The Hutchinson Partnership

How the proposed budget changes to IHT impact on family farms

December 2024

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- Like you we have been very disappointed by the IHT changes announced in the budget.
- It is even more concerning that before proposing these changes the Treasury has failed to undertake any impact assessment.
- Furthermore, a lot of the claims being made by Government spokespeople are hard to reconcile with our knowledge of the industry.

The Hutchinson Partnership is a firm of Chartered Accountants that specialise in preparing accounts and giving taxation advice to the agricultural industry. We felt we should endeavour to bring some factual foundations to the debate so that it is based on the impact on genuine family farming businesses.

One of the problems with traditional accounts is that the balance sheet is prepared on a historic cost basis which is of limited use for valuing someone's estate for IHT purposes. Whilst we work for a range of rural businesses, we have asked our farming clients to provide us with realistic market valuations of their businesses. We are pleased to note that this report is based on over 60 farming businesses. We have sense checked this and merged it with other data we hold to enable us to calculate the average impact for our clients. When calculating the valuation of clients' estates, we have done this per family farm. We have included the valuation of clients' farming businesses, the value of any diversifications, and the value of their personal assets such as savings and pensions and then we have deducted borrowings.

It is important to start with some facts:

Based on the data received, the average size of our clients' farms was 585 acres of which 453 acres were owned and the remainder rented in. In all cases, clients live on the farm and are actively involved in the running of the business. In nearly all cases, they derive the majority of their income from the farm business.

Fact: These are not large farms. They are family farms run commercially by their owners who are relying on the farm business for their income.

The average number of business owners per family farm was 2.8. We have recognised partners or shareholders as business owners.

Fact: It is rare for our clients' farming businesses to support more than 4 owners or 2 households from the available income, predominantly because there are insufficient profits. Whilst some have been able to bring in the next generation there are many that haven't as yet because the next generation may not be ready.

The average age of the oldest generation of the business owners (they may still be a couple or in some cases a widow) was 70, the range was 53 to 96. However, it is also the case that 61% of our clients' farming businesses are owned by at least one family member aged 70 or over.

Fact: Contrary to Government assertions, many of our clients are of an age where mitigating the impact of these IHT changes is simply not possible. When gifting assets, none of us can be certain of surviving 7 years and this expectation realistically diminishes with age. Many of our clients are caught in a catch 22, do they gift or not? If one doesn't survive 7 years then there is a risk of being taxed twice – not only will there be IHT payable on death, but if assets have to be sold to meet this liability, then a not insignificant CGT liability will be incurred by those that inherit, as assets have been transferred to them at their historic base cost.

Average family farm valuation

Based on the data collected, the average taxable estate valuation for the data collected from our clients was £8,921,000 per family farm.

Fact: This is somewhat higher than the numbers we have previously seen used in debates which have centred around land. In adopting this approach there has been a failure to include other significant asset groups such as machinery, livestock, the value of diversifications and personal assets.

This is broken down between asset groups as follows:

	%
Land	51.9
Farm buildings, let property and farmhouses	25.7
Plant and machinery	4.6
Breeding livestock	1.2
Working capital	1.6
Loans	(9.0)
Other business interests	14.0
Personal assets including pension funds	10.0
Total	100.0

Average IHT charge

Having established an average value of a farming client's estate we have then identified assets that are eligible for Agricultural Property Relief (APR) and Business Property Relief (BPR) and claimed the relevant reliefs which currently would apply post 5 April 2026 i.e. a £1m APR/BPR Nil Rate Band and a reduction of the balance by 50%. We have assumed that only 70% of the farmhouse value is eligible for APR. The other 30% of the farmhouse value together with the remaining personal assets, including any pension funds have been taxed at 40% (albeit the pension fund tax doesn't impact until 2027).

No one client is the same, their family structures and circumstances are all different. We have therefore made assumptions and calculated the IHT charge for three different scenarios that would be typical of our clients' situations.

- A family business where only the senior generation owns all the property and other assets equally. We have therefore split the balance sheet 50:50 between two people.
- A family business where the senior generation has been widowed and the deceased has not unusually left all their assets to their surviving spouse. We have therefore allocated the whole of the balance sheet to a single person.
- A family business that has already done some planning, or perhaps bought more recent assets in the name of the next generation. Dad, Mum and one of their children are in business together and all assets are split equally between the three of them. We have therefore assumed that the balance sheet is split three ways equally.

Scenario	Description	IHT Liability, £
1.	Dad and Mum are both 70 and own all the assets equally	£702,500 on each death, total £1,405,000
2.	Dad is 70 and is widowed, all the assets are in his name	£1,605,000 on Dad's death
3.	Dad and Mum are both 70 and are in partnership with their son who is 45. The assets are split three ways.	£367,500 on each of the parent's deaths, total £735,000 plus, a further £340,000 on son's death, total £1,075,000

Under Scenario 1 the liability is £1,405,000 on the death of both Mum and Dad. This increases to £1,605,000 in Scenario 2 simply because the APR/BPR Nil Rate Band of £1m belonging to the deceased spouse has been lost as it is not transferrable.

In Scenario 3, the total IHT liability for all three partners has decreased to £1,075,000; the £330,000 reduction from Scenario 1 is achieved by having available an additional £1m APR/BPR Nil Rate Band and another £325,000 Nil Rate Band.

Since Dad and Mum have already given away part of their estate in Scenario 3, then their joint liability is reduced to £735,000. Despite the material reduction it is still a significant amount of IHT to have to finance. Even if it was possible to spread it all over 10 years interest free, it would still be £73,500 to find every year.

It is worth noting that in all three Scenarios, we found that every individual's share of the net assets exceeds £2 million, therefore they are not able to claim the Residential Nil Rate Band of £175,000. Each individual only has £1.325m of assets not subject to IHT (£1m APR/BPR nil rate band and £325,000 Nil Rate Band), somewhat less than the £1.5m widely broadcast by Government.

Impact: We can conclude that under each of the three Scenarios there is a significant amount of IHT to pay.

Paying the IHT – from profits, borrowing or asset sales?

The Treasury has naively assumed that businesses could afford to pay any IHT arising on the death of the owners. In an agricultural context this is very difficult due to their limited profitability compared to asset values.

In theory, the IHT could be paid:

a) From available profits,

b) from further borrowing or

c) from asset sales

or a combination of all 3 and we consider each in turn.

We assume the IHT due is as per Scenario 1 above, i.e. a total of £1,405,000. This has to be funded on the death of both parents. We will assume that the whole liability can be spread over 10 years, interest free, which will give rise to an annual charge of £140,500.

a) Funding from available profits

We have calculated the average profit after tax and drawings generated by our clients' farming businesses is £57,500. This is the amount we consider could be available to repay IHT. We have calculated this using a three-year average of farming profits for the years ending 31 March 2022, 2023 and 2024.

Normally our clients would choose to apply these available profits to either repay past debt or to invest in future growth or simply to meet the additional working capital needs in these inflationary times.

Just to clarify this figure of available profits is per business and not per individual. Given the scale of capital invested, this profitability figure is astonishingly low. However, this is the reality of the numbers and of farming in the UK. For context, the profitability for next year ending 31 March 2025 is projected by many commentators as worse than this after a very difficult growing year. The issue of the lack of profitability in UK farming, and the disconnect between profit and asset values, is a huge one for the industry but not within our individual clients' control, and beyond the scope of this note.

Impact: Available profits are clearly inadequate to meet the annual IHT charge of £140,500 and leaves an annual shortfall of £83,000 every year for 10 years.

b) Funding from more borrowing

In theory this is an option. However, in reality, banks have very strict lending criteria, the main one being serviceability of the additional debt, from available profits. Funding the IHT liability at a modest interest rate of 6% would cost £84,000 pa in interest alone, before capital repayments. Based on available profits of £57,500 pa, it is self-evident that further debt is not an option as there is insufficient profit to cover the interest, let alone repay the debt.

Impact: Further debt is not affordable.

c) Asset sales

The only realistic option available to our average client is to sell a proportion of their main asset, the farm. In the data collected the average land value is circa £10,000/acre, the average client will therefore have to sell approximately 140 acres or 31% of their land owned, unless they can make up some of the shortfall from off farm assets.

Impact: Selling such a significant proportion of the farm is at least going to mean a major restructuring of the business to realign overhead costs with the reduced size of the business. At worst it could signal the end of the business if the reduced size is inadequate to generate sufficient income upon which the family can survive.

Other impacts that appear to have been overlooked

As we have reviewed the impacts with our clients in many meetings since budget day, a number of issues have come to our attention which appear to have been overlooked (or simply ignored) by the Treasury.

- The eldest of our clients are unable to plan for this. With 61% of our farm businesses having at least one owner aged 70 or over, then the majority of our farming businesses have a high probability of facing a significant tax liability over the next 10 years. We are unable to square the facts from our client base with the Government statements that only a very small number of family farms will be affected every year.

- Farmers plan, invest and train over a generation. Any farm that has a potential liability of this amount in the next generation will need to consider mitigating action now. However, it is clear that many will have limited options. Should the next generation commit to an agricultural education and training in a business which may or may not be around once their education has finished?

- There has been much talk of gifting assets and surviving 7 years as a way out of this. However:

    - If one gifts and does not survive 7 years, not only will the IHT liability still be due in full or in part, but the inability to rebase the assets for CGT purposes will cause additional tax on beneficiaries if they need to then sell. Gifts made by the elderly may therefore well attract additional tax, rather than save it.

- If one gifts to a spouse, under certain circumstances, if the spouse then dies within 2 years (or possibly 7 years depending on specific circumstances) of the gift, APR will be lost entirely, as the 2 or 7 year ownership / occupation rule may not be established. So, the IHT payable will potentially double, from 20% to 40%.

- Once capital is given away, the previous owner must not retain a benefit, otherwise HMRC treats the gift as ineffective for IHT. Land cannot be gifted unless the owner reduces his profit share from the business. In many cases the farm is our client's pension fund. Where will his or her income come from if gifts are made?

- If children are too young or relationships are not secure, or they are not ready for the responsibility of running a business, a gift made early or to the wrong person to minimise IHT may well backfire from a commercial point of view.

- Under the old rules it has not been necessary to prepare date of death accounts and to have machinery and stocks professionally valued at the date of death as 100% relief was available. Under the new rules this all changes and market valuations and date of death accounts will become essential. This will create significant extra work, take extra time in what is already a difficult period and incur extra cost (circa £10,000 per death).

- Perhaps the biggest issue that we have seen is the impact on client emotions and their mental health. Our clients have universally been hugely upset by these proposed changes. Due to the national interest and continued publicity of this, clients have told us that in the event they die before the rules change on 6 April 2026, then their estate will escape the charge. In our opinion, no policy issued by any Government should have this unintended consequence.

- Farmers are now faced with many difficult and in some cases impossible decisions:

    - Should we give assets away?
    - Do we have to move out of the farmhouse now?
    - What do I need to keep to provide enough income in my later years?
    - What if we don't survive 7 years?
    - Who should we give assets to?
    - Are the recipients ready to receive those assets?
    - If an IHT liability arises, how can we afford it?

Alternatives to this policy

Our observation is that levying IHT on family farming businesses is unfair and potentially discriminatory, in that it targets the elderly, and it seeks to raise tax from a business which is mourning the loss of one of its owners, and so is not in a strong position to raise funds. The business is at its most vulnerable at this time. IHT is a “dry” tax in that the death of an owner in itself does not bring more cash into the business from which to pay the tax. The family essentially has to sell the very land from which it is generating its livelihood.

However, an increase in CGT rates from 24% to say, 30% may be a fairer way to raise the required tax. CGT is levied when an asset is sold, and therefore there are funds available to pay the tax. In this way, the Treasury would share in the increase in land values, at a natural time for a business, rather than forcing a business to cope with a liability without the funds to pay.

Much has been said about wealthy non-farmers investing in land as an IHT shelter being the cause of rising land prices. We would suggest that the reinvestment of the proceeds from the sale of land for development has had as much if not more of an impact. We also question the merit of the continued availability of CGT rollover relief when it has been derived from the sale of land for development. Could CGT rollover relief be limited to agricultural value only, and CGT be charged on the balance of gains due to development value?

In our opinion, if the policy of the Treasury is to prevent wealthy non farmers from sheltering funds from IHT by buying farmland, whilst protecting the family farm, then the proposals may well achieve precisely the opposite. Wealthy non farmers who will otherwise pay 40% IHT on their Estates may well still invest in farmland under the new rules, as they will halve their IHT bill, whilst family farms will be the sellers.

Conclusion

The proposed changes to IHT legislation have been naively conceived without any thought as to the practicalities and impact of what has been announced.

Sooner or later, all family farmers will be affected, but family farms with elderly owners have been especially unfairly prejudiced. If no action is possible or indeed appropriate, then large IHT bills will be faced which will in most cases be impossible to fund from trading profits. Even if farming families find a way to fund some or all of the liability it will stymie growth in agricultural businesses for the next generation.

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The Hutchinson Partnership

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