

# Country cottage

The apparently idyllic country cottage can give rise to less than happy tax issues, warns **Julie Butler**.

In these difficult times for farming, with Brexit and the first Agriculture Bill in more than 40 years, letting farm cottages can provide a useful source of extra income, but landowners should beware of inadvertently granting a 'secure tenancy'. Indeed, much farm diversification and survival depends on such successful lettings. The legal basis under which cottages are let is a key issue for protection for the landowner and understanding tax planning. More farms are expected to come to market through death or survival requirements and the legal and tax position of these buildings must be clear before a sale can proceed.

“Under the assured shorthold tenancy regime, the farm landlord can regain possession of a cottage by giving notice.”

## Private letting

For many years, it has been possible for a landlord to avoid an occupier gaining security of tenure of a property by using an assured shorthold tenancy (AST), which is governed by the Housing Act 1988. Such tenancies can be used to let a cottage (with two acres of land or less) as long as the rent falls within specific limits. And, under the AST regime, the farm landlord can regain possession of a cottage by giving notice, although a court order may be necessary. Before February 1997, to create an AST, the landlord had to serve a particular notice on the tenant before the tenancy was granted. Generally, that requirement was then removed, except for farm workers.

The tax position of farm cottages must be considered as part of the legal protection. Their letting is key to qualifying for inheritance tax relief under the *Balfour* principle (see *CRC*

### Key points

- Landowners should take care that lettings to employees are not subject to a secure tenancy.
- Providing notice of an assured shorthold tenancy.
- The benefit-in-kind rules for accommodation cannot be taken for granted.
- The tenant may be exempt from a tax charge on accommodation, but these will not always apply to directors.
- In some circumstances, occupation by an employee after retirement will not result in a tax charge.



*v AM Brander (Earl of Balfour's Personal Representative)* [2010] STC 2666). In brief, this case reinforces that, as long as the underlying business is not wholly or mainly an investment or dealing business, inheritance tax business relief will be available on the entire business. This can include not only the property involved in the trading activities, but also the property involved in the investment activities.

## Letting to farm workers

The rules relating to farm workers are complex and differ from those relating to other tenants. Although a landlord can use an AST to avoid security of tenure problems, there are extra conditions to fulfil. These include the requirement that a prescribed shorthold notice must be served on the tenant before the tenancy is granted. Without this, the letting will be an assured agricultural occupancy which can be created if three conditions are satisfied as follows.

- The letting is a relevant licence or tenancy. Generally, this depends on whether the occupier has exclusive occupation – it does not matter that no rent is being paid.
- The cottage is or has been in 'qualifying ownership'. The cottage will qualify if it is owned by the employer or if arrangements have been made between the owner and employer for a farmworker's use of the cottage.
- The worker is or was a 'qualifying worker' (see below). Importantly, the employment does not have to be with the same employer and the time working in agriculture does not have to be during the term of the tenancy.

Unexpected problems can arise if the tenant:

- is not an agricultural worker when they move into the cottage, but subsequently changes their job thereby becoming one later on;
- is not working on a farm when the tenancy starts, but the owner discovers that they qualify due to their previous employment elsewhere; or
- is working on a farm for someone else and the cottage owner agreed with the employer to make the cottage available.

## Assured agricultural occupancies

If a tenant has an assured agricultural occupancy:

- their spouse or civil partner will have rights of succession;
- the rent will be controlled; and
- the landlord has limited grounds for repossession of the cottage, which can have problems on probate or sale.

The message to the landowner is to take proper tax and legal advice before allowing the prospective tenant to occupy the property. The owner of the cottage should establish the tenant's previous employment history and, if there is any doubt, the prescribed notice should be served in case the tenant qualified as an agricultural worker.

Note that once an assured agricultural occupancy has been created, it is difficult to rectify the position.

### A qualifying worker

To be a 'qualifying farm worker' in the context of an assured agricultural occupancy, the employee must:

- work for 35 hours or more a week – unless they have a permit to work shorter hours as a result of an industrial injury;
- work for at least some of the time on maintaining crops, livestock, forestry, or tractors, and other equipment – market gardens and plant nurseries are also included;
- have been employed in agriculture for at least 91 of the past 104 weeks – this includes time from a previous employment, as well as paid holiday and sick leave. It is not necessary for the farm worker to have been employed by the same employer, or worked on the same farm to meet this requirement.

### Eviction of agricultural tenant

To regain vacant possession, the landowner and farmer can only issue a possession order against a farm worker who has an assured (which is not a shorthand agricultural occupancy) or regulated agricultural tenancy. The landlord can obtain a possession order against the worker only in specific circumstances. Among other things, these include situations in which the agricultural worker:

- does not pay the rent – there may be rules on how much and for how long;
- breaks a condition of the tenancy;
- causes a nuisance; or
- damages the home.

The landlord or the local council may also have to provide suitable alternative accommodation which can be positive for the agricultural landlord. And from the agricultural tenant's point of view, they must be careful to ensure that they do not lose their strength of possession by committing the above breaches.

## Benefit in kind exemption

Traditionally, agricultural industry employees have been provided with living accommodation by their employers and the question as to whether this becomes a taxable benefit has recently been brought under the spotlight by changes to the farming industry, the question of incorporation, and the fact that directors do not always qualify for the exemption. A business operating as sole trader or partnership would not result in an accommodation charge on the trader or partner. However, after incorporation the trader or partner who is now a company director could fall foul of the benefit-in-kind rules for accommodation in ITEPA 2003, s 102 unless they were exempt under the exclusions in ITEPA 2003, s 99 and s 100 (see also HMRC's *Employment Income Manual* at EIM11331).

There is often an assumption that there is no taxable benefit in kind on the provision of accommodation in the farming community because exemption can be achieved under the provisions for the proper performance of duties (s 99(1)), and it is customary for accommodation to be provided for the better performance of duties (s 99(2)). However, it is important to note that these exemptions do not apply to directors of companies unless they have no material interest in the company and either work full-time for it or the company is non-profit making or established for a charitable purpose (s 99(3)). Thus, if a farm incorporates with the property owned by the company, the directors must be careful not to incur unnecessary taxable benefits.

“ There is often an assumption that there is no taxable benefit in kind on the provision of accommodation.”

### Retired agricultural employees

Under the Housing Act 1988, s 24 and Sch 3, a person occupying a dwelling house has protection as an assured agricultural occupant once they have occupied the dwelling house in connection with employment in agriculture, on a full-time basis, for two years. The question is whether the continued provision of the accommodation to a retired agricultural worker who enjoys protection as an assured agricultural occupant gives rise to a taxable benefit under ITEPA 2003, s 401(1). This imposes a charge on any benefit '...in connection with ... the termination of a person's employment...'

If s 401(1) does apply, it should be noted that a taxable benefit would arise following retirement even if the employee was exempt from the 'basic' charge while they were an employee; in other words, the exemptions from the 'basic' charge do not apply to s 401.

HMRC has now made it clear that the continued provision of accommodation to an individual who was exempt from a benefit charge before retirement is excluded from a charge under s 401 as long as the property has not been materially improved in the five years before their retirement. A material improvement for this purpose is one not conducted to comply with statutory requirements (or similar) and which increases the market value of the property by 20% or more. Thus a caring landowner could create tax problems by improving

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property for their tenants. To be excluded from the taxable benefit in kind charge, the employee must have occupied the accommodation (or similar accommodation) continuously throughout the five years before retirement and then after retirement. See the Employer-Financed Retirement Benefits (Excluded Benefits for Tax Purposes) Regulations SI 2007/3537.

“ If cottages are occupied by agricultural workers, qualification for agricultural property relief should be checked.”

### Action plan

Many farm owners consider legal protection of their property ahead of tax protection and will ensure their farm workers are subject to an AST. There has been much debate about whether such tenancies remove the tax benefit of the agricultural advantage of accommodation focusing on the ‘customary test’ and whether such advantage should continue.

#### Planning point

The exemptions for accommodation benefits in kind do not apply to company directors unless they have no material interest in the company and either work full-time for it or the company is non-profit making or established for a charitable purpose.

Farm landowners should review all farm cottage lettings. For inheritance tax purposes, if cottages are not let to agricultural workers, qualification for business relief under *Balfour* can be achieved as long as the conditions are met. If cottages are occupied by agricultural workers, qualification for agricultural property relief should be checked.

For farm disposal strategy, it is assumed that farmers will die ‘with their boots on’ or the farms will be sold and the capital gains tax position will be positive. An assured tenancy might prevent the full sales price being achieved. And let cottages will not achieve such a favourable tax position with capital gains tax at 28%. When selling farms in these difficult times, it is likely that those with the potential for a variety of income streams will continue to be in demand. ●

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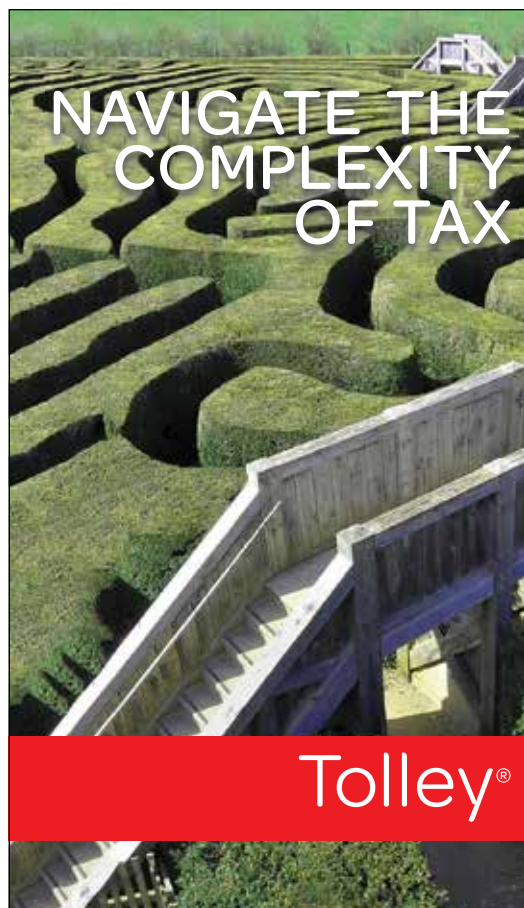
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