

TAXATION

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What Future Lies Ahead?

Will tax legislation direct the future of the farming (and the landscape) in the United Kingdom? **JULIE BUTLER** asks.

THE REVOLUTION HAS arrived. From 2005, farmers can receive their subsidies (the single farm payment), irrespective of production. Under the Mid-Term Review of the Common Agricultural Policy reform, subsidies are being progressively siphoned from production.

The tabloid newspapers have branded the farming community 'lazy fat cats', for just receiving the subsidy and not having to produce anything. The environmentalists have praised the possibility that the Mid-Term Review will result in a better environment and landscape for the United Kingdom through schemes such as environmental stewardship, e.g. environmentally sensitive area schemes and farm waste grant schemes.

The system and its proposals have been attacked and praised in varying proportions from every angle. But where does that leave the tax status of the farmer? A decision from the Inland Revenue is still awaited.

Margaret Beckett told MPs on 12 February 2004 that the new system 'is a decisive and irreversible shift which offers huge opportunities to the [farming] industry' (*Hansard* vol 417, no 40, col 1587).

Farming has apparently been unprofitable for a long time and its unprofitable production has reputedly cost the economy £200 to £500 million a year. It is argued that farmers continued to produce in order to receive the production subsidies which rectify the production loss. It is also argued that farmers kept producing in order to take advantage of the beneficial tax reliefs, e.g. agricultural property relief, business property relief, rollover relief, and business asset taper relief. The latter means capital gains only attract a ten per cent rate of capital gains tax (40 per cent at 75 per cent relief). Farming losses can also be offset 'sideways' using the loss relief rules in sections 380 and 381, Taxes Act 1988, and losses can be offset against capital gains under section 72, Finance Act 1991.

Single farm payment

The single farm payment has been described as an 'annuity'. The cynics have described it as a 'redundancy payment'. In the same way that we could no longer mine coal and steel cost-effectively in the 1980s, no longer can we compete in the agricultural world marketplace. However, the Mid-Term Review promotes freedom of production in the unsupported world. Farmers have freedom: they can still farm, they can still produce, or they can do nothing (just keep the land in 'good agricultural and environmental condition'). But where does this leave the availability of the tax reliefs? The Inland Revenue has not yet announced what it intends to do about this.

It is generally understood that the single farm payment will be taxed as Schedule D, Case I farming income. Subsidies which are paid to make up for loss of income are liable to income tax as farm income. However, it is not clear if it will still be farming, if the farmer ceases to farm and just keeps the land in good agricultural and environmental condition. Will the very valuable asset of the farmland and buildings still be eligible for the inheritance tax reliefs of agricultural property relief and business property relief?

Article 1 of the European Union regulation describes the single farm payment as 'income support for farmers', but it is undoubtedly dependent upon land management and not husbandry. Until the exact details of good agricultural and environmental condition are known, it will be difficult for the Revenue to make a decision. The single farm payment is a political creation, and is therefore a form of property within section 21(1), Taxation of Chargeable Gains Act 1992.

What is farming?

The following definitions may help with regard to defining farming, agriculture and husbandry for tax purposes:

- Section 832(1), Taxes Act 1988: Farming is defined as the occupation of land wholly or mainly used for the purposes of husbandry.
- *Lean and Dickson v Ball* (1925) 10 TC 341: 'For a business activity to be classed as farming, it must be dependent on the produce of land occupied by the person carrying on the activity'.
- Section 362(1), Capital Allowances Act 2001: This governs the tax position on agricultural buildings allowances and defines husbandry as follows: 'any method of intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption and the cultivation of short rotation coppice' (as defined in section 154(3), Finance Act 1995). Thus, for agricultural buildings allowances purposes poultry farming and fish rearing are husbandry.
- Section 115(2), Inheritance Tax Act 1984: Agriculture land is found as follows: 'Agricultural property means agricultural land or pasture and includes woodland and any building used in connection with the intensive rearing of livestock or fish if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture; and also includes such cottages, farm buildings and farm houses together with the land occupied with them, as are of character appropriate to the property'.
- Section 361(1), Capital Allowances Act 2001: Agricultural land means land, houses or other buildings in the United Kingdom occupied wholly or mainly for purposes of husbandry.
- Article 2, Farmer (under the Mid-Term Review of the Common Agricultural Policy Reform): 'the production, rearing or growing of agricultural products including the harvesting, milking, breeding animals and keeping animals for farming purposes or maintaining the land in good agricultural and environmental condition'.

- Section 124C, Inheritance Tax Act 1984: Land in habitat schemes is agriculture (includes land within conservation schemes and set aside).

Ceasing production

If a current farmer, filling in 2004 and 2005 IACS forms, decides to cease production, take the single farm payment and employ contract farmers to keep the land in good agricultural and environmental condition, it is not yet known if the income will be assessed under Schedule D, Case I or Case VI. This might, however, be deemed to be academic compared to the eligibility of inheritance tax and capital gains tax reliefs that are at stake here.

If the single farm payments are received without production, is the farmer or landowner mainly holding investments as opposed to farming? Does this preclude the claim for agricultural property relief or business property relief? The impact of section 105(3), Inheritance Tax Act 1984, which precludes a business consisting wholly or mainly of the making or holding of investments, would mean that a claim under agricultural property relief/business property relief would fail. This would impact on the 'single farm payment banker', a former farmer just taking the single farm payment and ceasing to farm. Although pre-2005 'set aside land' had counted as agricultural land, as has land in habitat and conservation schemes, this was land which was part of a large farming enterprise involved in the act of husbandry and production. It was not of enough significance to evoke section 105(3).

It could be that the farmer looks after the land himself in order to achieve good agricultural and environmental condition status; machinery and capital allowances would still be involved, but would this be agricultural production or husbandry? Would the farm still be caught under section 105(3) so as not to qualify for agricultural property relief?

Diversification

An alternative would be to maximise income and profits from other directions e.g. rural initiatives, environmental schemes, production of alternative energy crops or herbs, woodland production, letting of sporting facilities, letting grazing rights and letting redundant buildings. There will be some saturation of the diversified markets and not all farmers will be in ideal locations for this direction. A large amount of the income will be taxable under Schedule A. Although section 160, Finance Act 2003 might help towards allowing business asset taper relief for the let assets, there are still the inheritance tax reliefs to consider. If inheritance tax allowances are given on let assets to the farming world, this might impact on other industries. The Special Commissioners' case, *Farmer (Farmer's Executors)* [1999] SpC

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216, allowed business property relief against let cottages under Chapter I of Part V of Inheritance Tax Act 1984, at sections 103 to 114. These cottages were an integrated part of the farming business. What impact will this case have on the 'single farm payment banker'?

The move to environmental schemes and rural initiatives required under the Mid-Term Review will raise all sorts of questions over what is farming and what is not.

If the lack of production might lose the right to achieve agricultural property relief or business property relief, the aging farm population may continue to farm (despite the losses) just to receive the tax reliefs. This is one way that tax legislation may have a future influence over farming. Cynics would say that, since the last profitable harvest of 1996, many farmers have only stayed in farm production out of habit and in order to secure tax relief and Mid-Term Review subsidies, thus the tax legislation has already influenced farming over the last few years.

However, as previously mentioned, farms have enjoyed a number of beneficial inheritance tax reliefs for two decades, e.g. 100 per cent agricultural property relief on the value of the estate including the farmhouse, and since 2002, the disposal of land and buildings has been subject to only ten per cent capital gains tax, provided they qualify for business assets. Despite these generous reliefs, tax advisers have not necessarily been suggesting the passing down of farms over the last few years, or indeed now, in order to secure the tax reliefs before they disappear (especially the farmhouse). Worries have been over the uncertainty of the Mid-Term Review entitlements and possible failed potentially exempt transfers (section

113A(1), Inheritance Tax Act 1984). Business property relief is allowed against the potentially exempt transfer if the conditions for obtaining relief were fulfilled at both the date of the transfer and the date of the subsequent death. If the farm is passed down now and the transferor dies within seven years of the gift, will the asset qualify for business property relief? Will farms that have been passed down over the last few years still qualify at date of death if within seven years? Will the farms stay in production farming just to achieve tax reliefs?

The average age of the United Kingdom farmer is apparently over 60 and the potential inheritance tax and capital gains tax reliefs would be far greater than the cost of funding production losses. Will tax continue to drive the direction of the farming industry in the future? If so, where does that leave the farm tax adviser and farm practitioner?

- Do they advise farming clients stay in production?
- How do they help their clients to maximise single farm payment and tax relief?
- Where is the direction of future farm tax planning?

Tax advisers have to wait for the Inland Revenue's direction on these issues. The interpretation of the Inland Revenue's decision could have a big impact on the United Kingdom farming community and the landscape. ■

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