Wilsons

Farm Partnerships – Practice Notes

A series of eight practice notes for Practical Law written by

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Practice Note 2. – Who owns the business and assets?

The series comprises:

1. Basic Principles
2. Who owns the business and assets?
3. Dissolution and winding up – retirement and death
4. How land can be owned and occupied in a partnership situation
5. Running the Partnership
6. Borrowings in Farm Partnerships
7. Tax
8. Limited Partnerships and LLPs

Farm partnerships: who owns the business and assets?

- **Resource type: Practice note**
- **Status: Maintained**
- **Jurisdiction: England**

Farm partnerships: who owns the business and assets? is part of a collection of eight practice notes on farm partnerships.

This practice note looks at farm partnerships as asset-holding vehicles, exploring the question of ownership of partnership interests. The note looks at how the value of a partnership interest is determined, the assets that commonly appear at an undervalue and the implications improvements to property have on the ownership of partnership interests. The ownership of entitlements and Single/Basic Farm Payments is also explored.

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Scope of this note

Farm partnerships often involve the ownership of valuable assets, and have to deal with issues of land ownership and succession to a family business. These raise very different questions. This note looks at farm partnerships as asset-holding vehicles, exploring the question of ownership of partnership interests. The note looks at how the value of a partnership interest is determined, the assets that commonly appear at an undervalue and the implications improvements to property have on the ownership of partnership interests. The ownership of entitlements and Single/Basic Farm Payments is also explored.

This note is part of a collection of eight practice notes on farm partnerships.

For further information on farm partnerships, see Practice notes:

- *Farm partnerships: basic principles (www.practicallaw.com/5-614-4486)* .
- *Farm partnerships: dissolution and winding up: retirement and death (www.practicallaw.com/0-614-4525)* .
- *Farm partnerships: how land can be owned and occupied in a partnership situation (www.practicallaw.com/8-614-4526)* .
- *Farm partnerships: running the partnership (www.practicallaw.com/6-614-4527)* .
- *Farm partnerships: borrowings in farm partnerships (www.practicallaw.com/8-614-4531)* .

- *Farm partnerships: tax (www.practicallaw.com/6-614-4532) .*
- *Farm partnerships: limited partnerships and LLPs (www.practicallaw.com/4-614-4533) .*

Farm partnerships as asset-holding vehicles

It is now common for farming partnerships to hold valuable landed assets, so they have become significant asset-holding structures. The question of ownership of the partnership interests is therefore very important.

How to determine the value of a partnership interest

A share in a partnership is notoriously difficult to define, and probably means different things in different contexts (for example, a deceased partner's interest compared to a continuing partner's). Therefore, it is not easy to understand how ownership and value is determined between partners.

Logically, the correct approach when determining the value of a partner's interest is to analyse what he would receive on a winding up. Unless a partnership agreement specifies otherwise (for example, by way of an option arising on death or retirement), this depends on the statutory rules in *section 44* of the Partnership Act 1890.

Broadly, section 44 provides that on a winding up, the assets are realised and the net proceeds are applied in the following order:

- Third party creditors are paid out.
- Partner loans and current accounts are paid out.
- Partnership capital (theoretically a fixed sum) is paid out.
- The remainder is "divided among the partners in the proportion in which profits are divisible".

Note that section 44 makes no distinction between income and capital profits. Where a farming partnership includes valuable assets that sit at an undervalue in the accounts (that is, there is a substantial revaluation surplus), there can be a large amount of value to be divided.

If the partnership agreement clearly states the capital profit sharing ratios, this should determine the ownership of the revaluation surplus on a solvent winding up.

Where the partnership agreement is silent on the point, the income profit sharing ratio will normally be applied. If it is an old agreement and the ratios have changed over time, the only evidence of "the proportion in which profits are divisible" is likely to be the division of income profits in the accounts over the last few years.

This can lead to considerable shifts in the ultimate ownership of a partnership over the years, often in a way that is unintended, and unknown until some triggering event occurs that requires interests to be calculated.

In the context of farming partnerships, this can arise when, over the years, the older generation take a reduced role and lower share of income. Unless their capital profit shares are spelt out in the Partnership Agreement, they can find that large amounts of value (that is, of the revaluation surplus) have passed to the other partners in a way that was unintended (and with potentially significant tax consequences).

Assets that commonly appear at an undervalue

Farming partnerships frequently involve assets that (for very good reasons) are not revalued on the balance sheet, and therefore may appear at an undervalue. Examples commonly encountered include:

- Freehold land.
- Entitlements.
- Livestock on the herd basis.

Improvements to property

Improvements to the land and buildings create difficult questions. As a matter of land law, where a house or farm building is fixed to the land, it (and its value) becomes part of the freehold. The issue is to sort out who owns the underlying assets, and to avoid unintended tax liabilities.

This can arise where the partnership makes improvements to land and buildings that are not held as part of the general capital, but are held as separate property, or on land capital accounts held by some of the partners.

The treatment of these improvements should be agreed and recorded in the partnership minutes, or by way of a memorandum signed by all the partners.

Entitlements and Single or Basic Farm Payments

Entitlements and the Single Farm Payments (and their successors, Basic Farm Payments) are derived from EU law and are subject to change. At present, broadly speaking, entitlements must attach to land, but are tradable.

Where farmland has been in a family partnership for many years, entitlements will have arisen and will usually not appear on the balance sheet.

Perhaps the simplest view is that ownership of these entitlements should follow the ownership of the land from which they were derived. As the values do not usually appear in the balance sheet, this needs to be spelt out in the partnership agreement.

Purchased entitlements should normally be treated as general capital if purchased out of the general funds of the partnership.

The income arising from them (that is, the Single or Basic Farm Payments themselves) are normally treated as general income of the partnership. The obligations to meet cross-compliance would also fall on the partnership.

Resource information

Resource ID: 8-614-4507

Products: Agriculture

This resource is maintained, meaning that we monitor developments on a regular basis and update it as soon as possible.

Resource history

Changes made to this resource

We will record here any changes to this resource as a result of developments in the law or practice.

Related content

Topics

Farm partnerships and farming agreements (http://uk.practicallaw.com/topic9-607-6428)

Practice notes

Farm partnerships: basic principles (http://uk.practicallaw.comtopic5-614-4486)

Farm partnerships: borrowings in farm partnerships (http://uk.practicallaw.comtopic8-614-4531)

Farm partnerships: dissolution and winding up: retirement and death (http://uk.practicallaw.comtopic0-614-4525)

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