

Why inheritance tax charges are really good for real fa...

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I am aware I touched on the issue [of inheritance tax on farms yesterday](#), but I felt it was worth another go. There is a lot of additional analysis in this post, so I hope it is worthwhile reading.

When farmland has become financialised in the way it has been because of inheritance tax exemptions, farming can't work, so farmers need to realise that actually having an inheritance tax charge helps them to reclaim farming for farmers and for the benefit of the people of this country. They really should not be protesting today: Labour is, for once, on their side and even doing the right thing.

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This is the transcript:

We need to talk about farms. We need to talk about farming economics. We need to

talk about inheritance tax. And we need to talk about why all these issues are related.

Farmers are up in arms and are complaining about their tax bills.

Let me tell you that I first worked for a firm of accountants in East Anglia more than 50 years ago now and at that time farmers were up in arms and complaining about their tax bills. This is the normal state of farming in the UK. Farmers are not happy people by definition, it seems. They will always find something to moan about and the government and will always be high on that list.

So, let's not get overly upset about the fact that farmers are suddenly getting a bit angry about the fact that Labour has had the temerity to impose a very small inheritance tax charge on them, which is much more favourable than that which is going to be paid by the rest of society on their homes or their assets and so on. And let's take a look at what is really going on in farming because I do understand that farmers do have some real reasons to be upset. It's just that inheritance tax is not really the cause for that. It might be the symptom that has given rise to the process, but behind this issue, there's a great deal to unpack.

And that, fundamentally, is that farms and farming economics are all going wrong. Why is that? Let me put some figures into this and maybe a little bit of economic theory to try to explain why it is I think this situation has arisen.

If we go back to the type of economic theory which is taught at most universities, and I'm being very simplistic here, but there's nothing wrong with that because this is what people are told, there are what are called four factors of production.

Those factors of production are land, they are capital, they are labour, and they are enterprise. And the return to those four factors of production, which are supposedly all-encompassing of what is required to produce goods and services, are rents, and interest, and wages. And those are the supposed returns that should be made on those four factors of production.

So, that is the framework in which we can examine farming inside what we might call a liberal capitalism framework.

A liberal capitalist society is one in which it is assumed that the capital of that society is brought together to produce goods and services for the benefit of everyone through a market system. And that, again, is what is taught as being the way in which our economy works. And I stress it's what is taught, because we might find that there are problems with that analysis later on, but let's start with it.

If we come to farming, I want to use a few numbers to explain how what I might call a typical farm might work.

That farm might have land worth, I'm making an estimate here, £3 million. And £3

million will ensure that inheritance tax would be paid on this farm if it was passed on at death by the farmer or their spouse under the new laws that Labour is introducing. So I've chosen a number that is deliberately big enough for that purpose.

That £3 million of land should produce an economic return under economic theory, and that return will probably be expressed as a percentage of its value. Let's assume that the land should produce a five per cent rate of return on the capital employed, and that would be £150,000 a year that should be paid to the farm for the use of that land.

Now, let's look at the second resource that the farm uses. Let's assume that it owns £1 million of farming equipment. That's the capital employed in this business, which would, by the way, be included in the valuation of the business that would be subject to inheritance tax. So again, I've deliberately chosen a number that is big enough to trigger this charge. And that capital equipment is things like tractors and combine harvesters or whatever else is required to make the whole thing work.

On that, there is a rate of return. It actually is interest. But let's assume the farmer funded it themselves for the moment, and instead realise that, of course, that capital equipment doesn't last forever. It has a finite life. Let's assume that it has a life of, let's say, five years. That might be a bit tight in some cases. I see tractors rolling around East Anglia that are 25 twenty-five years old. But we'll give it that for the sake of argument.

And that means that the farmer's got to generate £200,000 a year of income just to cover the replacement equipment. That's a fair assumption.

Then we come to the farmer. And the farmer gets their return in two ways. One is a wage. Now, the farmer, and quite possibly their spouse, will work long hours on the farm, and therefore I'm not suggesting that the wage they should get should be anything like the median wage in the UK, because they work very long hours, they work very hard hours, they work anti-social hours, they do it 365 days a year in some cases, so clearly they should make more than the median wage. Let's presume that they're going to make £50,000. That may not be enough, but I'm going to use it as a symbol of the wage return.

But it isn't the only return that the farmer should get, because the farmer is not only a worker, the farmer is, in the conventional analysis of the inputs into this business, an entrepreneur. They provide enterprise, and the return to enterprise is profit. They bring to the business something more than their labour. They bring their ability to coalesce the land, the capital, and the labour together in a way that produces a useful output. So, they're entitled to a return on that activity, which is profit. And I'm going to suggest that this activity, which does demand real skill, could return another £50,000 a year to the farmer, giving them a total reward of £100,000, which most farmers would be pleased to see, but which is made up of these two components, one labour, and one profit. And I summarise all this in the chart that's now on the screen.

But, now let's talk about what returns are really made, because returns to farmers are nothing like the £450,000 which is required to cover the return for labour, the return for profit, the return to the land, and to cover the cost of the equipment.

And I do show in that chart that £200,000 is both a return required and a cost, but still, that this business should have a net return of £250,000 split between the return to the land, and the return to the labour, and the return to the profit. Somebody else is going to get the return on the capital. In effect, the manufacturer of the equipment gets the return on that. But the farmer's got to cover it.

Now, very few farms will be making that much money. What we're actually hearing from many farmers right now is that they basically don't make a return on the land that they employ in their business. And I'm going to take those farmers at face value and presume that is correct; that there is actually no return on the land that they use in the business, even though they are now going to be asked to pay tax on it if they pass it on from generation to generation.

So, in other words, the £150,000 that should have been generated to cover the return to the land is simply not there. They lose that money. They're employing £3 million worth of land in their business which doesn't generate a return at all.

And, I hear farmers saying that they are really not making an adequate income anymore. And, this is so widespread a complaint that I believe it. In that case, I'm going to presume that not only does the farmer make no profit at all - in other words, cancelling that £50,000 that they should make, because of their ability as entrepreneurs - and that they might even make a loss on the labour that they put into the business because they do not make enough to actually cover the value of the time that they expend on the farm, therefore reducing the value of the labour to £40,000 and cancelling the profit altogether. So, what they're actually making is £240,000 a year, but £200,000 of that is to cover the cost of the equipment written off during the period, and therefore not available to the farmer at all. They're living on just £40,000 as a return on £3 million of land, and £50,000 worth of labour, and £50,000 worth of enterprise effort put in by them to try to make the business work, but it doesn't. In other words, if I expand that summary of the farm accounts, what we're really seeing is that the farm could be making a loss of £210,000 a year against the opportunity that it should apparently have created if it had worked well, but it doesn't.

Farm economics

Asset	Value £	Rate of return	Required income £	Actual £	Loss £
Land	3,000,000	5%	150,000	-	(150,000)
Equipment	1,000,000	20%	200,000	200,000	-
Farmer's labour			50,000	40,000	(10,000)
Profit			50,000	-	(50,000)
Total			450,000	240,000	(210,000)
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Less, costs			200,000	200,000	-
Net income			250,000	40,000	(210,000)

Now, my question is, why are farmers complaining about inheritance tax then when it is very clear that it is something else that is wrong in farming. If farmers aren't making a return on their land, it's not because of inheritance tax. Let's be clear about it. The price that they're being paid for their product must simply be too low because they should be able to make a return on their land, or alternatively, their land is worthless, in which case there shouldn't be an inheritance tax charge on it anyway.

Now, let's just explore that. If they're being paid too little money, that's because there are two forces that are lining up against them, and maybe three. One is Brexit, and let's leave that one aside because it has reduced the subsidies they get.

The second one is the large food manufacturing companies because, let's be clear, most food does not leave the farm and go straight to a supermarket. Most will be used for food, as an input into a manufacturing process, which does then result in a manufactured product called food, which does eventually end up on the supermarket shelf, but with that manufacturer taking a significant profit margin out on the way. They, those manufacturers and traders in food, are seriously forcing prices down to farmers.

They are the problem for the farmer, and, let's also be honest, so too, thirdly, is the supermarket, who insists on trying to sell food at the lowest possible price as the basis for price competition between the supermarkets, which in turn then feeds their quite large profit margins on other products that they sell alongside the foodstuffs.

Now this is where the problem for farmers is, and it is where they need protection. Farmers are not being paid enough and government should be ensuring that they are. They should be angry with the government. They should be angry that they have not been protected against the monopsonist power of either the food manufacturers or the supermarkets. And a monopsonist, by the way, is somebody who is a single buyer or a small group of buyers who can control the prices that large numbers of people can charge to them on the supply of products. So this is a form of monopoly, but used against suppliers instead of against the consumer.

So, they need action against the monopsonists.

They also need some realistic appraisal of why it is that farmland, which makes no return at all, according to farmers, when used as farmland, is currently valued quite significantly. The £3 million that I put into this calculation is based upon the fact that farmland changes hands for significant amounts of money now, much more than it did only a decade or two ago.

Why has it suddenly gone up in value? Well, that's because some people are buying a great deal of farmland. They are assembling farms. There's one in East Anglia which apparently has 36,000 acres of land under its control, which is being assembled for one straightforward reason and that is to make use of the inheritance tax loophole which

has guaranteed that an estate could be passed on free of tax under past inheritance tax legislation. In other words, farmland has been used as a financial instrument.

It's not really being used as an input into the farm production process or the food production process, whichever way you wish to look at it. It's simply being used as a tool to be put in place to reduce a tax bill. It's therefore not now an input into the liberal capital system. It's part of the financial capital system. And we don't really have a liberal capital system of the type that in fact I explained earlier on at all in this country anymore.

Liberal capitalism is, in a very real sense, dead. The idea that we run an economy for the sake of producing goods and services which might be a benefit to humankind is frankly to be considered history now. In the sense that the whole of the City of London has turned capitalism into a financial product system, farmland is just a product to be used for financial engineering.

So, the farmers actually should want an inheritance tax charge on this land because if there was an inheritance tax charge on this land, it would no longer have a value for financial purposes. It would only have a value for farming purposes. And for farming purposes it has no value at all, which means actually they could pass on their estates to their children however they like with no tax charge arising. It solves their problem to have an inheritance tax charge.

They are protesting about the wrong thing when saying that inheritance tax is penalising them. It isn't. It's helping them.

It actually will help them in another way. If we have serious inheritance tax charges, the price of farmland will fall so much that people will actually be able to enter into farming because farmland will be affordable to people who want to become farmers. And let's be honest, there is nothing that says that farming is a purely inherited business. Why should it be? Like every other business, people can acquire the skills to farm and not just through their genes. So, it would be entirely possible that if farmland fell in price because it wasn't used as a financial product new farmers would come into the business and that would be good for farming.

It would be good for our society.

It would be good for sustainability, most like.

But, at the present point in time, farmers are objecting to that inheritance tax charge and are therefore making life for farmers harder, and that makes no sense at all.

Now, let's stand back and summarise all this. As I've explained, the model that is being used to analyse return to farmers suggests that, in fact, there's something seriously wrong with the economics of farming. There isn't a proper return being made. There is

no return to land. But land has value because land has been valued as a financial instrument, not as a farming input. In that case, farmers need to change their economic arguments. They want the value of land to fall if they are going to be able to pass on their farms to the next generation without inheritance tax charge, which you can always do if something has no worth, and they want the value of farms to fall to encourage new entrants into the market, which the industry desperately needs because the age of farmers is growing steadily.

So they shouldn't be complaining about inheritance tax charges. They should be welcoming them. But what they should also be demanding is that the government take action against the rigged market that prevents them getting a proper price for the sale of their product. That is also critical. And the government that doesn't want to do that is a government that is going to fail the people of this country because we do need farmers for food security.

I am actually on the side of farmers here.

I want farming to work.

But when farming has become financialised in the way it has, it can't work. And farmers need to realise that actually having an inheritance tax charge helps them to reclaim farming for farmers and for the benefit of the people of this country.