Reap what you sow

Agricultural diversification can make a farm work harder, but advisers need to ensure they do not get tangled up in thorny tax issues, says *Anne Elliott*

Farms and farmers come in all sorts of shapes and sizes, as do the problems they bring. This makes agriculture a particularly fascinating area of practice, which is proving to be increasingly challenging.

Notwithstanding (and perhaps because of) the extremely generous agricultural and business property reliefs (APR and BPR) of 100 per cent and 50 per cent of open market value, no longer can any farmer who has undertaken any degree of diversification assume that his/her land and business assets are going to pass on (whether by way of lifetime gift or on death) without any liability in terms of capital taxation.

This article will focus on inheritance tax (IHT) and the farmer/landowner who has or intends to diversify to maximise the commercial opportunities which present themselves and hopefully, therefore, the income and/or capital return on the land.

> **“HMRC is increasingly active in its attempts to deny BPR on non-agricultural assets”**

Risk aware

In my experience, and perhaps understandably, the vast majority of farmers assume that, because they live on farms and are farmers, regardless of what they do on the land, they will secure APR and BPR and the manner of the conduct of the business will not prejudice their eligibility.

They do not perceive IHT as a problem or something that will trouble them in terms of passing on assets to the next generation, whether in lifetime or on death.

As advisers and practitioners, we know that this is not the case, and we need to highlight the potential risks that diversification can bring. Certainly, we need to help our clients maximise the value of their assets and their income from those assets.

Equally, we need to warn them of potential pitfalls and help them assess and manage the risk (of losing APR and potentially BPR).

While acknowledging that agricultural diversification schemes can

Making the most of it

How can advisers help clients maximise their commercial opportunities, yet still secure the tax reliefs?

Professional advisers, i.e. accountants, lawyers (both property and tax lawyers), land agents and financial advisers need to work together. Ideally, when land and buildings are acquired, all of the advisers should be involved with the client in determining how the arrangements are best structured.

Various issues need to be addressed, including:

1. Should the acquisition be by:
   - the farming partners as individuals (so the land is held 'off' balance sheet); or
   - by the farming partners as partnership property (so that the property is held 'on' balance sheet) with then (to the extent that APR cannot be secured) the potential for BPR; or
   - by some of the partners - perhaps the younger generation?
2. Is the land purely agricultural and to be used as such or is there 'hope value' which is likely to be exploited?
3. Are there cottages/houses/other buildings likely to be let off as surplus to the requirements of the core business?
4. Are there buildings with potential for development for sale/for retention for alternative use/for retention to let?
5. How will the acquisition affect the terms of any partnership agreement?
6. How will the acquisition affect the terms of any wills?
7. How are the financing arrangements going to be structured? Is the lender looking for alternative or additional security?
8. In relation to any borrowing, are there assets within the ownership of the client that are not attracting APR/BPR which, for example, could be provided as additional security so as to leave assets attracting APR/BPR mortgage free (so as to maximise APR/BPR)?
9. If non-agricultural use is going to be an element of the business, for example, equine use/liveries/let cottages, is there the potential to improve BPR eligibility using the principles referred to in *Brander*?

The overall enterprise needs to be reviewed. To the extent that income is potentially investment income, the client should try to ensure that the core trade outweighs any investment element. If a claim for APR might fail, then a claim for BPR must not.

Remember, that in terms of securing BPR, the enterprise has to be commercial, there has to be a trade and there has to be activity.

provide a welcome and crucial capital/income stream to supplement that of the traditional farming business, there are tax issues. If APR is to be lost, then, to minimise the IHT liability, BPR must be secured.

Proactive accountants, lawyers, land agents and financial advisers need to work together to provide their landowning clients with practical advice as to how any risk areas are best managed.

So, what are these risk areas?

They will vary from farm to farm and business to business. The BPR eligibility issues surrounding caravan park developments are well documented. Clearly, running a caravan park involves non-agricultural use, but depending on the degree of services provided to the site occupants, there is scope for securing BPR.

Similar considerations arise in respect of liveries, perhaps developed and run alongside the farming business. There are apparently 1.35m horses in Britain owned or cared for by 720,000 people. Not all of the owners own land and liveries can and are a lucrative and obvious area for diversification.

> **This is an area where there are huge opportunities for advisers to provide 'added value'**

The nature and the extent of the equine operation can, however, have a direct impact on eligibility for both APR and BPR.

Lettings of surplus houses and cottages on holiday/assured shorthold lets have been under scrutiny in recent years in the context of eligibility for BPR.

We now have helpful principles established in *Farmer* and *Brander*, but the nature and treatment of rental income receipts and expenditure on let properties has to be dealt with appropriately if BPR is to be secured.

What the landowner is doing on the land and in the buildings directly affects eligibility for APR and BPR and needs to be established before the risk can be established or quantified.

We can only assess the risk if we know the position 'on the ground' – itself often a changing scenario.

Activity monitor

How is APR secured?

The statutory provisions are contained within ss115 to 124 of the Inheritance Tax Act 1984 (IHTA) (as amended), with further explanations provided in the inspectors' manuals.

APR is available on the agricultural value of agricultural property.

As well as the nature and agricultural value of the property itself, there has to be use/occupation for agricultural purposes and there has to be a degree of activity in relation to that use/occupation.

Occupation need not be exclusive; it can be shared, for example, by way of the landowner's involvement in a partnership or a share farming arrangement. However, activity is very important.

If the use of any of the elements of the land/buildings is not agricultural and the occupation is not for the purposes of agriculture, then APR cannot be secured. If then, any IHT relief is to be secured, the taxpayer will need to be able to satisfy the BPR criteria.

In any valuation, not all of the value will necessarily be agricultural. To the extent that it is not, then BPR is crucial.

How is BPR secured?

BPR rules are contained in chapter I part V of the IHTA 1984, again, as supplemented by the manuals.

Ownership and use for the purposes of a trading business are crucial. HMRC is increasingly active in its attempts to deny BPR on non-agricultural assets, as evidenced by the case law, and by the questions being asked of personal representatives in the APR and BPR claim forms filed in connection with probate applications.

With land values having increased so significantly in the past five years, the potential for a significant IHT liability is so much greater if HMRC succeeds in denying the taxpayer/his estate any APR/BPR.

There are many things that advisers can do to help their clients maximise their commercial opportunities, yet still secure the reliefs (see box).

However, there are a few potential danger areas.

It is perhaps surprising that a non-farming owner of bare agricultural land, used for agricultural purposes, purchased as an investment, and let on a farm business tenancy, can secure APR at 100 per cent after seven years ownership of the land.

Compare and contrast the owner of a small traditional farm, who has farmed all his life, with, perhaps, his son, farming in partnership with him where, say, surplus cottages are let (perhaps on assured short-hold tenancies) to third parties.

The cottages would not attract APR and it might be difficult to secure BPR unless it can be argued that the rental income is trading income treated as partnership (not personal) income.

If treated as personal income and if the farm is 'off' the balance sheet, there is likely to be no APR and no BPR.

These cottages can be very valuable and this is a tricky area.

Similarly, in relation to derelict/unoccupied farm cottages/buildings, a claim for APR/BPR will be weak as there will be little or no proof of agricultural value/occupancy or agricultural or business use.

In terms of an equine livery business, will the income be considered to be trading income or investment income?

> **"To secure BPR, the enterprise has to be commercial, there has to be a trade and there has to be activity"**

A business merely letting stables and grazing (as with DIY livery) is much more exposed in terms of eligibility for BPR than is the serviced livery involving the provision of feed, mucking out, and general management activity on the part of the landowner.

The facts of each case will be investigated in relation to any claims. To include an element of training riders and breaking or training horses will denote commercial activity and trading income and therefore enhance the prospects of securing BPR.

Strategic plan

So, what am I advocating? Essentially, a regular review of the detail of clients' activities and a 'joined-up' approach on the part of the professionals.

The accountant is perhaps in the best position to 'promote the cause' of ensuring that clients secure APR and BPR, having regular year in, year out contact and being the one with first-hand knowledge of income/expenditure, sources of income and of capital expenditure (or its purpose). The accountant is also the one with the opportunity to ask questions as to where the business is, where the business is going, and how the owners of the business plan to achieve their business objectives.

Accountants, architects, planning consultants and land agents are likely to know at an early stage about proposals with regard to diversification involving planning regulation.

That is the stage when securing valuation and legal advice would be important and that advice should be sought before (and not after) proposals become a reality/planning permission is granted.

I also advocate a regular review of not only the business operations, but of all documents relevant to the farm and the family, for example, deeds, wills, partnership agreements, and tenancy agreements.

Out of any review there will invariably follow opportunities, not only to look at the APR and BPR issues, but also look to the future and succession planning for the family.

A general review can chart a way forward for future generations and encourage the family to work to a strategic business plan where older and younger generations and their expectations marry up and dovetail.

This is an area where there are huge opportunities for advisers to provide 'added value'.

Farm tax is complex and farmers often fail to appreciate the ramifications (in tax terms) of their actions.

As advisers we owe it to our clients to alert them to the risks/help undertake risk assessments. There does have to be considered the cost of not only assessing risk but perhaps then implementing advice.

Are our clients prepared to pay for advice? Perhaps not (or perhaps reluctantly), but what is the cost to them if they do not? ■

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