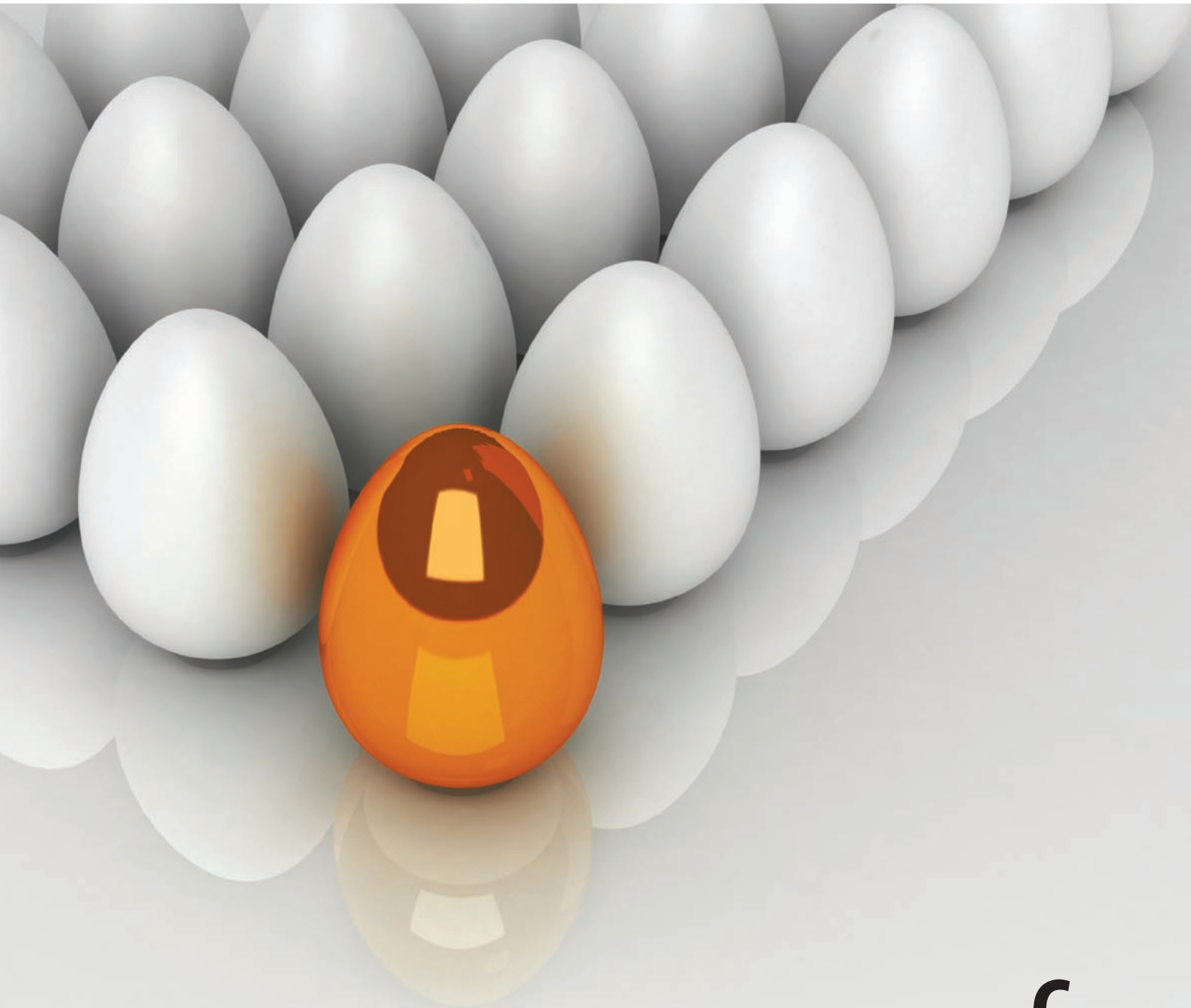


How can “Farmer” help the farmer?

mfg Solicitors: A new shape of lawyer





By Alan Neal

The rather cryptic title to this article refers to the case of Farmer and Giles (Executors of Farmer Deceased) v Inland Revenue Commissioners. One perhaps could not choose a better name for a case relating to agricultural tax than have two taxpayers called “Farmer” and “Giles”!

The facts of the case are as follows:-

1. Mr. Farmer and Mr. Giles were the executors of Frederick Farmer deceased who died on 30th April 1998. The deceased ran a farm known as Home Farm. For many years he had farmed the entire farm himself in hand. For good commercial reasons he had diversified and in particular had let a number of the buildings for non agricultural uses. At the time of the deceased’s death the Home Farm comprised about 449 acres of which 274 were arable, 60 acres grassland, farmhouse farm buildings and incidental land of about 9 acres, woodland of 98 acres and rented properties of about 8 acres. The farm had remained very much unchanged during the eight years prior to the deceased’s death.



2. The farm was run as one business with all income and expenses going through the one trading bank account and being recorded in the Home Farm accounts. In other words the business comprised not only the income from the farming but also the rental income from the various investment properties.

3. At the time of Mr. Farmer’s death there were 23 separate tenancies on the farm, one an agricultural tenancy of a farm cottage occupied by a former farm worker, six of original farm cottages but at the time of death let out to non farm workers, four tenancies of original farm buildings or barns let out to small businesses, four let out for non agricultural storage, three for mobile homes, two for stable blocks, one for grazing, one a separate bungalow let with some stables and grazing land, one a prefabricated bungalow and finally some redundant land let for the storage of timber.

There was therefore considerable diversification since of the 23 tenancies only one of these, namely the cottage let to the former farm worker, was actually related to the farming business. The residential lettings were all shorthold tenancies for either six months or one year. The commercial lettings were generally on leases where statutory protection had been excluded.

The tax issues were therefore very stark since HMRC were determined to tax the non farming assets which had arisen as a result of diversification.

The taxpayer claimed Business Property Relief (BPR) for Inheritance Tax (IHT) purposes on the entirety of the enterprise. That would have relieved the entirety of the property from IHT. HMRC denied BPR on the non farming assets and were claiming that they were investments, and thus subject to IHT. In simple terms the difference between the two positions was that the taxpayer said that one needed to look at the entirety of the enterprise and consider that as an overall business entity notwithstanding the fact that they were elements of it that were pure investment, whereas HMRC said that one needed to look at each individual aspect of the enterprise and examine whether or not each particular part qualified or failed to qualify for BPR.

Pleasingly the Special Commissioner found in favour of the taxpayer and came up with five tests that she said needed to be applied to ascertain whether or not there was a single business entity to which BPR could be applied. These tests are as follows:-

1. The capital test – This involves comparing the value of the capital assets used in the business as against the capital value of the investments.

2. The turnover test – This involves looking at the turnover produced from the farming business as against the turnover produced from the rents or other investment income.

3. The net profit test – This involves looking at a similar comparison of net profit.

4. The employee involvement test – An assessment needs to be made as to the amount of time spent by employees on the one hand in the farming business, and on the other, looking after the investment properties.

5. The overall view of the activity test – This requires one to stand back and take an objective view of the position as a whole rather than looking at the constituent parts.

In this particular case the Special Commissioner decided that the taxpayer qualified in each respect. It is clear, however, from the decision that to win one does not need necessary to tick all of the boxes but there must be a preponderance of tests that are satisfied and in particular the fifth, namely the overview of the entire business enterprise, is critical.

What worked particularly in favour of the taxpayer in this case was the fact that notwithstanding the diversification of the enterprise, everything had been dealt with through a single business account and run as one business entity, and the fact that all of the properties being let out for investment purposes had formerly being used within the farming business but subsequently diversified out for financial and profit reasons. There were no new investment properties that had not previously been used within the farming business.

In other words not only had the farming profits but also the rental income been paid into a single business bank account and out of that had been paid the costs of running the farming business e.g. labour, fertilizer, crops etc and also all outgoings in respect of the let premises e.g. insurance and repairs. The taxpayer's accounts reflected a single enterprise and the reality has the same namely that this was run as one business activity.

Because the elements that were investment rather than business were in overall terms not significant, BPR was given on all assets. Had it been that the Special Commissioner found that there was a business but that the non business elements were significant then BPR would have been apportioned between the two separate elements and tax would have been paid on an element of the investments. Significant is usually defined for tax purposes as more than 20%.

This case is of fundamental importance to farmers and those involved in agriculture and rural businesses if they are not to lose the benefit of important IHT reliefs.

Comparison should be made at this point between Agricultural Property Relief (APR) and BPR. APR is given on the agricultural value of land, buildings, cottages and farmhouses, whereas BPR is given on business assets.

Inevitably in a farming or rural business situation the two can overlap since land, buildings and cottages could qualify both for APR and BPR (I will say more about farmhouses below).

If both are available, APR is considered before BPR and insofar as APR is not available then BPR can apply. There are two potentially important aspects of this, first the fact that APR is only given on the agricultural value, which is a hypothetical value which presupposes that the particular agricultural property can only be used in perpetuity for agricultural purposes, whereas BPR is given on the full market value. Consequently if one owns a barn in respect of which there is planning permission for conversion to residential use, APR can only be given on the value of the barn as a barn, whereas BPR can be given on the full market value if it also qualifies as a business asset.

The second difference is that as APR is restricted to agricultural property as I have described above, BPR is given in the much wider context and can include incidental assets used within the overall business context even if they are not actually being used for agricultural purposes, as in the Farmer case.



I am sure that in the Farmer case APR was given on some of the assets. This is not clear from the case as it was not actually relevant to the decision. The critical issue for the taxpayers was to obtain BPR on the non agricultural assets and hence relief on the full market value.

We have just successfully settled a large case for a client where we have used Farmer in circumstances not dissimilar from the case, though where we were not able to satisfy all five tests. The critical issues that were apparent in the Farmer case and in the case that we have recently successfully argued, are the fact that the business is run as one entity and that there is no separation of activities. Interestingly in the case that we have successfully settled, the farm was being run through a contract farming arrangement and not being farmed in hand which was a significant difference between the two cases. However, the contract farming arrangement did provide for an element of financial risk for both farmer/landowner and contractor and we were able to prove from both verbal and documentary evidence that the farmer/landowner was significantly involved in the day to day decision making in relation to the contract farming and that this was not a case where the farming activities were simply left to the agent or the contractor to undertake with little or no input.

One of the problems with which we are frequently faced is having to argue the situation after death when IHT is payable, since it is not possible then to rewrite the history books. If it is that a particular farmer has diversified but has set up separate business accounting records, and the entities perhaps traded under separate names, or possibly in different formats e.g. a partnership, company etc then that would be fatal to a Farmer argument. What is absolutely critical in these circumstances is that planning is done in advance and at least two years in advance as there is time qualification requiring for both APR and BPR.

Furthermore it is vitally important that not only the accounts, but also the activities reflect the actuality of one business run as one entity for commercial purposes.

I promised above that I would return to the farmhouse. Except in one limited extent to which I will refer, BPR is not available on the farmhouse since the prime use for the farmhouse is as residential accommodation.

It is vital that APR is secured on the farmhouse in order to establish the overall business context and equally to obtain relief on what will be a substantially valuable asset. It is likely, however, that there will be some disallowance of tax relief because of the difference between market value and the agricultural value. The only element of the farmhouse in respect of which BPR may be obtained is any part that has been specifically dedicated to business rather than residential purposes e.g. if there is a designated part of the house set aside as the farm office.

If you are thinking of diversifying or if you have diversified you need to take advice on the structuring of the business to ensure that reliefs are maximised and so far as possible come within the Farmer case in order to get relief on the entirety of the business activity including former agricultural assets now used for investment purposes. We are in the process at the moment of acting for a number of clients where we are advising on restructuring of business entities to ensure that Farmer tests are complied with as far as possible.

If you wish to seek advice in relation to this please contact either Alan Neal or Gary Priest at our Halesowen Office.

Call: 0845 55 55 321 for further information