

CONTRACT FARMING – FYFFE V ESSELMONT

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A recent court ruling in the Scottish Land Courts has provided food for thought for landowners operating contract farming arrangements. The case, *Fyffe v Esslemont*, was not primarily concerned with taxation but nonetheless provided interesting analysis on contract farming arrangements.

BACKGROUND

The case concerned an agricultural tenancy where sub-letting was not permitted, and where a contract farming agreement had been put in place. The court held that the contracting agreement was only superficial, and as a result the tenant had “wholly or substantially abandoned agricultural activity upon the Farm” with the result that the statutory protections were lost.

A key concern in the courts drawing this conclusion was that the tenant no longer bore any business risk in relation to the farm’s activities. For example, the contractor benefitted from the crops of the farm with only notional invoicing arrangements in place, where the sale price was only based on the cost of the inputs rather than the market value of the crop produced. This effectively left the contractor with a free crop and the tenant with a ‘no risk no reward’ outcome.

THE IMPLICATIONS

Though this case primarily concerned whether the tenant had in fact sublet his land, it is possible that this could prompt HM Revenue & Customs (‘HMRC’) to review the substance of contract farming arrangements. If such arrangements are not genuine then farmers could lose the favourable tax regimes currently available to those carrying out an active farming business. This would potentially include the loss of Business Property Relief for

Inheritance Tax, and Entrepreneurs’ Relief and Holdover Relief for Capital Gains Tax. Those undertaking contract farming therefore may wish to review their agreements for robustness.

EXAMPLES OF CONTRACT FARMING

Typical features of true contract farming, as indicated by the Scottish Land Court as part of the case, include:

- A formal contract regulating the rights and responsibilities of the parties and how it is administered
- The contractor providing the labour and equipment
- The contractor receiving a fee, which may include a profit-sharing agreement
- The contractor may order inputs on behalf of the farmer although if this is the case then the farmer should pay for them, usually through a separate bank account
- The farmer retaining risk with regard to his income.

A key factor in any contract farming agreement should also be that the farmer makes key management decisions. The mere letting or subletting of land is unlikely to involve any active trade, as indicated by this case.

SUMMARY

Contract farming is often employed by landowners and if correctly executed can give rise to beneficial tax reliefs. *Fyffe v Esslemont* may cause HMRC to scrutinise these arrangements more closely. Clients may therefore wish to review their contract farming arrangements in light of this case.

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