Executor stress

Coronavirus has emphasised the need to review farm wills, consider the key role of the executors, and understand the complexity of marginal inheritance tax reliefs, argue Julie Butler and Fred Butler. There are also new capital gain tax rules to grapple with

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In this article, we explain the main pressure points and developments farm executors need to watch out for in 2020.

Tax tribunal cases

It is fair to say that the role of the farm executor is an onerous one. Recent, albeit marginal, tax tribunal decisions and uncertainties in the farming industry have served to underline this.

An early area of concern is the claiming of agricultural property relief (APR) and business property relief (BPR), which has been complicated by some recent cases: *Vigne* [2018] UKUT 0357 (TCC) on liveries; *Graham* [2018] TC 06536 on furnished holiday accommodation; and *Charnley & anor* (*Estate of Gill*) [2019] UKFTT 0650 (TC) on grazing agreements.

Where the evidence for APR / BPR eligibility is marginal or contradictory, the executor is faced with many considerations, such as whether there is enough valid documentation to support the claim for inheritance tax (IHT) relief. One key area for the executor to understand is whether the ownership of the farm has been fully understood. For example, if the farm is not shown in the accounts as partnership property, but 100% BPR is required, then the executor and their advisers must assess whether the accounts have to be adjusted to show the correct ownership position, and to help claim the maximum IHT reliefs.

There would, of course, need to be evidence of the farm being partnership property – for example, a partnership agreement stating that fact.

By making the farm an asset of the partnership, the owner of the land 'gives up' their ownership of the freehold property and 'replaces' it with an interest in partnership equal to the value of the land they originally put in. This is on the basis that the partnership agreement has a clear schedule setting out underlying ownership of the land, and this should dovetail with specific land capital accounts showing the same.

The will should reference the partnership interest, rather than the freehold property. This can lead to difficulties if assets that make up the partnership are to be left separately in the will, such as farmland and buildings to a farming child, and let cottages to a non-farming child.

If an executor identifies incorrect farm accounts that impact on the IHT claim, they must consider rectification. Where the farm accounts show a misunderstanding as to farm ownership – that is, the farm is put 'in or out of the balance sheet' in error – these should be rectified to ensure the will is correctly followed and the beneficiaries are protected. Errors in accounting assumptions can often impact on farm accounts that are to be submitted with form IHT400. Getting the correct understanding in advance is key to a robust submission.

Hope value

One of the important protections of 100% BPR is potential development value, also known as "hope value". Recently, *Foster v HMRC* [2019] UKUT 251 (LC) has potentially increased the quantum of risk for the executor. Here, the Upper Tribunal (UT) accepted HM Revenue & Customs' (HMRC) 'top down' approach to the value of land with hope value, on the assumption that planning permission could be obtained, and based its valuation on a lower per-house price than HMRC. The UT also applied larger discounts than HMRC to reflect risk, and as such, the UT's valuation was lower than HMRC's original valuation.

The reality is that executors must always consider potential hope value, especially in light of the prime minister's recent exhortation to "build, build, build".

Where 100% BPR can be obtained, there are arguments that including 'hope' in valuations is a positive, as it will help make the base cost for capital gains tax (CGT) more robust. However, claims for BPR are weak if there is incorrect disclosure, or where the farmer / landowner fails to increase the amount of services / farming activity towards the 'correct' end of the spectrum in relation to whether it is wholly or mainly operating as an "investment business", rather than a "trading business". This was illustrated in *Gill*, where grazing licences with "services" qualified as a "working farm" for BPR purposes.

Sales above probate value – capital gains tax compliance and planning

Farm sales can progress with large variances in this current climate of uncertainty. With "rollover" monies available, some very high prices are being achieved. Executors could be looking at higher CGT bills due to increases in value since probate.

It could be that the probate valuation was incorrect, and there is a need to submit a revised IHT calculation where there are, for example, IHT reliefs to spare and the incorrect probate valuation can be justified. It is difficult to value farms, especially if the farm has not been on the open market for many years. Farm estates are never simple for executors to manage; ideally, executors will need agricultural experience and professional property advice.

With more farms potentially coming onto the market to raise money to pay out non-farming siblings after the death of a farmer, the probate and market value can vary considerably and result in CGT being payable or, at the very least, the need for CGT planning by the executor. The potential for objective, careful CGT planning should always be considered early on in farm estate administration. The executors should handle the estate assets to best effect, and the necessary advice should always be sought, mindful of the IHT / CGT interaction.

New capital gains tax

CGT is often overlooked by executors, though its impact can be considerable when, for example, assets are sold for more than probate value. The new 30-day residential property CGT return (in force from 6 April 2020) means that CGT must be reported to HMRC 30 days after the completion of the sale, and tax paid thereon. This results in an acceleration of tax payments – and the calculations must be ready. The new return applies to farm residencies, and executors must be aware.

An annual exempt amount for CGT will still apply to executors, just as with individuals, but only for the tax year in which the death occurred and the two tax years following that.

The executors will have to be mindful of the new return when selling residences – especially with the recent boom in buying homes in the countryside – post-31 March 2021, when the stamp duty land tax 'holiday' ends. There is debate currently as to whether a 30-day return needs to be completed for land attached to a house ('pony paddocks'). You could consider the following rule of thumb as a way forward.

1. If the house and land are on a single title deed, then a return is required for any land in excess of the permitted garden area of half a hectare.
2. If the land exceeding the permitted garden area is on a separate title deed, then no return is needed. The land sale can be reported separately in the usual way on the client's annual tax return.

Note that HMRC's stance on claiming any land over the permitted half a hectare seems to be getting tougher. Combined with the new 30-day return, this signals a big opportunity for HMRC to charge interest and penalties.

Complex farm wills

Many farmers and landowners have complex wills / family arrangements. They often leave the farm to members of the family who stay in the farming business and leave the other investments to other relatives. The impact of this on succession planning and the will must be considered as part of tax planning.

There can be manipulation by some members of the family to ensure that the investments are used on the farm. It is advantageous for the farming sibling to convince the parent to keep investing in the farm (new kit, machinery, buildings, repairs, and so on), thus increasing the value of the farm and, at the same time, reducing the value of the investments and creating further discrepancies between what the children will receive. In this regard, they can use tax efficiency as a 'smokescreen'.

Farm advisers should remind clients to check the impact of all tax planning on their will and other legal agreements. Executors could be faced with the added difficulties of sibling rivalry or manipulation when distributing the assets.