Employee accommodation: converting disused buildings

Employment Tax



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With a crisis in staff shortages threatening the farming industry, we consider the tax implications of converting disused farm buildings to residential accommodation.

Key Points

What is the issue?

When a farm or equine business is trying to survive and looking to recruit a member of staff from outside of the area, building more workers dwellings so as to provide assured accommodation can be vital.

What does it mean for me?

The business will need to meet certain criteria to prove that they have a genuine requirement for the dwelling with an appraisal comprised of two key tests: the functional test and the financial test.

What can I take away?

The application must demonstrate that the business can sustain the worker based on at least minimum wage. The applicant must also be prepared to embrace a complex tax position in the round when embarking on such an application.

There have been many headlines in the farming industry regarding the shortage of staff and the problems that creates. *Farmers Weekly* recently reported on the labour crisis in dairy farming, stating that one in 20 farmers were taking steps to cut the number of milkings and 6% to reduce herd size as a direct result of staff shortages. Dairy co-operative producer Arla Foods reported that: ‘If nothing changes, 12% of dairy farmers said they will quit the sector in the next year.’ The shortages throughout the farming industry are also experienced by the equine industry.

When a farm or equine business is trying to survive and looking to recruit a member of staff from outside of the area, the provision of accommodation will be of extra importance. The answer to help the problem can be building more workers dwellings so as to provide assured accommodation.

In June, there was an announcement in Blackpool by Boris Johnson of the lifting of restrictions on the conversion of disused farm buildings to residential accommodation. (As with so many issues, we wait to see if this will be pursued under the new administration.) Even so, building farm and equine worker accommodation does have delays, and some farms and equine businesses will have to put workers in rented local accommodation to cope.

Genuine requirement for staff accommodation

It is assumed that the owner of the farm or equine business already lives on site and requires an extra dwelling. In line with the National Planning Policy Framework, planning policies and decisions aim to avoid the development of isolated homes in the countryside except in certain circumstances. One of these exceptions is if ‘there is an essential need for a rural worker, including those taking majority control of a

farm business, to live permanently at or near their place of work in the countryside’.

However, the business will need to meet certain criteria to prove that they have a genuine requirement for the dwelling. This might seem an extra burden to a large number of rural businesses who are very short of staff. The same principles apply whether the accommodation is for an equestrian or an agricultural worker.

To prove that the business meets these criteria, a planning application would need to include an agricultural or equestrian appraisal, alongside the planning application forms and plans or drawings. The local authority may also require additional documentation as supporting evidence.

These requirements show the clear role of the tax adviser in the exercise of trying to recruit enough staff and build more accommodation. The tax considerations of building new staff accommodation are of significance to the overall cost of the business; for example, claiming the input VAT on construction and the potential benefit in kind for the staff when living in the new accommodation.

VAT and employee benefits

The construction has potential VAT and benefit in kind advantages and also tax traps. ‘New build’ is zero-rated for VAT purposes, which can have obvious advantages. On a new build, the contractor will agree to zero-rate the supply of labour and materials because it is a new residential property constructed from bare land.

The potential for a benefit in kind on all accommodation has to be submitted via a P11D form. Eligibility for exemption from paying any benefit in kind tax by the employee has to be reviewed in depth. The key conditions that need to be in place to achieve the tax-free benefits in kind for the farm and equine employees are dependent on proper and better performance of the employee’s duties and also the customary provisions.

Traditionally, farm workers have qualified for tax-free job-related accommodation, but can this benefit still be enjoyed with the move to diversification? The conditions for job-related accommodation are where:

- it is necessary for the proper performance of an employee’s duties that he should reside in the accommodation (Income Tax (Earnings and Pensions) Act

(ITEPA) 2003 s 99(1)); and
- the accommodation is provided for the better performance of the duties of his employment and he is in one of the kinds of employment in the case of which it is customary for employers to provide living accommodation to employees (ITEPA 2003 s 99(2)).

Where cottages are occupied by farm workers working wholly for the business, who are carrying out farming activities and living there in a rent-free capacity, then the input VAT on expenses in relation to the farm worker's cottage can be claimed. If, however, the work carried out by the employee is connected to exempt activity supplies, then the input VAT should be apportioned or included in the partial exemption calculation as residual input VAT.

As part of tax planning considerations, if a cottage is to change use and be let out, the timing of this needs to be considered and maximum use should be made of the farm worker status within the strict rules that are associated with the advantage.

Agricultural or equestrian appraisal

The appraisal (that is needed for planning permission) is essentially a review of the business and is comprised of two key tests: the functional test and the financial test.

The functional test

The functional test assesses whether there is a genuine need to have an additional member of staff living on site (and therefore within sight and sound of the equine yard) on a full-time, year-round basis for animal welfare, security, etc. It is based on a system of standard man days (known as the SMD system). A person is expected to work at least 278 standard man days or 2,225 hours of labour a year.

To justify a further dwelling and assuming that one person is already fulfilling the above requirement, the business would need to be looking at a total number of days or hours at double this level to pass the functional test. Consideration would be given for holidays, sick days and time spent not working.

It is recommended that a professional produces the appraisal, even if the business itself does the rest of the work. There are industry standard figures for each sector. To undertake a quick check that the business must meet the required level, the

detail would need acreage and a breakdown of number of animals. For equine, this would include full livery, part livery and activities such as breaking and training and so on. For farming, the information should be readily available from the internal recording, especially in, say, the dairy industry.

The financial test

The financial test is about assessing the viability of the business, making sure that it can continue to produce a sufficient profit to retain the new member of staff in the long term. This aspect of the test would be carried out with the help of an adviser, based on three years of accounts and forecasts for two years, for a permanent dwelling. (For new businesses, there are different requirements and they would be likely to be applying for a temporary dwelling in the first instance while the business establishes.)

The application must demonstrate that the business can sustain the worker based on at least minimum wage. Often £20,000 as a minimum profit is considered and then the funding for the proposed dwelling is considered separately. With the loss of subsidies and all the problems facing farming, this could be difficult.

Other considerations

It is key for the functional and financial tests to be considered in tandem, so make sure that there is good communication from the outset between the client, planning consultant and adviser to maximise the chances of success.

In terms of the type of residential dwelling, if there is a suitable barn for conversion this is an option. However, often all existing buildings are utilised by the business so a new build dwelling would be more appropriate.

Any dwelling would be subject to an occupancy restriction and the size would need to be appropriate. As mentioned, a new dwelling could qualify for the zero-rate VAT of a ‘new build’ and this should be given serious consideration to ensure there is compliance as best utilisation of VAT planning.

There are problems due to the fact that the tests in national parks are ever more demanding but again this was mentioned in the easing of restrictions.

Inheritance tax and capital gains tax on the worker’s cottage

The farmer or equine worker’s cottage should qualify for inheritance tax relief should the owner die, which is an attractive tax advantage. Likewise, should the owner sell, the business asset could qualify for rollover relief and business asset disposal relief, provided it meets all the conditions. As with all changes to the farm or equestrian establishment, the impact on inheritance tax and capital gains tax should be considered.

It might be considered that obtaining the planning permission will be time consuming and arduous. However, obtaining more buildings in the farm and equine business has financial and tax advantages, whilst potentially increasing the value of the farm. The main immediate ‘benefit’ of the extra farm workers accommodation, though, is the ability to attract farm workers from ‘out of area’, which is of most interest – together with being able to present a better package to potential employees.