



The Family Farm : Maximising the benefit of Agricultural Property Relief

BRIEFING

Farming or, more generally, land ownership is for many individuals or families a way of life, passed down from one generation to another. The reliefs given from capital taxation on both chargeable lifetime gifts and inheritances on death are an important part of the picture: without those reliefs many families would find it impossibly difficult to sustain the succession. This Briefing assumes that the sometimes difficult decision over who will succeed has been taken. The issue is how that can be achieved tax-efficiently, in particular in the context of inheritance tax (IHT).

The reliefs, given principally at 100% though for some assets at just 50%, are two-fold: agricultural property relief (APR) and business property relief (BPR). They must not be confused with each other, as there are important differences between the two. Where both could apply to particular property, APR takes priority. While below we make brief references to BPR as applying to certain types of property which APR does not cover, eg interests in partnerships, this Briefing is devoted principally to APR.

APR in a nutshell

The effect of APR is to relieve at 100% or at 50% 'agricultural property' as defined, which has been occupied for agricultural purposes for at least two years or owned for at least seven years (with agricultural occupation throughout that time).

'Agricultural property' means:

1. agricultural land or pasture;
2. woodland and any building used in connection with the intensive rearing of livestock or fish, if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture; and
3. such cottages, farm buildings and farmhouses, together with the land occupied with them, as are of a character appropriate to the property.

The above more or less (though not precisely) replicates the statutory definition. The distinction between the three limbs of the definition is important. It has been established that limb 1 covers only bare agricultural land or pasture, for example. It is this property to which the limb 3 farmhouses etc must be 'of a character appropriate'. More on farmhouses below.

Occupation

The alternative ownership and occupation tests mean that the typical owner/occupier, whether a sole trader or a partner, will get relief on a chargeable event (eg death) after just two years. By contrast, in a case where the land is let, seven years ownership is required. The two-year occupation test has an interesting application in both planning cases as follows.



Illustration

Mother is a partner in a family farming partnership in which she has a 50% income and capital share. Two 25% shares are owned by each of her two children. There is land in the partnership worth £2m. The farmhouse is occupied by the younger daughter and is attributed to her capital account. Mother, who has been told that she is unlikely to live for more than another six months, also owns £0.5m of cash and equities. Subject to capital gains tax (CGT) on disposing of the shares, she could acquire from her children a further interest in land which as a partner she has occupied for at least the last two years. There should be no liability to Stamp Duty Land Tax (being the transfer of an interest in a partnership) and the family as a whole would be prospectively saving £200,000 of IHT which would otherwise be charged on the cash and equities.

Whether the two-year occupation or the seven-year ownership test is in point, there must be occupation throughout that period for agricultural purposes. This is easy enough to achieve for the most part with agricultural land or pasture – and indeed HMRC Inheritance Tax will tend to accept a claim to relief on grazing land which is not occupied throughout the year. Specifically, in relation to set-aside land (although payments from the European Community are now a thing of the past), land which is being maintained in accordance with the requirements of the scheme will be treated as occupied for agricultural purposes.

Assuming that the farmhouse attracts APR under general principles (see below), there can be a

problem with the occupation test where, having lived in the house for many years, the farmer becomes ill and is admitted to a hospital or nursing home in the full expectation that he will recover and return, but sadly dies while away from the farmhouse. Technically therefore, subject to other members of the family who are actively involved in the farm living in the house, it is unoccupied at the moment of chargeable transfer and so any relief at all is prejudiced. Another reason for absence might be sufficiently extensive building works as to force the family to move out for a time. HMRC Inheritance Tax say to their officers:

*‘Cases where the owner is absent due to ill health can be contentious and difficult to decide. You will need to ascertain the length of, and reasons for, the absence ... As always it is the function of the house that it is fulfilling that is paramount and it is possible that even if the transferor is not actually resident there the evidence will show that the house remained the centre of the farming operations ... However, a temporary cessation of activity – for example, due to ill health – will not, in itself, prevent a residence being a ‘farmhouse’ if, on the precise circumstances of the case, it can properly be described as **functionally** remaining attached to the farm,’*

This point should be borne in mind in any appropriate case.



Farmhouses

The limited confines of this Briefing do not permit a detailed discussion of all the types of agricultural property. (Woodlands, for example, will attract APR only if 'ancillary' to bare land or pasture, which is generally taken to be a restrictive test in covering only small areas of woodland, copses and the like. However, larger areas of woodland may instead attract BPR if it can be shown that they are managed with a view to profit. Such a requirement is not an element of APR which therefore can be obtained by hobby farmers.) However, the subject of farmhouses does require some detailed attention, both because it can be extremely valuable in terms of relieving IHT and because, largely for that reason, it is a contentious issue.

It might seem curious that 100% relief can be obtained for a farmer's private dwelling, whereas the residence of any other businessman attracts no special relief from IHT. The justification of course is that traditionally the farmer must 'live over the shop' – or its equivalent in rural terms. But the connection between house and land established by custom has certainly weakened over the years, even if it remains true for many working farmers up and down the country, especially of course where the farm includes livestock. There have been a number of interesting decided cases in the Courts on the issue. Further, significant changes have recently been made to HMRC's instructions to their officers, as evidenced in the new Chapter 24 on agricultural relief in their Inheritance Tax Manual released in April 2009.

The farmhouse issue crops up especially in what might be called 'non-working farmer' cases, that is where, as is increasingly found for reasons of economies of scale, there is a contract farming (or perhaps share farming) structure, whereunder the day-to-day farming operations are conducted by someone other than the landowner. Taking the contract farming structure, the contractor agrees to work the owner's farm under the owner's instructions, receiving a flat management fee and a profit-sharing commission. Each of owner and contractor is carrying on a separate farming business with all receipts and payments being put through the owner's bank account. The owner retains occupation of his land and so, typically having been farming the land himself, the availability of APR is not prejudiced once the contract begins.

The decided cases have established that qualification of the house for APR depends on two factors. First, that the house must be a 'farmhouse' occupied for agricultural purposes. Ideally (though not essentially) the farm office will be situated in the house and, while not directly related to the availability of IHT, some income tax benefit will be obtained, e.g. an acceptance by HMRC of a deduction of say 20% of running costs against farming profits. Meetings are held, perhaps with the contractor and any agents, and duly minuted decisions are taken in the house. In a recent contract farming case called *Arnander*, a claim for relief after the deaths of the taxpayers, Mr and Mrs McKenna, was bound to fail, because by the time of their deaths they were too old and infirm to manage the contract farming operations themselves, which were left in the hands of an agent carried on outside the house.



HMRC Inheritance Tax accepts in principle that a house can be a farmhouse under a contract farming structure, but they will examine very carefully claims to relief. For example, they say that *'the key factor is to identify if the occupant of the house has a significant role in the management, or actual operations, of the farming activity being carried out on the land involved'*. And in the new schedule IHT414 (Agricultural Relief) to the Inland Revenue Account Form IHT400 to be completed after death, one is now asked on farmhouses to *'explain the extent of their involvement in the farming activities'*. Those farming activities, in relation to the agricultural land, prompts a question as to the deceased's involvement throughout the previous two years which asks *'what actual tasks did the deceased carry out and how many hours did the deceased spend on these tasks each week.'*

The character appropriate test

Once it has been established that the house is a farmhouse, the question then arises whether it is *'of a character appropriate'* to the bare land or pasture in the ownership of the farmer. Here HMRC Inheritance Tax have in their Manual set out nine *'indicia'* as to what they look for, as follows:

The main factors to be applied when determining whether a farmhouse is of a 'character appropriate' are considered to be as follows:

- *Is the farmhouse appropriate when judged by ordinary ideas of what is appropriate in size, layout, content, and style and quality of*

construction in relation to the associated land and buildings?

- *Is the farmhouse proportionate in size and nature to the requirements of the agricultural activities conducted on the agricultural land? You should bear in mind that different types of agricultural operation require different amounts of land – this is an aspect on which the VOA [Valuation Office Agency] will be able to advise.*
- *Within the agricultural land does the land predominate so that the farmhouse is ancillary to the land?*
- *Would a reasonable and informed person regard the property simply as a house with land or as a farmhouse?*
- *Applying the "elephant test", would you recognise this as a farmhouse if you saw it? (Although this test involves some subjectivity it can be useful in ruling out extremes at either end of the scale.)*
- *How long has the farmhouse and agricultural property been associated and is there a history of agricultural production? (The matter has to be decided on the facts that existed as at the date of death or transfer but evidence of the farmhouse having previously been occupied with a larger area of land may be relevant evidence.)*
- *Considering the relationship between the value of the house and the profitability of the land, would the house attract demand from a*



commercial farmer who has to earn a living from the land, or is its value significantly out of proportion to the profitability of the land? (If business accounts have been supplied, then copies should be forwarded to the VOA. Business accounts can offer a useful indication of the extent of the agricultural activity being carried on, although it should be noted that a loss-making enterprise is not of its own considered to be a determinative factor.)

- *Considering all other relevant factors, including whether any land is let out and on what terms, is the scale of the agricultural operations in context?*
- *There must be some connection or nexus between “such cottages, farm buildings and farmhouses, together with the land occupied with them”, and the property to which they must be of a character appropriate. ...’*

The question of comparables is important, that is in such and such part of the country how much land would you expect to go with a farmhouse of this size and character? That was the question in a case called *Antrobus* where on the basis of expert evidence the Special Commissioner held that the Grade II listed Cookhill Priory, albeit in a poor state of repair, was of a character appropriate to the 126 acres of agricultural land. Note that the land or pasture within limb 1 of the statutory definition can include tenanted land as well as owned land.

Certainly in terms of structuring the farm before the death has occurred, it is important to

appreciate in advance what questions will be asked on death. And it may be that if an *Arnander* situation is likely to arise that a lifetime gift rather than a gift on death may be preferable (see below).

Agricultural value

This is a further difference from BPR: BPR is given on market value, whereas APR is given only on the ‘*agricultural value*’ of any agricultural property, which assumes the existence of a perpetual covenant prohibiting non-agricultural use. Obviously, there will be a restriction here in the case of land which has development value. However, if the land is owner-occupied, APR will be obtained on the agricultural value, with BPR given on the balance. The question becomes especially germane where the asset concerned does not attract BPR as in the case of the house. Traditionally valuers have looked for a discount from market value of up to a third to reflect agricultural value, as indeed it was held in the Lands Tribunal decision in the *Antrobus* case. However, this should not be accepted without question: expert valuation for the taxpayer is essential.

Rates of relief

The 100% rate is given where at the date of the chargeable transfer:

- the taxpayer has vacant possession or the right to obtain it within 12 months (extended to 24 months by concession);



- the taxpayer has owned his interest in the land since before 10 March 1981 and has never been entitled to the old 'working farmer' relief under Capital Transfer Tax (up to the greater of £250,000 and 1,000 acres, the test for relief including time limits, amount of time engaged in farming, relevant income etc) and at no time between 10 March 1981 and the relevant transfer has there been a right to vacant possession; or
- the transferor's land has been let (whether or not on a farm business tenancy) under a tenancy commencing on or after 1 September 1995.

Otherwise, relief is given at 50%, which will typically apply in the case where the land is subject to an Agricultural Holdings Act tenancy (which gives security of tenure to the tenant) commencing between 10 March 1981 and 31 August 1995.

Territorial limitation

BPR is given to qualifying business property anywhere in the world. APR has traditionally been limited to land in the UK, the Channel Islands or the Isle of Man, though this is to be extended by Finance Act 2009 to agricultural property within the European Economic Area, with retroactive effect to April 2003.

Business property relief

Typical farming assets which do not constitute 'agricultural property' may well attract BPR, for example livestock, plant and machinery, harvested

(as opposed to growing) crops, development value and interests under a partnership.

To qualify for BPR, the business must be carried on with a view to a profit. Further, there is a clear distinction between (in broad terms) (a) trades and (b) investment or dealing businesses. A business which is wholly or mainly one of investment or dealing attracts no relief at all. Further, once you have a qualifying trade, assets within it which broadly are not used or acquired for business purposes are excluded from relief as so-called 'excepted assets' (though very often it is possible to get out of this limitation).

Let land

So, whereas for BPR purposes land which is let is treated as an investment and attracts no relief, let land may qualify for APR, whether at 50% or 100%, provided that (now) it is within the EEA. It remains the case that let agricultural land owned by a UK domiciled taxpayer in say Australia will attract neither APR nor BPR.

There is a significant knock-on effect on let land in relation to the farmhouse. A landowner who occupies the house (which he may well call the farmhouse) but lets all his land will get no APR on the house even if he gets APR on the land. This is because he occupies the house in the capacity not of farmer but of landlord. By contrast, if the land is grazing land and is occupied not by a tenant under a tenancy but by a licensee under a grazing agreement, the landowner will be treated as carrying on a trade (viz of providing a crop of grass for the animals of the grazier to consume) and, so if the house is a farmhouse and is of a



character appropriate to the grazing land, he may secure relief on the house. This is quite a technical subject: a recent case called *McCall* deriving from Northern Ireland has recently been lost by the taxpayer in the Court of Appeal of Northern Ireland, on the grounds that the landowner through her agent was not doing sufficient on the land provided to the grazier to constitute other than a disqualifying investment business. The decision may be subject to appeal to the House of Lords.

Lifetime gift or inheritance on death?

The rates of APR and BPR were increased under the last Conservative Government in 1992 and have remained as such throughout twelve years of Labour Governments, despite widespread speculation especially following 1997 that the rates would again be reduced to 50% and 30% respectively. It is against that fear in particular (though no such proposal now appears to be on the political horizon) that some have considered making a lifetime gift of their agricultural property, whether in whole or in part, rather than wait until death.

Capital Gains Tax

A lifetime gift carries an immediate CGT downside, assuming that the property carries an inherent gain and generally continues to appreciate in value. The rule on death is that inherent gains fall out of charge and the beneficiary acquires the asset at its market value on death. By contrast, under a lifetime gift, there is a disposal for CGT purposes, with any excess of market value over acquisition or other base cost charged at now

18%. However, in the case of business property (which would include agricultural property which attracts APR), donor and donee can elect to 'hold over' the gain which effectively postpones the charge by transferring the donor's base cost to the donee, until such time (if ever) as the donee might dispose of the property, though holding it until his own death would have the effect of 'washing' any inherent gains.

IHT issues

There are two technical IHT points to watch where a lifetime gift is made. First, where the gift comprises qualifying agricultural or business property, it will either be a potentially exempt transfer or PET (as a gift to an individual) or an immediately chargeable transfer (as, typically, a gift to trustees). In either case, should the donor (or in the case of a PET the donee) die within 7 years, the claw-back rules must be considered. With a PET, the original gift is treated as not reduced by the appropriate relief **unless** immediately before the death the donee retained the original or qualifying replacement property. In the case of an immediately chargeable transfer the result is the same in principle, though rather better in detail as the effect is only to disapply the relief in computing any additional IHT on death, ie with no impact on the donor's nil-rate band.

The second IHT point derives from the reservation of benefit (GWR) rules introduced in 1986. If, having made the gift, the donor enjoys any benefit from it which is not earned, eg by services rendered under a partnership or indeed by payment of consideration, and that happens within seven years before the donor's death, the property



is treated as remaining comprised in the estate for IHT purposes. While there are some quite helpful rules which in the case of agricultural or business property can operate to disapply these GWR principles, the assumption with any lifetime gift should be that **all** the benefit of the property which has been given away (including occupation of the house) clearly accrues to the donee. (While, if GWR does not apply, there are also from 2004/05 some anti-avoidance rules applying an income tax 'pre-owned assets' charge, these should not apply if GWR would not apply, e.g. under the 'full consideration exception', though the subject should be considered carefully.)

Wills

Assuming that the transfer of the agricultural property is to be left until death, careful attention should be given to the terms of the will, ensuring typically a chargeable transfer on death carrying the benefit of (ideally) 100% relief. The gift of the agricultural or business property should be a '*specific gift*' as defined in the legislation, in order to side-step some insidious anti-avoidance rules.

Conclusion

This is a fascinating but technical subject and those farmers and landowners who wish to adopt

and review any tax-efficient arrangements should take specific advice.

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