Wilsons

Farm Partnerships – Practice Notes

A series of eight practice notes for Practical Law written by

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Practice Note 6. – Borrowings in Farm Partnerships

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: borrowings in farm partnerships

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

Farm partnerships: borrowings in farm partnerships is part of a collection of eight practice notes on farm partnerships.

This note discusses borrowings in farm partnerships, including the important issue where a partner introduces land into the partnership which has been purchased using borrowings or is charged to a third party. It discusses whether lender's consent is required, who pays the interest, and IHT reliefs on borrowings.

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Contents

Scope of this note

This note discusses borrowings in farm partnerships, including the important issue where a partner introduces land into the partnership which has been purchased using borrowings or is charged to a third party. It discusses whether lender's consent is required, who pays the interest, and IHT reliefs on borrowings.

Farm partnerships: borrowings in farm partnerships 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: who owns the business and assets? (www.practicallaw.com/8-614-4507)* .

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

Land purchased using borrowings

A number of different scenarios may arise.

Land may be purchased by the partnership, and treated as part of the general capital. If the partnership borrows money for the purpose, the position should be straightforward. The capital repayments and interest should be treated as normal outgoings of the business.

Land may be introduced as partnership property, where it has been purchased by one or more of the partners using borrowings. In this situation, the partners concerned can keep the borrowings private, paying the capital repayments and interest themselves. Alternatively, the borrowings may appear in the partnership books, with the capital repayments and interest coming out of the partnership. This situation raises issues in terms of liabilities to the lender as between the partners, and also questions of accounting treatment.

The need to analyse borrowings

Where borrowings exist within a partnership or are being contemplated, the following questions need to be considered:

- How much is the loan?
- What are the terms, particularly as to income and capital repayments?
- What is it being used for?
- Who is the borrower?
- What property is the borrowing charged on?
- Who pays the interest?
- Who pays the capital instalments?

Partners introducing land as partnership property which has been purchased using borrowings, or is charged to a third party

Is consent required from the lender?

The loan document (the charge and facility letter) need to be checked to ensure that no covenants are breached. On the face of it, if the property is charged to the lender, the borrower is transferring the beneficial interest to another party (the partnership) without the lender's consent.

In the simple case, where the individual wishes to introduce the land but retains separate responsibility to pay the interest and capital, the borrowing would not appear in the partnership accounts. In that event it may be possible for an individual to hold his interests in land on trust for the partnership subject to the charge, and it is possible that consent will not be required.

If bank consent was required, this would probably be out of the ordinary so far as the bank was concerned. They may well require a new loan facility to be granted to the partnership, with new charging documents. This would add to the expense.

Who is paying the interest?

The mechanics by which interest relief is given for income tax purposes needs to be considered. This is likely to have affect whether the borrowing remains a personal liability or is transferred to the partnership.

Who is paying the capital instalments?

In principle, these need to be charged in the partnership books against the partners entitled to the value of the land. If not, the other partners are effectively adding to capital and transferring value to them.

If this happens, it is important to adopt a mechanism in the accounts to ensure that other partners are credited with the additions to capital made by them. The result should be that the partners entitled to the value of the land remain entitled to capital profits and losses (and effectively own it for capital gains tax purposes, see *Practice note, Farm partnerships: tax: Land as partnership property: CGT (www.practicallaw.com/6-614-4532)*), but the loan repayments are properly accounted for.

Obligations and indemnities as between the partners

The partnership documents should contain a covenant by the borrower to meet his obligations to the lender, and corresponding covenants by the partnership to do the same, possibly with indemnities either way. This should cover both financial obligations and covenants under the charge or facility letter (for example, obligations to keep in repair, not part with possession).

Where should the debt appear in the balance sheet?

This is an accounting question, but where the relevant land is held in a land capital account there would seem to be logic in applying it against that land capital account.

Borrowings and IHT reliefs: the position after Finance Act 2013

The *Finance Act 2013* (FA 2013) introduced a series of restrictions on how liabilities could be set off against the value of assets for IHT purposes (see *Practice note, Inheritance tax: restricted deduction of liabilities (www.practicallaw.com/6-536-0466)*).

Loans used to finance relievable property

Before the FA 2013, it was standard inheritance tax (IHT) planning for a farmer with borrowings, holding relievable assets (attracting ***Agricultural Property Relief*** or ***Business Property Relief***) and also non-relievable assets, to charge the borrowings against the latter. Under the IHT rules, the borrowings reduced the value of the non-relievable assets for IHT purposes.

For borrowings taken up on or after 6 April 2013, they will be deducted against the value of relievable property to the extent that they were taken up for the acquisition of such property, or for the maintenance or enhancement of its value (see *Practice note, Inheritance tax: restricted deduction of liabilities: Liabilities used to finance relievable property (www.practicallaw.com/6-536-0466)*).

Discharge of liabilities on death

Under the FA 2013, restrictions have been applied so that, if a liability of the deceased is not repaid after death, and there is no genuine commercial reason for it to continue, it cannot be deducted from the estate for the purposes of calculating the IHT (see *Practice note, Inheritance tax: restricted deduction of liabilities: Discharge of liabilities on death (www.practicallaw.com/6-536-0466)*).

Resource information

Resource ID: 8-614-4531

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

Farm partnerships: how land can be owned and occupied in a partnership situation (http://uk.practicallaw.comtopic8-614-4526)

Farm partnerships: limited partnerships and LLPs (http://uk.practicallaw.comtopic4-614-4533)

Farm partnerships: running the partnership (http://uk.practicallaw.comtopic6-614-4527)

Farm partnerships: tax (http://uk.practicallaw.comtopic6-614-4532)

Farm partnerships: who owns the business and assets? (http://uk.practicallaw.comtopic8-614-4507)

Inheritance tax: restricted deduction of liabilities (http://uk.practicallaw.comtopic6-536-0466)

Glossary

Agricultural property relief (APR) (http://uk.practicallaw.comtopic0-383-5823)

Business property relief (BPR) (http://uk.practicallaw.comtopic2-383-4498)