LOWS ORKNEY LTD

FARM BUSINESS HANDBOOK

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Lows have been advising farming families for generations. This handbook brings together many of the common themes that we see when acting for farm businesses. We cover issues affecting farm businesses such as ownership, leases and partnerships. We also discuss the main succession planning concerns, wills, legal rights and lifetime transfers. We seek to highlight the legal gaps that may need addressing to safeguard a farming business' future. The benefits of proper planning are to provide certainty and security for the next generation.

Farm Ownership

Title to land is held either on the Sasine or Land Register. The Scottish Ministers have tasked the Registers of Scotland to hold all land in Scotland on the map based Land Register by the end of 2024. If your land is on the Sasine Register it may be that you consider a voluntary registration to have your ownership boundaries plotted on to the Land Register. Land in Orkney began entering the Land Register in 2003 so if you haven't bought or secured land since 2003, it is likely to still be on the Sasine Register. Voluntary registration is a particularly popular route for those with complex or piecemeal titles that they do not wish to leave for their families to resolve.

A Land Registered title simplifies the conveyancing procedure, making future transactions easier, cheaper, and faster. The replacement of missing sasine deeds can be an expensive and timely process. Once Land Registered, all relevant information and deeds are compiled into one document which can easily be accessed digitally.

There will be costs associated with registering your property, including registration dues based on the value. However, if your property is registered for the first time by way of Voluntary Registration then you will receive a 25% discount from the Registers of Scotland. There will be legal fees incurred for the work involved in applying for voluntary registration priced in accordance with the complexity of the titles involved.

Leases/Licences

If you are occupying land that you do not own it is important to know what type of legal arrangements exists between you and the landowner. In order for there to be a lease there are 4 essential elements:- two different parties as landlord and tenant, identifiable subjects/property being let, a rent passing and a duration/expiry date. If you do not have exclusive use of the land/property it may be that you have a licence for a particular purpose. A Grazing or Mowing lease for a maximum of 364 days a year are straight forward and often not in writing. If a tenant does not remove after this period the lease may convert into a longer lease known as a Short Limited Duration Tenancy, if the landlord does not take action. Leases for less than 5 years are a Short Limited Duration Tenancy. A lease for a minimum of 10 years is a Modern Limited Duration Tenancy.

Whether or not you have a "secure" 1991 Act tenancy of land depends on several factors. Occupation of the land before the 27th November 2003 is crucial in reviewing the facts and circumstances of each case. There are many hurdles to overcome such as in relation to the occupation and use, landlord's consent, regular payment of rent, clearly defined parties to the agreement and the area of land/buildings involved. If all of the facts can be established then it may be that an agricultural tenancy exists – on the basis of an unwritten lease. In cases where the arrangement began after the 27th November 2003, the default position is that the tenancy constituted will be a Short Limited Duration Tenancy of no more than 5 years duration.

Business Structure

Farming businesses are usually operated as a sole trader, a farming partnership or a limited company. When considering the structure, you need to make provision for when someone wants to leave the business and also cater for changes or family animosities, either in the current generation or future ones. You should try to review the agreement every few years and particularly in the event of any major life changes (or anticipated changes). There may have been changes to legal or tax requirements since the previous review and you should consider whether wills and accounts still reflect the position set out in the Partnership Agreement.

A Partnership at Will (unwritten partnership) exists where two or more people carry on business together with a view to generating a profit. These are governed by the Partnership Act of 1890 and are not comprehensive enough for the realities of modern business as the partners will not have any carefully considered clauses to fall back on in the event of dispute. A partnership governed by the 1890 Act alone may be dissolved by any of the partners at any time. If relations are hostile then this may lead to court action to resolve any dissolution arguments.

If your farming partnership does have a written agreement you should check whether it is up to date. The Agreement may be historic with further partners added along the way without the initial Agreement being properly updated or amended. For example, if a partner wants to leave the partnership – how is the outgoing share to be calculated – at "book value" or is a revaluation required. If there are inadequate dispute resolution or governance arrangements, the outlook can be tortuous and costly to unravel.

Partnership Agreements and the accounts need to be particularly careful on how title to the farm and lending to the farm business is dealt with. In Scotland, when someone dies, their spouse and children are entitled to Legal Rights (irrespective of the terms of any Will or Partnership Agreement). Legal Rights can only be claimed in respect of moveable property – generally everything but land and buildings. However, even if title to a farm is held in an individual's name, if this has been entered on the balance sheet in the firm's accounts, the individual in effect holds the land/buildings as trustee for the firm, which makes the land partnership property. This means that the heritable property is effectively partnership property and it is deemed to be moveable property for the purposes of calculating Legal Rights. This could significantly increase the value of the moveable estate, and consequently the legal rights entitlements of the deceased's family will be much larger. In the event the deceased's estate does not have sufficient other assets to meet the Legal Rights entitlement, this could lead to part of the heritable property having to be sold to settle the claims.

It may be that parties previously involved in a partnership have followed accountancy, tax or legal advice to form a farming company. They may not be fully aware of differences in the regulation and administration requirements. The governance systems of the company may also be inadequate to deal with a dispute or decision making.

Family Agreements

These are contracts entered into prior to marriage which enable the couple to regulate financial matters in the event of a breakdown in their relationship. The agreement can provide that the assets held by each of the spouses prior to the marriage (and anything deriving from those assets), will not form part of the matrimonial 'pot' to be divided on divorce. This is particularly important for farming families, where a business or partnership may have been built up over generations. If this business or partnership finds its way into the 'pot' to be divided on divorce, this could have significant consequences not only for the divorcing spouse, but the family as a whole.

The legal position on divorce is that assets acquired prior to the marriage, or those gifted by a third party or inherited during the marriage do not form part of the matrimonial property to be shared on divorce. The difficulty arises when the 'non matrimonial' asset changes form and inadvertently leads to an asset falling into the 'pot' to be divided between the couple. If the marriage has already taken place it is possible to enter into a post-nuptial agreement on similar terms to a pre-nuptial agreement. It can also, for instance, be used to regulate a specific transaction.

Register of Persons Holding a Controlled Interest in Land ("RCI")

The Scottish Government's new Register, aimed at improving transparency on who controls land across Scotland, became active on 1st April 2022. Farmers and landowners are particularly affected and need to take this new legislation very seriously. Where the owner or tenant noted in the Scottish property register is not the person in control of the land, a RCI needs to be made to contain details of those who control and make decisions relating to the property. The information must be submitted to the RCI before the grace period expires on 31st March 2024.

For example, if the farm is in the father's individual name but is being farmed by the partnership then the various partners require to be registered with Registers of Scotland in order to comply with the RCI regulations.

If the registered owner or tenant fails to disclose the required information, or provides false or misleading information, they will be guilty of a criminal offence and may incur a fine of up to £5,000. All parties involved have a duty to provide the required information and non-compliance is a criminal offence. Penalties will not be charged before the end of the grace period on 31st March 2024. This will allow time for owners, tenants and the relevant parties to comply with their RCI duties.

Succession Planning

When considering your succession plan you should prepare and provide for:

1. Death
2. Disability
3. Disaster
4. Divorce
5. Debt
6. Disagreement/Dispute

Most people agree that increased equality of all kinds is a good thing. Many want their children or some wider class of relations to benefit equally from their estate when they die. However, that is rarely the case in farming families. There is often one child who might be termed "the farmer" – i.e. who works on the farm and sees their future there. Other children pursue other careers which may have nothing to do with farming.

The value of the farm and farm business is usually by far the largest asset. If you have several children, both farming and non-farming, and want to leave everything equally in your Will that is fine. The result though, is likely to be that the whole farm and business will have to be sold and the cash then divided amongst the children, unless the farming child is able to raise the capital to buy out his or her siblings share of the estate.

If, on the other hand, the farming business is to be preserved, the farming child will inevitably have to get the lion's share of your estate. That may leave other children with very little inheritance. In the past this was often accepted by all siblings as the way things had to be to keep the farm going, but this is becoming less so nowadays. Ill feeling often arises and disputes emerge where some children are receiving very little and their farming sibling receives an inheritance worth £1,000,000 or more.

There is no simple solution to this, but there are ways to preserve both the farm and family harmony.

Wills

Firstly, speak to your family and make a Will. The worst family fall-outs happen when these matters were never discussed. On a parent's death a child discovers they are receiving nothing and their farmer sibling is effectively getting everything. However, we find that there are rarely disputes when parents discuss things openly at the time they make their Wills. You can tell the children you love them equally, but also want to ensure the continuity of the farm. When children hear this from you they are more likely to accept an unequal division of assets when you die because they know why this has happened and that this is what you wanted.

There are things you can do to make provision on your death for the non-farming children. For example, life insurance policies and other investments can be taken out and earmarked for the non-farming children. A Will can require the child who inherits the farm to make payments to his siblings for a number of years, e.g. £5,000 each for five or ten years after the parents' death. In considering this option, it is extremely important to speak to your accountant. These payments must not be so burdensome that the farming child loses heart and decides to sell up.

Legal Rights

You do not have complete freedom to decide who gets your estate on death. Under Scottish Law you can bequeath land and buildings to whoever you want. However, all other assets (referred to as "moveable estate") are subject to a claim by any biological or adopted children. Your moveable estate includes money in the bank, livestock and implements, shares in farming companies, motor vehicles, investments and generally all assets apart from land and buildings. On a parent's death a child can either accept whatever provision is given under the Will or they can opt to claim what are known as their "Legal Rights" over the parent's moveable property.

If there is a surviving spouse or civil partner, the Legal Rights amount to one-third of the moveable estate. If there is no surviving spouse or civil partner then the Legal Rights are one-half of the moveable estate.

For example, if the father is the last of a couple to die and has moveable estate of £150,000 then £75,000 would comprise the children's Legal Rights entitlement. If there are three children they would each be able to claim £25,000 from the estate regardless of the terms of the Will.

Legal Rights claims can be significant in farming families because they affect key farming assets including interests in a partnership and shares in a farming company. The best way to avoid unwanted Legal Rights claims by children is to speak to the children about the issue when making your Will. They can also be asked to sign a Legal Rights Disclaimer, which is effectively them renouncing any claim to their Legal Rights on your death. This can then be kept with your Will for when the time comes.

If a child is difficult about the issue of Legal Rights then you could consider:-

1. Transferring ownership of the farm and business over to the farming child during your lifetime; or
2. Making gifts during your lifetime of your moveable assets or turning your assets largely into land and buildings so they are not vulnerable to a Legal Rights claim when you die.

Powers of Attorney

Powers of Attorney can be for financial or welfare purposes, but we usually prepare combined Powers of Attorney covering both. This enables your appointees, usually your spouse and children, to manage your legal and financial affairs if required, and also to take personal or welfare decisions should you lose capacity.

Farming can be a dangerous occupation and sadly we have seen cases where farmers are injured and lose capacity. The result, if no Power of Attorney is in place, is a nightmare for the family, having no means of managing the farm, the business bank accounts, or of taking decisions. Their only option is to go to court seeking an Intervention Order or more likely a full Guardianship. The process is expensive, stressful and time consuming and often does not give the desired result.

All that can be avoided by having a Power of Attorney in place. You might never need it but having it there can save a lot of issues for your family should something unexpected happen.

Lifetime Transfers

Farmers often wrestle with whether to make over the ownership of the farm during their lifetime or only on death. For many giving up control of their farm, which they've lived and worked for decades is a difficult and daunting move. There is no simple answer and each case and family is different.

The main reasons for making a farm over during your lifetime are: -

a. If you go into a care home, costs will be less likely to have an affect on the farm.

b. There can be no question over what is to happen on your death, as it has already been dealt with.

A potential downside could be that Capital Gains Tax may be an issue, however, your accountant will usually be able to take steps to mitigate this.

The alternative, of course, is to transfer the farm on death by leaving it under your Will. Most farming assets are exempt from Inheritance Tax and no Capital Gains Tax arises on death.

There is, however, the risk in this case that you go into residential care and costs are charged up against the farm assets. The local authority could register a charging order against the farm, which would cover the care charges incurred and this would need to be paid in order that the property can be transferred. Ultimately, this could require the sale of the farm following death in order to repay the care charges.

Estate planning for farmers is complex and involves balancing several competing priorities. The two key things to remember are: -

1. Discuss your wishes with your whole family and make sure they understand what you are doing, what your wishes are and why; and,

2. Make a Will which makes this clear and does not leave the matter open to doubt or conjecture on your death.

The terms of your Will and the larger picture of your whole estate and estate planning, can be key. Making specific bequests can not only serve to satisfy your wishes and the future of the farm, but could also have significant tax benefits. It is vitally important for you and for the future of your farm to get detailed advice from suitably experienced solicitors and accountants at an early stage, in order to provide business stability and also assist in mitigating your tax liability.

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