have the advantage for the tax adviser of flagging up concerns regarding tax risk.

The non-corporate entity

For various inheritance tax, capital gains and income tax purposes, most farming businesses are run as a partnership. The Companies Act disclosure guidelines therefore do not strictly apply, but should still be followed.

However with the growing current fashion for more corporate partners. the corporate disclosure consideration would be of more pertinence.

Problems could arise if freehold property values decline, but again this could be a strong reason for FRS15 guidelines on freehold property to be considered.

Summary

With the recent increases in farmland values, the need for borrowings to expand the farming enterprises and the need for "fair" freehold property values, FRS15 will have to be considered by most farms. □

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Valuation of farm freehold property

With the huge increase in land values over the last few decades, many farming accounts are still showing their main asset at a historic cost that bears no relation to its current value.

This may not be a problem for some farming businesses, and revaluing is certainly not an easy operation, but anyone trying to raise finance will know that a strong balance sheet is half the battle in convincing banks to lend.

But there can also be tax reasons for revaluing assets. Proper tax planning, especially for inheritance tax or capital gains tax, needs accurate information about what assets are potentially taxable and what those liabilities could be.

As our rural tax expert, Julie Butler, explains, good revaluations are therefore an important tool in the tax planning armoury.