

Chapter 1

Farming and the need for diversification

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- **Farming and alternative land use**
This chapter explains the need for the tax planner to be aware of the subtle (and unsubtle) tax differences between farming and diversification. What is government policy? Farming attracts unique tax reliefs and rules, eg agricultural property relief (APR), farming as one trade, averaging and the five-year rule for losses. It is currently essential to understand what activity is deemed to be *farming* (agriculture) and what is deemed to be *diversification* (alternative use of land) and what direction the complex tax changes are taking.
- **Protecting against the loss of valuable farming tax reliefs**
With the move to the alternative use of land (diversification), it is essential that all the tax reliefs currently available to the farming industry continue to be used to maximum benefit. The book aims to show how these reliefs can be identified and used effectively and the tax pitfalls of the potential loss of tax reliefs understood.
- **Inheritance Tax Manual (IHTM) Chapter 24**
HMRC issued guidance in February 2009 which helps define what is agriculture and what is not.
- **Tax planning through change**
The move to diversification and the massive changes to the farming industry can trigger tax-planning opportunities and tax pitfalls, and this book attempts to identify these. The HMRC 'Rural Diversification Project' highlights the need for full awareness of HMRC interest into the farming and diversification platform.
- **Understanding the single payment entitlement**
The third edition focuses on farm tax planning and compliance now that the adaptation to the 'single payment scheme' has been made by the farming industry. The full impact of the Common Agricultural Policy (CAP) reform and the Mid-Term Review (MTR) are now understood by farmers and their advisers and the key has to be maximising the tax advantages and avoiding the disadvantages. This is considered such an important subject that it has been given its own chapter (see Chapter 20).

1.1 *Farming and the need for diversification*

THE FARMING EVOLUTION AND CAP REFORM

1.1 The 'single farm payment scheme' (SFP) was effective from 1 January 2005 within the farming community and the transition from the production-based system to 'land management' system of the SFP is extremely complex.

The principal aim of this book is to aid the tax planner to ensure that, with the adaptation of the farming industry to the fluctuations of the last decade together with the acceptance of diversification, tax reliefs of land ownership and agricultural activity are retained, understood and enjoyed to the maximum.

In January 2003 the detail of the CAP reform was published. It included three main reform points:

- to encourage farmers to produce what the market wants, getting away from 'farming for subsidies';
- to remove the environmentally negative incentives of the current policy; and
- to improve and provide encouragement for more sustainable farming practices.

The CAP reforms seek to separate farm subsidy from output and link it to farm size, other sources of income, quality and environmental functions. The aim is to wean UK farmers off subsidies and to make them more responsive to the marketplace.

The single payment scheme replaced ten major CAP payment schemes.

The aim of modulation (see **1.17**) has been the progressive siphoning by the government of direct payments to the funds of agri-environmental schemes and rural development initiatives and plans.

Whilst the loss of production subsidies is bad news for farming in the UK, it has shown landowners that they need to embrace potential opportunities for alternative land use.

The attitude of the farming community to diversification has evolved over the life of this book. When the first edition was published diversification was something to consider for farms. At the time of writing the second edition, diversification was necessary for survival. Now, the landowning community is much more comfortable with a large amount of alternative land use and the future looks brighter for farming at the time of writing.

For the purposes of income tax, the distinction between farming income and non-farming income could appear to be of little relevance until the 'hobby farming' rules are considered. The impact of the definition of farming on other taxes such as inheritance tax (IHT) and capital gains tax (CGT) means that interpretation assumes considerable importance, and borderline situations can create the most problems. This book looks at all these concerns in depth.

The long-awaited guidance on inheritance tax agricultural property relief (APR) is now contained in Chapter 24 of HMRC's Inheritance Tax Manual (www.hmrc.gov.uk/manuals/ihmanual/IHTM24000.htm).

Is the farming unit itself generating a 'true commercial profit'? The question of the use of tax losses is dealt with in Chapter 12.

The main tax benefits available to a landowner of trading are that he can obtain income tax, CGT, IHT and VAT reliefs from running his land as a genuine business. This will be explained in greater detail throughout this book and the underlying principle is the need to obtain/maintain business/commercial status as the key to the enjoyment of the tax reliefs currently available.

At the time of writing, with agricultural land values remaining high and some potential for development profits (despite the crash in development land values in 2008), the landowner has a very valuable capital asset which must be protected from attacks by HMRC. In order to preserve business status, it is essential to understand the definitions of farming, diversification, agriculture and business for tax purposes.

The book tries to provide guidance on the key issues but there are constant changes to the role of farming, alternative land use and the need for food and fuel production and there are colourful tax cases in connection therewith. It is essential to look at these changes and adapt accordingly.

RISK OF LOSS OF FARM TAX RELIEFS

1.2 There are a number of tax reliefs that are unique to the farming industry. A move to diversification could put these reliefs at risk. The question is what tax reliefs can replace them or how can they be preserved?

Examples of these specific agricultural tax reliefs include:

- agricultural property relief (APR) for inheritance tax (IHT) on the farmhouse (see Chapter 4). If the farm is no longer surrounded by land in the same ownership that is principally used for farming, then is the house still a farmhouse?
- APR on the farmland and buildings (see Chapters 5 and 13).
- Job-related accommodation. It has always been taken for granted that farm workers will live in cottages 'tax-free' due to the advantages of 'job-related accommodation'. Will farm workers who move from carrying out farm duties to non-farm duties still qualify for 'tax-free', job-related accommodation? (See **1.15.**)
- Five-year loss rule (hobby farming – see Chapter 12).
- Farmers' averaging of profits for tax purposes (see **1.14.**)
- Agricultural buildings allowances (ABAs) (now being phased out) (see **7.12.**)

Not many pure farming activities are consistently profitable and some form of diversification is necessary in order to achieve overall profitability for the farming unit. This might simply be the letting of redundant farm buildings and cottages, or more radical diversification activities.

1.3 Farming and the need for diversification

The average farm in the UK can be worth several million pounds and the tax risks of not qualifying for IHT reliefs can cost many hundreds of thousands, if not millions, of pounds. This is not monopoly money.

DEFINITION OF FARMING

1.3 'Fiscal farming' is farming that qualifies as farming for tax purposes (see **1.12**). There is a special tax regime for the profits of a trade carried on in the UK under ITTOIA 2005 Pt 2. Whether or not a person is carrying on a trade is a question of fact, but the word 'trade' includes the idea of exchanging goods or services for a reward. The courts have indicated what might constitute trading in a large number of cases – the badges of trade. Under ITTOIA 2005 s 9(1) farming or market gardening conducted in the UK is treated as the carrying on of a trade for income tax purposes.

Under ITA 2007 s 996 and CTA 2010 s 1125(1), 'farming' means the occupation of land wholly or mainly for the purposes of husbandry but does not include market gardening'. Thus, to be a farmer a person must satisfy two tests: the person must be in occupation of the land and the purpose of the occupation must be at least mainly for husbandry. The actual use of the land will normally be indicative of the purpose of occupation, but is not necessarily conclusive. Nor need the occupation be exclusive of others (share farming is an example where two persons may occupy land and each be farmers). 'Husbandry' is specifically said to include hop growing and the breeding and rearing of horses and the grazing of horses in connection with those activities (ITA 2007 s 996(2) and CTA 2010 s 1125(2)). Farming and market gardening, and the intensive rearing of livestock or fish on a commercial basis for the purpose of food consumption count as a qualifying trade, profession or vocation for the purposes of making an averaging claim (ITTOIA 2005 s 221(2)(b) – see **1.14**).

The cultivation of 'short rotation coppice' is specifically described as husbandry, and thus constitutes farming: ITA 2007 s 996(3) and CTA 2010 s 1125(3) (for non-corporate and corporate taxpayers respectively). Short rotation coppice means a perennial crop of tree species (normally willow or poplar) 'planted at high density, the stems of which are harvested above ground at intervals of less than 10 years': ITA 2007 s 996(6) and CTA 2010 s 1125(6).

Farming is further defined in the case of *Lean and Dickson v Ball* (1925) 10 TC 341, where it is stated that for a business activity to be classed as husbandry it must depend to a material extent on the use of the produce of the land occupied by the person carrying on the activity. IHTM Chapter 24 (see **1.1**) has also helped with the definition.

The grey areas of definition are:

- energy crops (see **2.22** and **6.47**);
- market gardening/horticulture;
- certain types of intensive livestock rearing;
- forestry and woodland (see Chapter 6); and
- agri-environment work schemes (see Chapter 2).

A lot of the farm tax planning hinges on the definition of husbandry.

The Capital Allowances Act 2001 (CAA 2001) s 362(1) defines husbandry as 'including any method of intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption'.

It is interesting to note that intensive activity where, for example, livestock is kept indoors or fish are kept in tanks and they are fed on purchased feed, is not considered to be farming. However, the buildings are often considered to be agricultural for APR, ABAs (see 7.12) and rating purposes. HMRC state that the occupation of land for the purposes of breeding thoroughbred horses is to be treated as farming but this does not extend to any activities involved in training racehorses (HMRC BIM55701).

The sale of farmland is generally not subject to income tax, but to CGT. The benefits that can arise from this are discussed in Chapter 14. However, there may be some instances where HMRC might try to classify land sales as a trading activity.

The difficulty may be in deciding whether the new activity (alternative land use) falls within the definition of farming. For example, some letting activities may qualify as farming such as letting land for grazing or 'grass keep' (see Chapter 11) under an agreement for less than 365 days and with no right of renewal (BIM55065), unless the animals grazing the land are non-qualifying stock, eg racehorses, hunters or children's ponies in which case HMRC may argue that the letting was not farming.

The reasoning in respect of the above is that although the landowner is still occupying the land, he is not occupying the building for the purposes of husbandry. In HMRC's view the grazing of horses, unless it forms part of a commercial stud operation, is not 'agriculture' and therefore not husbandry. Exceptions are made if the grazing forms only an occasional or small part of a larger farming operation (CTO Advanced Instruction Manual L.246.2) and if the grazing is part of the breeding operation which is husbandry.

ACTIVITIES CONSIDERED TO BE FARMING

1.4 Activities considered to be farming would include the following:

- the production and sale of cereals (arable);
- the production and sale of milk and associated products (dairy);
- the production and sale of animals (livestock);
- stud farms (see 6.17);
- share farming and contract farming correctly structured (see Chapter 11);
- fruit farming (see 19.5);
- 'set aside' now abolished (see 2.4);
- growing and selling of turf (*Assessor for Lothian Region v Rolawn Ltd* 1990 SLT 433);

1.5 Farming and the need for diversification

- income from grazing correctly structured (see **11.3**, **11.31** to **11.35**);
- short rotation coppice (see **6.4** and **6.11**);
- hop growing;
- farm shops selling farm produce (see **6.33**);
- normal energy crops (**6.47**);
- sales of turf and depositing soil (**6.23**); and
- certain minor receipts from granting licences over farmland may be treated as farming income (see **15.33**).

There are strong arguments to support the claim that the definition of farming should be expanded to incorporate diversified activities (see **1.6**).

Hop growing is regarded as husbandry, and therefore farming for tax purposes (ITA 2007 s 996(2)(a) and CTA 2010 s 1125(2)).

Growing Christmas trees in specialist nurseries is categorised as market gardening. Where, however, Christmas trees are grown on part of a farm, by HMRC practice the activity may be incorporated in the other farming activities conducted (see BIM 62601). See **6.5**.

IHTM24061 sets out the qualifying uses of land:

‘The following land uses should be accepted as for the “purposes of agriculture” within the meaning of IHTA 84/S117

- cultivation to produce food for human and animal consumption,
- use to support livestock kept to produce food for human consumption, such as meat or milk or other products such as wool,
- the keeping of such other animals as may be found on an ordinary farm, for example, horses kept for farm work,
- the breeding and grazing of racehorses on a stud farm. This is not an agricultural purpose (IHTM24068) under general law, but is made one for the purposes of agricultural relief by IHTA84/S115(4),
- land set aside for permanent or rotational fallow (IHTM24064),
- cultivation of short rotation coppice (IHTM24063).

Land that is normally used for agricultural purposes may occasionally be used for other purposes. Provided those other purposes are not the primary reason for the occupation of the land, the land should be regarded as occupied ‘for the purposes of agriculture’ when considering a deduction for relief. One example is a normal working farm over which an annual point-to-point horse race is run.’

Much help can be gained from Chapter 24 of the IHTM.

ACTIVITIES NOT CONSIDERED TO BE FARMING

1.5 Activities not considered to be farming would include the following:

- property development (see 6.38);
- parking, mooring and storage of vehicles and vessels (see 9.35);
- share farming agreements with minimum return (see 11.4);
- fragile/badly drafted contract farming arrangements (see Chapter 11);
- garden centres selling bought-in items;
- animals kept for exhibition;
- game birds raised for sporting activities (*Cook v Ross Poultry Ltd* [1982] RA 187);
- farm shops selling bought-in items (see 6.33);
- crops that grow naturally;
- gaming and fishing rights (see 6.51 to 6.54);
- grazing by horses (see 6.24);
- letting of sports facilities;
- income from industrial and office units (see Chapter 15);
- land let for 365 days or more (see Chapters 11 and 15);
- letting out redundant farm cottages (see Chapter 15);
- food processing (see 2.5);
- horse livery and other equine activities (see 6.24 to 6.29);
- furnished holiday lets and farm tourism (see 6.13 to 6.15);
- long-term woodlands and forestry (see 6.4 to 6.12); and
- market gardening.

HELP VIA THE DEFINITION OF AGRICULTURE AND FARMING

1.6 The definition of 'farming' for tax purposes excludes 'market gardening' (ITA 2007 s 996(1) and CTA 2010 s 1125(1)). Market gardening is defined as 'the occupation of land as a garden or nursery for the purpose of growing produce for sale' (ITA 2007 s 996(5) and CTA 2010 s 1125(5)).

If the alternative land use is for a new business activity that falls outside farming, it will be advantageous if the new venture qualifies for the tax reliefs available for a trade. If a particular activity does not, as a matter of fact, fall within the definition of farming, it may still be taxable as representing the carrying on of some other trade (alternative land use), if the land is occupied on a commercial basis with a view to the realisation of profit (ITTOIA s 2005 s 10 and CTA 2009 s 38). This rule could be particularly important for recipients of the SFP where, for example, the land is used for horse grazing in connection with a livery business. Alternatively, the activity may represent casual or occasional profits chargeable as income not otherwise charged (under ITTOIA 2005 Pt 5 Ch 8 for income tax or CTA 2009 Pt 10 Ch 8 for corporation tax.)

1.6 Farming and the need for diversification

In trying to understand what is and what is not farming, it is vital to look at the definition of agriculture. The definition of agricultural land is found in IHTA 1984 s 115(2):

‘Agricultural property means agricultural land or pasture and includes woodland and any building used in connection with the intensive rearing of livestock or fish if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture; and also includes such cottages, farm buildings and farm houses, together with the land occupied with them, as are of a character appropriate to the property.’

As mentioned above, agricultural land is further statutorily defined in CAA 2001 s 361(1) and means land, houses or other buildings in the UK occupied wholly or mainly for the purposes of husbandry.

There are many who rightly argue that the definition of agriculture should be widened so as to incorporate non-agricultural diversification. This argument is of particular importance to the agricultural tenant who is bound to carry out pure agricultural activities in accordance with the tenancy (see Chapter 15).

There are large variations in the range and type of enterprises carried out within the definition of agricultural. The choice of agricultural enterprise to date has been largely dictated by the quality and type of land topography, rainfall, proximity to markets and processing facilities and the quota available.

For example the western parts of England and Wales are more suited to grass growth than cropping because of topography and rainfall, therefore livestock enterprises predominate. (The west has also seen the diversification of the ‘racing yard’ achieve great success.) The better quality grass growing land in these areas usually supports dairy enterprises, with the remainder, including the hill areas, supporting beef and sheep. The drier eastern parts support cropping systems with the land type dictating the type of crop grown. Sugar beet is usually only grown in the proximity of sugar beet processing factories, largely in eastern England.

The best quality land is often used for growing vegetables, particularly where irrigation is available. In general these areas are located in East Anglia, Worcestershire, Lincolnshire, Herefordshire and Kent. There are similar ‘drivers’ for alternative rural initiatives and they must be able to integrate with the existing agricultural activity.

There are those who argue strongly about the expansion of the definition of farming/agriculture not just because there are currently grey areas and confusion in the tax legislation and guidance but because we are being guided towards alternative rural initiatives and they should be incorporated in a broader definition of agriculture. IHTM Chapter 24 has helped with the definition, but that definition should be expanded.

The basic tax principle is that the IHT relief, business property relief (BPR), is dependent on there being a ‘business’ or a trade. If a claim for APR fails then there is scope to turn to BPR (see 5.32) – there has to be a commercial business.

FARMING INCOME BY CONCESSION

1.7 There are certain types of income which are treated as farming income by concession, that is where the receipt is included in the farming profits, especially when the amounts have been small compared with the total income from farming. However, should that farming income be greatly diminished, this concession would no longer be available and this type of income would then be considered as a non-farming receipt. Examples of non-farming receipts treated as farming income by concession are:

- leasing quota (see 7.26);
- contracting income (see 6.35);
- licences given to treasure seekers (see 19.15);
- rental income from farm buildings (see 12.6 and Chapter 15);
- wayleaves (see 15.30 and 15.31);
- Christmas trees (see 6.5);
- energy crops (see 6.47)
- biofuels (see 6.48); and
- alternative agricultural crops.

In 2005, HMRC accepted that the growing of normal energy crops (eg beet, oil seed rape, cereals and miscanthus) was also husbandry (*Tax Bulletin*, Special Edition, June 2005). On the other hand, a farmers' co-operative butter-making business was held not to be husbandry. *CIR v The Cavan Central Co-operative Agricultural and Dairy Society Ltd* 12 TC 1. Land used for market gardening is agricultural land, so it is not necessary to decide whether or not market gardening is husbandry. As already mentioned a total review of the 'agricultural activity' definition is needed.

DEFINITION OF DIVERSIFICATION

1.8 So what is 'diversification'? It has been defined as putting land to a different use – alternative rural initiatives. It is generally considered that pure farming does not always give the required commercial return in the current business climate and the farmer has to look for alternative types of farming or alternative uses for his land and buildings.

Farming as food production is dependent on world food/commodity prices and therefore vulnerable to violent swings in profitability/loss. Diversification can integrate a more constant income/profit stream into the enterprise. At the time of writing corn prices are high and there is a world shortage of some foods (eg rice) but production costs (eg diesel) are very high.

Consideration has to be given to the type of soil (see for example 7.21) as to the choice of farming.

Diversification is the supply of land for an alternative use moving away from agricultural production, the supply of an activity (not defined as farming) on

1.9 Farming and the need for diversification

land. The land supplied could still be used for agriculture but the alternative activity (eg shooting) does not currently come within the definition of farming.

Alternative land and building use

1.9 At **1.5** we looked at activities that are deemed not to be farming; but are they diversification?

Diversification may involve the use of land for other farming uses, or non-farming uses. The main assets of a farm business can be the land and buildings it occupies for the purposes of farming. An inability to generate profits from farming the land, the availability of grants, government direction or some other circumstance, may dictate that:

- a different type of farming should be carried on using the same land and buildings;
- the land and buildings should be used for a non-farming purpose; or
- the land and buildings should be sold and the farmer may then try to make a living outside of farming (see Chapter 14 on property disposals).

Examples of possible diversified activities are as follows:

- energy crops (see **6.47**) (can be agriculture for APR);
- biofuels (see **6.48**) (can be agriculture for APR);
- alternative crops eg winter lupins, sunflowers, borage, pulses;
- diversified livestock eg wild boar, red deer, buffalo;
- cashmere, mohair, angora production;
- agricultural and countryside attractions (see **6.31**);
- recreational fishing (see **6.30**);
- vineyards (see **6.34**);
- plant hire;
- food processing and marketing eg butter, cheese, ice cream;
- opportunities in the food and shopping sector (see **6.33**);
- Christmas trees (see **6.5**) (might incorporate farming);
- farmers' markets (might incorporate pure farming);
- adventure games (see **6.32**);
- trading in land property developments (see Chapter 14);
- bed and breakfast (see **6.16**);
- caravan and camping sites (see **6.18** to **6.22**);
- clay pigeon shooting, including conventional land lasers (see **6.51**);
- furnished holiday lettings (see **6.13** to **6.15**, **12.7** and **15.18**);

- horse liveries, riding schools and horse trekking (see 6.24 to 6.29, and 15.27);
- golf (see 6.32);
- motor sports (see 6.32);
- water sports (see 6.32);
- downhill racing (see 6.32);
- farmland disposals (see Chapter 14);
- car boot sales;
- mobile phone masts (see 6.36);
- commercial shoots (see 6.52);
- sites for the music industry;
- commercially exploiting aggregates (see 19.8);
- property development 'growing houses' (see 6.38);
- long-term woodlands and forestry (see 6.5 to 6.12);
- mineral royalties (see 6.37);
- landfill (see 19.10); and
- the letting of farm buildings and cottages (see 13.26 to 13.46 and Chapter 15).

As set out in 1.7, on a small scale these diversified activities could be considered to be farm income by concession and some *will* still count as farming eg diversified livestock farming for human consumption.

The majority of the diversification activities will need legal help and advice and planning permission may be required and cause delays (see Chapter 3).

It is important to look at:

- the effect that such changes may have on the landowner's entitlement to all forms of tax reliefs which are featured throughout the book;
- how the landowner might use the CGT reliefs (eg roll-over relief, hold-over relief, entrepreneurs' relief) to implement the changes forced on him, without incurring a tax liability because of the change (see Chapter 14); and
- how the impact of VAT will affect such changes (see Chapter 9).

FARMING AS ONE TRADE

Alternative land use – new farming activity

1.10 All farming carried on in the UK by any particular person or partnership or body of persons is treated for trading purposes as one trade.

All farming in the UK carried on by a person or company, other than farming carried on as part of another trade, is treated for tax purposes as one trade (see

1.11 *Farming and the need for diversification*

ITTOIA 2005 s 9(2); CTA 2009 s 36(2)). The same applies to firms, except that the farming carried on by a firm which is treated as one trade is not included in any farming trade of any partner in the firm (ITTOIA 2005 s 859(1); CTA 2009 s 1270(1)).

Farming (which excludes market gardening) has always been considered as one trade: thus, an estate in Scotland, a farm in Yorkshire and a farm in the Home Counties owned by the same legal structure are all treated as one trade. This rule can have a major effect on the computation of farming profits and losses. Its application results in the aggregation of profits and losses (including capital allowances) from more than one farm into a single taxable source of income when more than one farm is operating at the same point of time but in different parts of the country. It is not relevant that perhaps two farms are managed as separate economic units, nor that separate sets of financial accounts are prepared, there should be coterminous year-ends. Likewise, there is no cessation of trade nor any new trade commenced where a farmer ceases trading at one farm, sells up, buys a new farm and starts afresh there.

Tax planning can be complicated where the farms are owned by different legal entities. The trades of diversified activities, as opposed to farming, do not have to comply with ITTOIA 2005 ss 9(2) and 859(1) for income tax and CTA 2009 ss 36(2) and 1270(1) for corporation tax ie all the farms have to be treated as one trade, which presents tax-planning opportunities in respect of the allocation and timing of profits.

If there has been a significant amount of time between the giving up of one farm and the starting of another, HMRC might take the view that a trade has ceased and a new one commenced. This can be an important factor when looking at tax-planning principles surrounding hobby farming and IHT reliefs.

For example, the trade of growing and selling Christmas trees or a bed and breakfast business starting on the second farm would be a new trade within the provisions of ITA 2007 s 72 applying to opening year losses (see Chapter 12).

Since farming is to be treated as a trade it is charged to tax under ITTOIA 2005 Pt 2 or CTA 2009 Pt 3 in the ordinary way, provided the land is in the UK. (If the land is situated abroad, different problems arise.) That also applies to market gardening. The ordinary rules for calculating profits of a trade apply, subject however, to one major exception.

The rule that all the farming carried on by one business is treated as one trade (ITTOIA 2005 s 9(2) and (3) for income tax and CTA 2009 s 36(2) for corporation tax) does not apply to diversified activities and this can have major effects on the computation of farming profits and losses. It is not just the income from the diversified activity that must be removed but also the expenses that relate to that activity – this could include overhead expenses shared with the farming operation.

DIVERSIFICATION: BIG IMPACT ON THE FARM TAX COMPUTATION AND ACCOUNTS

1.11 Diversification could include a whole range of possible trading activities, some of which will fall under new tax regimes and therefore bring potential tax problems and tax-planning opportunities.

The difference between 'farming' and 'non-farming' income and expenditure has to be identified in the preparation of the tax computation. Most farmers look at their diversified farm as 'one unit', one business entity, but the tax rules dictate that there should be division. This is complex, time-consuming and invites error. A farmer's view is generally that all income from farming and farm diversification (including lettings) should be assessed as trading income (ITTOIA 2005 s 9) with no division of source.

When practitioners prepare the farm accounts and/or tax computation, it is important to remove the non-farming income items (see 1.5) and also to match the expenses. In practice, many practitioners are just preparing a computation, which arrives at a net profit or loss, with little regard for the allocation of expenses and income. It could be that income from items such as quota leasing and grazing by horses are inflating the profit for the purposes of the five-year rule for losses (see Chapter 12) and it is more tax efficient to combine the income as farming.

As a practical planning point, it is important to review all clients who are associated with farming to ensure the correct treatment of income and expenses. It will also be essential to review what future reliefs the client may need to claim, eg considering the 'commerciality' of the farm or the business. It is also useful to ascertain such facts as whether the client intends to claim APR for IHT purposes. If APR is lost, will BPR still be available? (See Chapter 5.)

While reviewing the tax computation, it is essential to see that farmers are still eligible for tax reliefs that are dependent on 'business/commercial' status. Examples of reliefs which could be lost are entrepreneurs' relief and roll-over relief for capital gains tax (CGT) (see 1.1).

THE FISCAL FARMER

1.12 HMRC *Tax Bulletin* (June 2005 special edition), which discusses the single payment scheme, defines the fiscal farmer. It clarifies that the SP can be taxed in various ways dependent on the underlying factors regarding its receipt as follows:

Fiscal farmer	ITTOIA 2005 s 9
Non-farming trade	ITTOIA 2005 s 10
Non-trading	ITTOIA 2005 Pt 5 Chapter 8

The definition of fiscal farmer will include more than the traditional farmer who continues to farm. As the definition of 'farming' turns upon the purpose behind the occupation of land, HMRC have conceded that those who do not produce anything on the land that franks the SFP will nevertheless be treated as being within this category (see also 20.5 and 20.6).

Preserving the main farming tax reliefs

Capital gains tax

1.13 It is essential, with the move to alternative use of land or diversification, that all the main tax reliefs available to the farming business are preserved.

1.14 Farming and the need for diversification

The CGT reliefs that might be affected by diversification, or that might be used to assist diversification, are:

- replacement of business assets (roll-over relief) (TCGA 1992 ss 152–159) (see **14.19**);
- incorporation of a business in part or whole (TCGA 1992 ss 162 and 165) (see Chapter 8);
- gifts of business assets and gifts on which IHT is chargeable (hold-over relief) (TCGA 1992 ss 165, 260, Sch 7) (see **14.26** to **14.30**);
- roll-over relief on reinvestment (reinvestment relief) (FA 1998 s 140(2)) and EIS (deferral relief) (TCGA 1992 Sch 5B) (see **14.62**, **8.16** to **8.19**); and/or
- entrepreneurs' relief as introduced by the Finance Act 2008 (see Chapter 14).

Expenditure incurred in the diversification process will be disallowed if it is not deductible in arriving at the true commercial profit calculated on accounting principles. Share farming and contract farming are actually considered to be farming and are taxed as trading income (ITTOIA 2005 s 9) provided they meet all the conditions (see Chapter 11).

FARMERS' AVERAGING OF PROFITS

1.14 Farmers' averaging was introduced in 1977. The system enacted was based upon a simple arithmetic concept of adding together the profits of two successive years and dividing by two. In practice, a variety of limitations are imposed. The rules are now contained in ITTOIA 2005 Pt 2 Ch 16. Only 'farm' profits not diversified profits can be averaged.

The aim of these provisions was (and is) to help ensure that farmers make full use of personal allowances and basic rates available for income tax purposes and do not unduly suffer higher tax rates one year and then fail to utilise these basic allowances and rates another year.

For the purposes of averaging relief, 'farming' includes the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption (ITTOIA 2005 s 221(2)(b)). Averaging can also be applied to trades of market gardening (ITTOIA 2005 s 221 (2)(a)). Only farming trades carried on in the UK may average profits. Also excluded are farming contractors because their trade does not involve the occupation of farm land, as are cases where farming activity is part of a larger trade that includes substantial non-farming activities (see BIM73110). Averaging only applies to profits chargeable to income tax, so companies liable to corporation tax cannot use these provisions (ITTOIA 2005 s 221(1)).

For the purpose of averaging relief, profits are taken before any allowance is made for trading losses sustained in the year of assessment, or those carried forward or sideways (see Chapter 12) so as to be applied to profits for the period (ITTOIA 2005 s 221(4)). However, profits are computed after any deduction or addition for capital allowances or balancing charges (see Chapter 7).

If there is an adjusted loss for one year, that is treated as 'nil' (ITTOIA 2005 s 221(5)) and the average over the two years becomes one half of the profit for the other year.

It is a precondition for relief that the profit of one of the two consecutive years does not exceed 75% of the profit of the other, or is nil (ITTOIA 2005 s 222(1)). This difference equal to at least 25% of the higher figure is assumed to be needed to justify the relief. However, there is a marginal relief, where the profits of one year exceed 70% but do not exceed 75% of the other year (ITTOIA 2005 s 223(4)). This adds further complication to the calculation.

JOB-RELATED ACCOMMODATION – THE FARMING ADVANTAGE

1.15 The key conditions that need to be in place to achieve the tax-free 'benefits in kind' (BIK) for the farm employees are dependent on proper and better performance of the employee's duties and also the customary provisions (farming is customary). Traditionally farm workers have qualified for tax-free job-related accommodation, but will this benefit still be enjoyed with the move to diversification? The conditions for job-related accommodation in relation to farming are as follows.

- Where it is necessary for the proper performance of an employee's duties that he should reside in the accommodation (ITEPA 2003 s 99(1)).
- Where 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)).

An individual who lives in job-related accommodation may find on leaving his job that another residence which he has owned has lost the CGT exemption for principal private residence (PPR) relief because he has failed to occupy it continuously. To meet this situation where there has been occupation of the job-related accommodation, for example the farmhouse (after 30 July 1978), it is treated as if it were the occupation of the employee's own house provided he intends to go and occupy it in due course. This is set out in TCGA 1992 s 222(8) (b). Whether the employee does intend to (re)occupy his residence is a question of fact. If the employee has occupied it before the relevant sale, this would clearly represent persuasive evidence. If the sale occurs before occupation, intention can still be demonstrated particularly if the proceeds are applied to buy another home so that the principal private residence relief is endangered.

There is a similar denial of relief for job-related accommodation, where the accommodation is provided by a company for a director, unless he has no material interest and works full time, or unless the company is non-profit making or a charity. The clear tax-planning point here is that farmhouses owned within farming companies and lived in by directors must be given a review to minimise assessable benefit (see **4.13**).

An exemption from the tax benefit in kind for job-related accommodation also requires that the accommodation be provided for the better performance

1.16 Farming and the need for diversification

of the duties of the employee. This is most likely sought where employees are provided with accommodation on a rural estate or farm. This requirement is clearly aimed at questioning the employer's reasons for providing accommodation.

The position regarding the kinds of employment created by diversification and the identification thereof for the BIK position does need review. A careful examination is made of the duties of the employment contrasted with both those of similar employees on other rural estates and the duties common to the generic class to determine whether those of the rural estate employee are neither rare nor untypical of the class of employee. So what of the duties carried out as a result of diversification?

Is the provision of accommodation customary? The *Vertigan v Brady* [1988] STC 91 case, helps in this decision where the court determined there were three constituent factors to be examined: the statistical evidence on how common the practice was; evidence on how long the practice had gone on; and whether the practice had achieved general acceptance. So what of the impact of diversification? Will the move away from farming cause problems with regard to the conditions of 'proper performance' or 'customary performance'?

DIVERSIFICATION OPPORTUNITIES

1.16 Examples of diversification ideas are set out in 1.9. More details are set out below.

- *Equine* – On investigation a farmer might find a local market for horse livery and riding facilities that could provide you with a profitable source of income (see 6.24 to 6.29).
- *Sport and recreation* – There is great potential for developing sport and leisure enterprises on farms (see 6.32).
- *Catering* – The catering industry is keen to develop supplies of fresh produce. In some locations there are opportunities for farmhouse restaurants and other types of catering services. Farmers' markets have helped many local food producers sell their produce direct to the consumer, with obvious financial and social benefits (see 6.33).
- *Provision of pre-school care* – Demand for places exceeds supply in many areas. Some farms have the facilities and a good location for the development of pre-school nurseries.
- *Food and retailing* – Farm shops, direct sales to caterers, farm-based restaurants and cafes, ice cream production, cheese production, linseed oil, essential oil (see 6.33). 'Farmgate' (see 1.21) is considered key to the farming industry.
- *Tourism* – Furnished holiday lets (FHLs), B&B, self-catering accommodation, caravanning, camping, visitor attractions, craft centres (see 15.8 to 15.20 and 6.31).
- *Phone masts and wind farms* (see 6.36, 6.49 and 6.50).

- *Sport and recreation* – Horse livery and riding schools, walking and cycling activities, motor sports, water sports, golf, fishing, shooting (see 6.51 to 6.54).
- *Crop related* – Energy crops, essential oils, herbs, pet foods (see 6.47).
- *Livestock related* – Goat and sheep milking, buffalo milk and meat, meat processing and direct marketing.
- *Property* – Offices and workshops, engineering works, building trades.

The availability of grants to support these activities is looked at in Chapter 2.

THE 'SINGLE FARM PAYMENT SCHEME' (SFP) – THE JARGON

1.17 The impact of the SFP on farming and diversification is given its own chapter (see Chapter 20).

The jargon that has evolved from the introduction of the SFP will feature throughout the book and needs some explanation.

- *Single farm payment (SFP)* – a payment based on a farmer's claim during a historic reference period 2000–02. It replaces arable aid payments, beef special premium, suckler cow premium, sheep premium etc. For England it is a hybrid of the area-based method and the history-based method (see 20.2 to 20.4).
- *Decoupling* – payment conditional on keeping land in good agricultural and environmental condition with no obligation to farm the land (see 2.2).
- *Partial decoupling* – a proportion of the payment is conditional on continuing agricultural production.
- *National reserve* – a national reserve will be established to deal with hardship cases, new entrants and some transitional problems. A linear percentage reduction of the reference SFP is allowed for in order to start a national reserve.
- *Transitional arrangement* – the transition period will create a number of problems for those that fall outside the qualifying criteria. They are complicated and warrant a book in their own right. Suffice it to say that expert advice should be sought when buying or selling land or in changes in tenancy.
- *Entitlement* – the number of tradable hectare rights to a specific annual single farm payment.
- *Modulation* – progressive siphoning of direct payments to fund agri-environmental schemes and rural developments initiatives.
- *Cross-compliance* – conditions of good agricultural and environmental (GAEC) practice which must be met to receive the single farm payment (see 20.17).
- *Negative list crops* – fruit, vegetables, potatoes.
- *Naked acres* – acres of land, which have no entitlement to the SFP.

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- *Non-fiscal farmers* – those farmers whose occupation of land was not principally for the purpose of husbandry (see 1.12).
- *History-based method* – refers to the farmer's claim in the three years 2000–02 which formed the basis of the calculation of the SFP (see 20.3).
- *Area-based method* – money available under the scheme is divided by regional agricultural area to yield a standard SFP was based upon 2005 area (see 20.3).
- *Financial discipline* – replaces the term degressivity and is a mechanism that can be used to reduce direct payments annually if the CAP budget ceiling is in danger of being breached between 2007–13.
- *Farmgate* – The basic principle of 'food chain reconnection', selling direct to the customer and ideally from the front gate of the farm (see 1.21).
- *Eligible land* – land eligible for the SFP; broadly arable and permanent pastures but excludes permanent crops, forests and land under non-agricultural use.
- *Farmer (under article 2)* – a farmer is someone who engages in an agricultural activity. The latter is defined as 'the production, rearing or growing of agricultural products including the harvesting, milking, breeding animals and keeping animals for farming purposes or maintaining the land in good agricultural and environmental conditions'.
- *Fiscal farmer* – the farmer whose occupation of the land is principally for the purpose of husbandry (see 1.12).
- *Severely disadvantaged areas (SDA)* – existing designated areas of disadvantaged upland making up most but not all of the less favoured area.
- *National envelope* – England does not use the 'envelope' system. Up to 10% of the total subsidy under the CAP reform could have been transferred into an envelope to fund agri-environmental schemes (see 20.16).
- *The Curry Report – The Future of Farming and Food Report* published in January 2002 (see 1.21).
- *Entry-level payments (ELS)* – payments under the pilot agri-environmental schemes (see 1.22 and 2.23).
- *GAEC* – good agricultural and environmental condition, the underlying basics to the 'cross compliance conditions'. The state of the land must be left in good order for farmers to receive the entitlement (see 20.17).

Subsidies and grants – taxation

1.18 The tax treatment of the subsidy (entitlement) will depend on the purpose for which the payment is made. Where a grant is paid because capital expenditure has been incurred, the capital cost is reduced by the grant when the capital allowances (whether plant or machinery or agricultural buildings) are

computed. If it is to reimburse revenue expenditure, it is taken into the profit and loss account for tax purposes.

When farmland is acquired compulsorily for the building of a new road, the compensation may cover the value of the actual land taken, the depreciation in value of adjoining land, the loss of crops, the reimbursement of costs of making good damage to land and fences, the loss of future income, the future additional costs of haulage, the future costs of maintaining new fences and many other items (see 14.57).

The payments for the capital items mentioned may be liable to CGT and this is considered at 1.23 and in Chapter 14.

Some small compensation payments are included in the 'monthly milk cheques', received by dairy farmers, and this element must be excluded from the profit and loss account. Where a farmer has to make a milk super levy payment, this is treated as a deduction in the profit and loss account.

The principles governing the tax treatment of grants and subsidies, together with examples from case law, are set out in BIM40455, to which reference should be made in any case of doubt or difficulty. The main general principle is the distinction between capital and revenue and the main determining factor is the purpose for which the grant is paid.

Decided cases on farming grants include:

- *Higgs v Wrightson* (1944) 26 TC 73 (ploughing grant held to be a trading receipt);
- *Watson v Samson Bros* (1959) 38 TC 346 (payments for rehabilitation of flood-damaged land held to be capital receipts); and
- *White v G & M Davies* (1979) 52 TC 597 and *IRC v W Andrew Biggar (a firm)* [1982] STC 677 (premiums payable under scheme for conversion of dairy herds to beef production held to be trading receipts) (see 2.25).

The time at which income should be recognised for tax purposes can be a complex area. Detailed guidance is provided at BIM34010 onwards, to which reference should be made in any case of doubt or difficulty.

A valid basis for determining timing issues is one which is arrived at from the correct application of generally accepted accountancy principles to the particular facts provided it does not offend the taxing statutes as interpreted by the courts. In some cases there may be more than one acceptable basis; but a valid basis, once adopted, should be used consistently unless there is good reason for a change. Where an acceptable basis has been adopted in the accounts, attempts to use some other acceptable basis by means of adjustments in the tax computations are usually resisted by HMRC. Chapter 2 sets out subsidy entitlement. The tax position of the SFP is looked at in Chapter 20.

LAND QUALITY AND DIVERSIFICATION

1.19 The enterprises found in both farming and diversification are largely dictated by the land type and quality. Therefore different enterprises are found

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in different regions of the country. DEFRA (Department of Environment, Food and Rural Affairs) classifies land in England and Wales into five grades according to its suitability to farming based on soil type, climate and relief. It is essential to understand the land quality before moving ahead with diversification.

- Grade 1 – Soils capable of growing a wide range of crops with high yields. These soils are mostly loams, sandy loams and peats with good drainage and water availability. These soils have a high level of natural fertility or are highly responsive to fertilisers.
- Grade 2 – Soils capable of growing a wide range of crops but with limitations which exclude the land from Grade 1. These limitations restrict the range of crops capable of being grown and their yield potential.
- Grade 3 – (split into A and B) Land which is capable of growing good crops but a more restricted range than Grade 2. At the top of the grade, the less demanding horticultural crops, ie cereals, roots and grass can be grown on the land.
- Grade 4 – This land has restricted potential, the choice of crops being limited, yield moderate and timing of cultivations restricted to times when the weather is favourable. This land is mostly down to grass, with smaller areas of oats, barley and feed crops for animals and has potential for diversification activity.
- Grade 5 – land with very severe restrictions, mostly being rough grazing and again this could be prime for diversified activities.

Arable area payments scheme -- before the SFP

1.20 The arable area payments scheme (AAPS) had been integrated into the UK farming industry since 1992 basically unaltered, although it changed radically with effect from the introduction of the SFP.

The AAPS arrangements were designed to limit the amount of farmland used for growing arable crops and required farmers to set aside a proportion of their arable land each year in exchange for a set-aside payment being made (see 13.25).

Amounts received for set-aside land are treated as farming income and taxed as part of the farm profits under ITTOIA 2005 s 9(1) in the usual way, subject to timing, and expenses relating to the land being deductible.

HMRC confirmed in their *Tax Bulletin* February 1994, p 108, that all arable area payments (including the required level of set-aside) were to be treated as sales subsidies and taken to the credit of the profit and loss account in the accounting period in which the crop has been sold.

With regard to AAPS, HMRC did say that a different treatment would be acceptable to them if it complied with generally accepted accounting practice.

HMRC's interpretation followed their general assumption that the tax treatment should be determined by the purpose for which the payment was intended. If

it was designed to supplement the income from a crop, it should have been taken for credit in the period in which the crop proceeds were credited to the accounts; if it was paid to meet certain costs, it was deducted from those costs.

Where the payment reduces the cost of a crop, which was growing at the end of the period in which it was received, then the valuation would be reduced by that payment (see Chapter 7).

The management of set-aside land represents the occupation and use of the land for agricultural purposes, and thus for CGT purposes it will continue to be eligible for roll-over, hold-over and ER (see Chapter 14). Set aside should also be eligible for APR for IHT purposes (see 13.25).

Direct payments are to be reduced by a set amount each year, with the proceeds to be made available as additional community support for rural development initiatives and agri-environmental schemes.

Farmers have already found applying for grants for diversification initiatives time consuming, complex and in some cases frustrating. DEFRA are working towards making it easier (see Chapter 2).

FOOD CHAIN RECONNECTION ('FARMGATE')

1.21 'Farmgate' can be described as farmers selling direct to customers or attempting to achieve better integration and understanding between farmers and customers.

The DEFRA-funded Forward Farming Project looked at how demonstration farm activities can help people in the farming industry to recognise and adopt best practice, technically, economically and environmentally. This can encourage customers to try and understand where their food comes from and just what it may or may not contain.

The government accepted the recommendation of the 'Curry Report', the Policy Commission of Farming and Food, to set up a project to establish a pilot network of demonstration farms.

The aim of the scheme is to test the effectiveness of different types of demonstration farms and associated activities in improving the economic and environmental performance of farms and their integration into the food chain and rural economy. This can involve farms selling direct to customers and missing out the supermarket, the activity is casually known as the move to 'farmgate'.

The suggestion was and is that farmers need to understand the supply chain better, both upwards and downwards. Reconnection was the central theme of the Curry Report. Red-meat strategy needs to be more balanced – mainstream as well as alternative market.

A broad programme of action might include:

- mapping of significant food chain customers and suppliers within the region as a resource for future work;
- more visits by farmers to customers' and suppliers' premises to promote mutual understanding;

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- more information from customers to explain to farmers what the market wants;
- more visits by food chain customers to progressive farmers in the region;
- more marketing awareness programmes by local training groups for farmers and other non-farming decision influencers (agronomists, feed reps etc);
- bringing together farms and rural businesses to promote and market their activities more effectively in the tourism sector (eg local food producers, owners of holiday accommodation, retail outlets etc) and jointly promoting their services;
- more effective and efficient exploitation of new tourism opportunities;
- extending the market for existing tourism activity; and
- improving market awareness and knowledge of farmers and rural businesses.

The accounting and tax treatment of the food chain reconnection will potentially be more complex with possible direct sales. The systems of livestock markets and livestock dealers have the advantage of simplicity and control.

The direction of food chain reconnection is followed through to Chapter 6 with the suggested activity of the 'shopping and food sector'.

One consequence of this has been the development in almost every part of the country of 'farmers' markets'. Most market towns and many larger centres of population will now have such a market on a weekly or monthly basis. Sometimes it will be held in the traditional market place or Town Hall, but it is equally common to find it in a supermarket car park.

Overall, the value of production passing through farmers' markets remains small in terms of national food consumption, and whilst highly visible, they are still mostly niche outlets for small-scale niche producers, and as yet, of little relevance for the larger farm producing agricultural products on an industrial scale. Nonetheless, they make a useful contribution in terms of margins, particularly if the farm is already geared up to retailing.

ACCOUNTING TREATMENT

1.22 There is a constant change in agriculture with regard to subsidies, worldwide food needs and demands and alternative land use and it is essential to review guidance from ICAEW and HMRC together with rural bodies such as the CLA (Country Land and Business Association).

CAPITAL GAINS TAX (CGT) REFORM: CHANGE OF TAX RATE

1.23 Finance Act 2008 reformed CGT for gains made on disposals made by individuals, trustees and personal representatives.

For all disposals made from 6 April 2008 onwards:

- indexation relief was abolished when calculating gains;
- taper relief was abolished when calculating gains;
- all assets owned at 31 March 1982 will be treated as having been sold and reacquired on that date (hence effectively 'rebased');
- a new flat CGT rate of 18% will be applied.

In relation to gains made on or after 23 June 2010, there will be two rates of CGT for individuals – a standard rate of 18% and a higher rate of 28%. The higher rate will apply to individuals whose total taxable income and post 22 June 2010 chargeable gains exceed the basic rate limit for income tax purposes of £37,400 (see F(No 2)A 2010, Sch 1).

Broadly, this means that higher and additional rate taxpayers will pay CGT on gains realised after Budget day at a rate of 28%, whereas for basic rate taxpayers the rate remains at 18%.

All gains realised by individuals before 23 June 2010 are taxed at 18%, regardless of the level of the individual's income (see 2.10 to 2.12).

Certain technical changes were also introduced, including in relation to disposals of assets acquired by way of gift between 1982 and 1988.

The abolition of indexation relief impacted particularly on individuals who had owned assets for a long time prior to April 1998 (when indexation was frozen and replaced by taper relief) and which had a high base cost. Similarly the abolition of taper relief affected certain entrepreneurs and investors adversely as they saw the effective rate of CGT increase from 10% to a very real 18%. This coincided with the collapse of land development values and the UK recession.

The CGT reform represents an interesting change to the farming community at a time when land prices have soared, diversification projects are working, there is an apparent world shortage of food and resources and no one has a crystal ball. This book tries to look at various alternatives in a dramatically changing world.

COUNTRYSIDE ACCESS

1.24 Farmers have concerns over farm access and potential liabilities (see protection via incorporation – Chapter 8). However a balance has to be reached between risk management and education.

Farming and Countryside Education (FACE) is the joint NFU/Royal Agricultural Society of England's education programme. It is understood that more than 30 industry bodies, agricultural societies and countryside organisations support it. FACE provides a one-stop shop for educationalists, with education co-ordinators working throughout the UK. It helps teachers undertake tailor-made study visits to farms and horticultural units for pupils of all ages. Advice is provided to host farmers on health and safety issues. FACE's website www.face-online.org.uk is the gateway to free curriculum-linked resources on food and farming. Resources are aimed at youngsters from nursery age to further education students. FACE

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is a stakeholder in the government-led Access to Schools project (www.farmsforschools.org.uk) and the Forward Farming Partnership that sprang from the Policy Commission on Farming and Food.

Soil and how it drives the farming activity

1.25 Soil quality is one of the main criteria for farmers who want to receive environmental payments. Bio-diversity is about farming not just organically but caring for animals and the soil – see Landcare (**1.26**) below.

Soil used for crop production must have a suitable tilth and structure in the surface layer of the seedbed to provide air and water for seed germination. The lower layer of the soil must be free draining and surplus water is usually removed by drains, clay tiles and plastic pipes etc. The tax relief on drainage is dealt with in Chapter 7.

The higher value crops such as potatoes and vegetables are usually irrigated. It is very difficult to obtain licences to irrigate crops, and specialist growers are considering investing in the construction of reservoirs to store winter water for irrigating in the summer. For the tax treatment of reservoirs etc also see Chapter 7.

For optimum crop growth soils should contain the correct balance of the required nutrients. The main nutrients are:

- nitrogen;
- phosphate; and
- potash.

The reason for discussing soil quality is to demonstrate how it drives the choice of farming alternatives and how difficult it is to make changes to adapt to fluctuations in world commodity prices.

Different crops have varying requirements as to soil quality and the required amount of fertiliser to be applied in the seed bed. There are very small reserves of nitrogen in the soil, therefore the crop is provided with the required amount, usually at its active growth state and in two or three applications of artificial fertiliser. Commercially purchased fertiliser is described in terms of its constituent parts eg 20:10:10 signifies 20% nitrogen, 10% phosphate and 10% potassium (always given in that order). Some crops such as peas and beans, being leguminous, manufacture their own nitrogen and therefore do not require any application.

Landcare

1.26 Landcare is about promoting sustainable agriculture and seeking positive changes to soil and water management. Again the commercial cost of compliance must be compared and tailored to the government grant income streams available.

Land management and ecology are now taught at agricultural college, which reflect the changes which lie ahead and which are already taking place. The land management function is incorporated into environmental stewardship.

There are those who argue that livestock represents one of the best forms of land care available when correctly farmed.

SIZE OF HOLDINGS (AND THE NUMBER)

1.27 Each farming business has a 'holding number' enabling a record to be maintained of all agricultural holdings. The size of holdings is measured in 'European Size Units' (ESUs). This is a measure of the financial potential of an agricultural business on standard gross margins. Holdings of under eight ESUs are considered to be part-time holdings.

Over half the holdings in the UK are officially recognised as being unable to financially support a family and are thus considered to be part time. A significant increase in registered units that are under eight ESUs has arisen as a result of the single payment system introduced on 1 January 2005 which has encouraged many smaller and previously unregistered holdings to become registered. This aside, it is a fact that more and more units become less financially viable and the number of full-time farmers decreases year on year with a corresponding increase in part-time farmers.

This clearly has a large impact on the underlying tax planning covered throughout this book.

HMRC RURAL DIVERSIFICATION PROJECT

1.28 HMRC's *Rural Diversification Project* followed on from the previous project on the game shooting industry. It is understood that attention in the rural diversification project will initially focus on the following matters:

- Whether proper regard has been paid to who owns what and whether farm assets are used partly for private purposes or by another entity for its business. One area of interest will be (where no commercial charge is made), whether VAT has been correctly dealt with (whether input tax has been recovered on costs where no output tax has been paid). Overhead costs should not be put through the farm accounts with VAT input tax claimed but not charges raised to, or payment made by, the 'associated' entity.
- Whether the liability of all income, including that from diversification, has been properly considered and declared to HMRC.
- Where diversification grants have been applied for, awarded and paid to a VAT-registered entity and are then used to fund a diversified business whether the grant and new business belongs to the original entity and if not, why not.
- Where business activities are carried on by separate entities whether the VAT disaggregation rules apply. This will particularly focus on holiday enterprises.
- Whether PAYE and benefit-in-kind implications of all payments and non-cash remuneration have been properly considered.
- Close examination of amounts claimed on private or non-business expenses.

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The VAT shooting project (see **6.52**) was so successful in terms of ‘tax take’ for HMRC that it is impossible to ignore the whole area of diversification.

The book will show the potential ‘tax take’ from HMRC’s attempts at denying BPR on non-agriculture values. The advice to both the tax planner and diversified farmer is that there are valuable tax reliefs at stake and waiting to be denied by HMRC – this is a tax minefield and the stakes are high!

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