The tax landscape of farming

OMB Personal tax



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In the first of a three part series on farming tax, Michael Steed asks how to define farming and considers the farming tax landscape

Key Points

What's the issue?
Farming clients can have relatively complex tax affairs, especially with diversified business models.

What does it mean to me?

The definition and scope of the farming and related trade rules needs to be carefully analysed for a particular set of client circumstances.

What can I take away?

We need to carefully check if a client is farming, or whether they have moved into other tax landscapes, where the tax rules will be different.

It ought to be fairly straightforward. If a taxpayer is farming, as defined in the legislation, then the basic farming tax rules will apply. Farmers can have some standard reliefs, such as farmers' averaging of profits, loss set-off against general income (subject to the hobby farmer rules) and the availability of the herd basis (where the production herd sits on the balance sheet, rather than in the trading account). They can have business asset disposal relief on sale or retirement (subject to the rules). They will probably mostly make zero-rated supplies for VAT; and on retirement or death, they should be able to claim the two leading inheritance tax reliefs of agricultural property relief and business property relief. In practice, it can be far less simple than that.

What is farming?

Farming is defined in both the Income Tax Act 2007 and Corporation Tax Act 2010 as essentially being 'the occupation of land wholly or mainly for the purposes of husbandry but excluding any market gardening'. It is worth noting that this applies to activities in the UK.

This can cause a bit of confusion for beginners, as some reliefs and restrictions only apply to farming and others are extended to similar activities, such as market gardening. For example, restriction of loss relief (see below) and farmers' averaging also applies to market gardening, notwithstanding the basic definition.

The basic definition creaks too, as technology has moved on and the legislation is slow to respond. Would dairy cows being raised and milked in big closed barns with no access to land specifically be farming, as opposed to a trade? Is growing salad crops in a vertical farm classified as farming or merely a trade? What about fish farms that are urban-based? The core of this is to understand what the words actually mean.

'Occupation of land'

This does not generally cause a problem for a famer who lives on the farm and farms it.

It is less clear if, say, the farmer lives in the farm but rents some land out to another farmer.

It’s quite common, however, for a farmer to be farming and to do something else, such as contracting, and this is a separate trade if it’s done on any appreciable scale.

We will revisit this in the second article as part of diversification (intended or otherwise).

Farming outside the UK

There is something odd too about the basic definition and that is the territorial aspects. Husbandry conducted on land outside the UK is not automatically treated as a trade for tax purposes (see BIM55095). It will depend on the facts. But farming outside the UK will be subject to the five year loss-relief hobby-farmer rules because the definition of farming for loss-relief purposes does not have territorial restrictions.

Wholly or mainly for the purposes of husbandry

Let’s go back to the definition of farming for a minute. ‘Husbandry’ is not defined in the legislation and should be given a common sense interpretation. This would include activities normally recognisable as farming, such as growing crops (tillage) and the raising of farm livestock.

The definition does presuppose a connection between the activity and the occupation of land, which goes beyond the mere use of the land as a site for the activity. So to fall within the statutory definition of ‘farming’, the produce of the activity must have some husbandry origin in the land occupied by the person carrying on the activity.
Therefore, an intensive enterprise – in which livestock are kept entirely separate from the land (for example, entirely indoors or, in the case of fish farming, in tanks) and fed entirely on purchased feed – is not farming (but it is clearly a trade).

Let’s think again about dairy cattle kept permanently in sheds. Is that farming (if cattle are fed on hay and silage that is grown on the farm, thereby having husbandry origin in the land)? Or is it a trade (and not farming) because all of the

feed is brought in? This will depend on the facts.

In CIR v The Cavan Central Co-operative Agricultural and Dairy Society [1917] 12 TC 1, butter made in a co-operative buttery from milk supplied by its farmer members was held not to have a husbandry origin. ITA 2007 s 996 also helps us. It provides that husbandry includes hop growing, breeding and rearing of horses (and associated grazing) and short rotation coppice.

Another example which could cause difficulty is ‘rewilding’ projects, where animals are introduced to land and are basically left to their own devices. Would that be farming as defined? Again, this will depend on the facts. If the animals are slaughtered and sold as meat, that would be farming. If not sold for meat, then it is less clear that this would be farming.

The significance of the definition of farming

The definition of farming is significant because a number of statutory provisions apply, or refer, specifically to farming. These include:

- all farming is treated as a trade and all farming carried on by a particular person (or partnership) is treated as a single trade;
- averaging of profits (not restricted to farming);
- herd basis (although not restricted to farming); and
- restriction of loss relief where losses are incurred in the five previous years (not restricted to farming).

The significance of this is that it is very easy for farmers to want to diversify into other areas, such as contracting, rental properties, glamping, renewables, etc.

However, you can quite quickly lose farming status, as the farmer will no longer be wholly or mainly in occupation of the land for the purposes of husbandry. This could also easily happen when a farmer wants to partially retire, so inheritance tax reliefs may be in danger.

The herd basis

Farm animals are normally dealt with as trading stock. However, some farm animals are kept by farmers not primarily for resale but for the sake of what they produce, such as offspring (lambs and piglets), milk and eggs.

These are in many ways more like the farmer's capital assets. The herd basis allows a herd or flock of production animals to be excluded from trading stock and treated instead as a capital asset on the balance sheet. This balance sheet treatment is also permitted for animal breeding and fish farming (which are trades and not farming). The legislation is in Income Tax (Trading and Other Income) Act (ITTOIA) 2005 ss 111-129 and CTA 2009 ss 109-127.

If a farmer elects for the herd basis (and it is normally in point when a farmer first acquires a herd or flock), then the following provisions apply:

- The initial cost of the herd is not an allowable deduction, nor is the cost of any subsequent increase in herd size.
- The net cost of replacing animals in the herd is an allowable deduction
- (including the cost of own-bred animals).
- Where the odd animal, or just a few animals, are sold from the herd and not replaced, the resulting profit or loss is taken to the P&L.
- Where the whole herd, or a substantial part of the herd, is sold and not replaced, the resulting profit or loss is not taken to the P&L (this is a quid pro quo for no tax relief on acquisition).

Therefore, an ageing dairy farmer who had adopted the herd basis when they first went into dairy could dispose of the herd tax-free on retirement.
Averaging fluctuating profits

The fate of many farming enterprises is written in the skies, so farmers are able to elect to average their profits over either two or five tax years (see ITTOIA 2005 ss 221-225). These claims can be made if the profits for one year are less than 75% of the other and can provide valuable smoothing tax relief for farmers who may be subject to different tax rates year on year. However, for the purposes of the averaging provisions of ss 221-225, the definition of 'farming' is extended to include market gardening and the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption.

Loss relief

Loss relief for farmers has always caused problems. There is a general right in tax to offset trading losses against other income, but farming (which includes market gardening for this purpose) has always had an extra layer and that is the loss of sideways loss relief after five consecutive tax years of losses (the so-called 'hobby-

farmer rules’).

The basic shape of sideways loss relief for farmers is that you make a normal ITA 2007 s 64 relief claim for farming losses to be offset against general income. However, the relief potentially evaporates after five years because of the rules in ITA 2007 ss 67 and 68, which generally stop a sideways loss relief claim from year six onwards, so from that point onwards the farming losses can only be carried forward.

However, there is an important get out of jail card in s 68, which is the ‘reasonable expectation of profits’ test. This essentially says that the five year restriction won’t apply if the expectations of a competent farmer would be that future profits will reasonably be made, but a competent person carrying on the activities at the beginning of the prior period of loss could not reasonably have expected the activities to become profitable until after the end of the current tax year.

There has been a battery of case law about the true meaning of these rather obtuse words. In this back to basics article, it’s sufficient to say that a tax adviser would need to research this area carefully before giving advice (see French v HMRC [2014] UKFTT 940 and Scambler v HMRC [2017] UKUT 1 as examples).

It’s also important to note that although the legislative heading above ITA 2007 s 67 refers to hobby farmers, this is unhelpful because the rules equally apply to full time professional farmers. The phrase does not appear in the text.

In the next article of this three-part series, I will examine the complexities of what happens when farmers diversify.