A diverse farm life

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In the second part of his series on farming tax, Michael Steed looks at some common diversification projects, but counsels caution on the possible loss of traditional capital tax reliefs

Key Points

What is the issue?

Diversification for farming clients can be very attractive, but it may have tax downsides.

What does it mean to me?

A diversification project needs careful analysis – is it trading or is it investment? What long term capital tax implications does that hold?

What can I take away?

We need to carefully check that we have examined all of the possible tax consequences of a diversification project.

Many farms in the UK have diversified into other commercial on-farm ventures, or are considering doing so. Using the farm's property assets for different purposes is an easy starting point and then there are the more esoteric projects, such as llama walking and rewilding.

What I want to do in the second of my Back to Basics articles on farming is to look at some of these and ask some basic questions about the tax consequences of such projects. I'm going to stick to on-farm diversification, as opposed to, say, running a different trade from the farm, such as agricultural contracting.

The letting of property

An obvious diversification from traditional farming is letting spare farm property. This could be as simple as letting a spare barn to third parties. But this instantly raises questions about whether such activities constitute an investment business, rather than farming, and what effects it could have in the future.

I'll come back to this point in respect of agricultural property relief (APR) and business property relief (BPR), but suffice to say that short term letting of buildings will not adversely affect farming status. However, medium and longer term property letting is clearly not farming and this pushes the activity into the investment parish.

The immediate direct tax consequence is that this will be income from land and not a separate trade; and that the VAT consequences will also need to be considered – this is an exempt supply for the farmer and will result in the farmer being partially exempt, so regular VAT calculations will be required. The farmer could opt to tax any let commercial buildings to increase VAT recovery on directly related input tax.

If the property is residential, this is also income from land and also an exempt supply for VAT. It is not possible to opt to tax residential property.

Furnished holiday lets

One of the more common diversification projects is the creation of furnished holiday lets accommodation on farms. This is a good plan following Covid-19, as overseas holidays are more difficult to achieve at the moment, but the tax consequences need to be looked at.

Good outcomes include the furnished holiday let business being treated as a trade for income tax purposes, so capital allowances are available on residential qualifying items and profits are relevant earnings for pensions purposes.

They also accrue good capital gains tax outcomes too: business asset disposal relief, roll-over relief and gifts relief apply.

Furnished holiday lets are standard rated for VAT.

The bad news is inheritance tax. HMRC will stoutly maintain that furnished holiday lets are investment properties under Inheritance Tax Act 1984 s 105 (citing the case of HMRC v Pawson [2013] UKUT 50), so the trade-off is the long-term loss of inheritance tax efficiency. We will look at mixed businesses further below.

The only glimmer of hope is the case of Graham v HMRC [2018] UKFTT 306, where the provision of extra services gained the approval of the tribunal, but this was a rare taxpayer win.

Glamping and camping

Glamping and more traditional camping are perennially popular, and the outlay costs for camping are relatively modest. The first question is whether this is a trade (it’s clearly not farming) or whether it is income from land.

There is no simple answer as it will depend on the facts.

It is possible that glamping might be a B&B trade; or it might be a furnished holiday let business. On the other hand, it may be simply income from land and not a trade at all.

And then there is the capital allowances position. Are tents apparatus that is used in a trade? Or if not, will they qualify for the structures and buildings allowance? There is no obvious authority on the capital allowances on this.

It is interesting to note that holiday caravans do qualify for capital allowances, so a shepherd's hut would probably be OK (see Capital Allowances Manual CA22100), but fixed pods would probably not.

And then there's the VAT: the provision of camping is standard rated for VAT, so VAT must be charged, but at least it helps a possible partial exemption problem.

Livery

Let's now look at another fairly common diversification project – livery and stabling for third-party horses. Is this part of the farming operation or a separate trade?

There are a number of possible permutations. It could be as simple as renting a stable and field, with the owner doing all of the work. Or it could be that the farmer is offering livery services with the associated sale of hay and straw for bedding.

How does this work for tax? Is this still farming? I think that's unlikely unless it's a short term grazing licence, where the owner is effectively responsible for the grass crop. If not, then it is likely that this will be income from land. It will again depend on the facts and the effect on long-term agricultural property relief and business property relief will need to be considered (see below).

Another area to look at here is VAT. What is the VAT treatment of this activity?

At its simplest, the renting of a stable and land is an exempt supply of an interest in land, but this will make the farmer partially exempt and VAT calculations will be required. The farmer could opt to tax the land and avoid the partial exemption issue, but this would increase the VAT loading on the horse owner.

In the alternate example (and depending on the facts), the farmer could be offering the use of facilities, which is standard-rated.

The feed issue needs to be considered too. Animal feed is zero-rated but not when supplied in conjunction with other supplies, which could constitute a single standard rated supply of livery services.

Are there long-term tax risks?

Basically, yes! A key message in this article is long-term risk recognition for capital taxes. The two key inheritance tax reliefs – agricultural property relief and business property relief – need to be kept firmly in mind, as diversification could materially affect these much admired and used reliefs.

This is not an in-depth review, so suffice to remind ourselves that they are inheritance tax only and therefore not capital gains tax (which would need to be considered for lifetime disposals). For farms, they often work together, with agricultural property relief covering the basic farm and with business property relief as a top-up for the non-agricultural property relief assets, such as livestock and deadstock.

The significance of this is that agricultural property relief is only available for 'agricultural property' in Inheritance Tax Act 1984 s 115. This section and the associated HMRC manuals merit close attention for any farming tax adviser.

It covers the land and buildings, including the farmhouse (but only of a character appropriate to the land); and very significantly, it is only available to a person characterised as a 'farmer'.

This means that the person must be in occupation of the land; and critically, the purpose of the occupation must be mainly for 'husbandry'. This needs to be taken into account for long-range tax planning, as diversification may easily mean that the person is no longer in occupation for the purposes of husbandry.

This principle was tested in the case of Gill v HMRC [2019] UKFTT 0650, where HMRC denied agricultural property relief on the farmhouse, as the Commissioners contended that Mr Gill was not an active farmer. HMRC also denied agricultural property relief on the farm buildings because it did not consider them to be occupied for agricultural purposes. In the event, the tribunal found for Mr Gill's executors, but it does remind us of the need to audit diversification projects.

Business property relief

The partner in crime to agricultural property relief is business property relief. It must also be considered for diversification projects. Long-term residential letting can create long-term inheritance tax issues.

The famous inheritance tax cases of Farmer [1999] STC (SCD) 321 and Balfour [2010] UKUT 300 examined mixed estates and whether such estates could qualify for business property relief. The courts in both cases held that they could qualify if the mixed business was still farming ‘in the round’.

In the more recent case of Vigne [2017] UKFTT 632, the First-tier Tribunal granted business property relief on a 30 acre livery business that offered significantly more than a simple right to occupy land. The livery business also offered valuable services for the benefit of horse owners, such as providing the horses with feed and worming products as well as a daily check.

Conclusion

As ever in tax, good peripheral vision and the ability to look over the hill are key attributes for advisers and the balance of the short-term advantage against long-term disadvantage will need to be carefully weighed.