



**JULIE BUTLER AND LIBBY JAMES HIGHLIGHT TAX IMPLICATIONS TO BEAR IN MIND WHEN NAVIGATING THE UK AGRICULTURE BILL 2017-19**

➤ **KEY POINTS**

**WHAT IS THE ISSUE?**

Under the new *Agriculture Bill 2017-19*, existing agricultural leases could become subject to adverse tax implications, so an awareness of the key pitfalls is required.

**WHAT DOES IT MEAN FOR ME?**

This is a good opportunity to carry out a health check of farm leases and reassess plans for farming clients.

**WHAT CAN I TAKE AWAY?**

In a time of great change for the farming industry, it is important to keep abreast of what is happening on the farm, both 'on the ground' and on paper, to ensure maximum tax protection for the agricultural landlord.

THE UK GOVERNMENT'S recently published *Agriculture Bill 2017-19* (the Bill) provides an opportunity for farmers and their advisors to review their current operations. The Bill noticeably adjusts its focus from the support of traditional or large-scale agriculture in favour of various environmental land-management concerns, for example air and water quality. At first glance, the management of such environmental concerns is neither 'agriculture' nor is it dedicated 'commercial business activities', and this further begs the question as to when the legislation will be updated for the modern-day farmer.

Whatever one's views on the Bill, how it fits within the current farming operation must be considered, and a health check of the financial and legal position must be carried out, as farming families are constantly faced with situations where failure to consider the tax impact has resulted in extra tax liability. One such

often-missed area is the review of a farm lease or licence in the context of capital taxes by tax advisors, which tends to be passed over because the farming family is not prepared to pay for the advice. However, money spent on professional fees now will usually pay dividends later in the form of tax savings.

**AGRICULTURAL ACTIVITY**

The first port of call when reviewing a tenancy is to ensure there is a clear understanding of the tenant's occupation of the land, as this is often where tax savings can be lost. Although let property can qualify for inheritance tax (IHT) relief in the form of agricultural property relief (APR), even if there is no trade, the advantage is lost if the act of agriculture is no longer carried out.

It is therefore important that, where a tenancy is granted, regular checks are made to ensure the property is still occupied for

'agricultural purposes'. Needless to say, there will be a fight with Her Majesty's Revenue and Customs (HMRC) for minor breaches of marginal use and those that occurred close to the date of death. It is therefore necessary to obtain a forensic understanding of the activities undertaken on all tenancies, and to collate and maintain evidence in preparation for such a fight.

### CHANGING TENANCY

The type of tenancy agreement in place can also affect the tax position of the land. For example, tax savings can easily be gained by changing from an *Agricultural Holdings Act 1986* (AHA) tenancy. Where a family AHA tenancy is kept in place, extra IHT may be payable on the agricultural element of the lease, as AHA tenancies only attract 50 per cent APR, not 100 per cent. This may easily be avoided via the use of a farm business tenancy or a share farming arrangement.

It is therefore imperative to carry out a thorough review of all family AHA tenancies. Where such a tenancy is in place, 100 per cent APR could be achieved by surrendering tenancy altogether. However, in reality, it is unlikely that this will be acceptable to the tenant without some means of compensation, given the substantial rights it gives them. Further, as the tenancy is likely to have significant value, a capital gains tax (CGT) liability could potentially arise on disposal. There is the possibility to reduce this by rolling over the gain into a new tenancy, but this may be only a temporary solution, as any new tenancy is likely to be a wasting asset for CGT purposes, meaning the gain can only be deferred for ten years unless a further non-depreciating asset is acquired.<sup>1</sup>

One alternative choice is to take advantage of the route provided in s.4(1)(f) of the *Agricultural Tenancies Act 1995* (the Act). Under this route, it is possible to preserve tenant's rights under the AHA but have the lease treated as if the tenancy was created after the Act came into effect (September 1995), as such a tenancy qualifies for 100 per cent APR for the landowner.

It is important, though, not to insert any significant variations of the original term to avoid a surrender and re-grant for other tax purposes, for example, CGT and stamp duty land tax (SDLT).<sup>2</sup>

An easier method of dealing with a change of tenancy was introduced in art.12 of the *Regulatory Reform (Agricultural Tenancies) (England and Wales) Order 2006*. Article 12 enables a new tenancy to be given that expressly states that the provisions of

the AHA are to apply to its replacement tenancy, so 100 per cent APR is achieved by the landlord.

### COMPENSATION

The question of whether to bring an existing family farming tenancy to an end is inevitably a more difficult question, because the answer may depend on the advantages and disadvantages secured under an existing structure, the tax costs of making a change, and what new structure should be substituted for the old. However, if a tenancy is brought to an end, the tenant will also need to consider their CGT position.

On the basis that the tenant surrenders their lease, their tax position will differ if what they receive is not a payment for the surrender of their tenancy but compensation in respect of disturbance under ss.60 and 63 of the AHA. Such payments are intended to reimburse the tenant for the loss or expense suffered in having to quit. Up to one year's rent can be claimed with proof of loss, and up to two years' rent if particular evidence of loss or expense can be provided. Receipts of such reimbursement are not derived from an asset and therefore no liability to CGT arises.

Similar treatment is accorded to comparable payments of up to four years' rent made under the *Agricultural (Miscellaneous Provisions) Act 1968* as compensation for surrendering the tenancy on a notice to quit from the landlord or on a notice of entry served by a local authority. Payments of this class are made where land is required for private or public development, or for other non-agricultural purposes, and again the tenant would be entitled to compensation under ss.60 and 63 of the AHA. This receipt would therefore

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be wholly exempt from income taxation and CGT.<sup>3</sup>

The question arises as to the taxation treatment where a tenant does not serve out a period of notice following the receipt of a notice to quit, but instead enters into a surrender agreement with their landlord. In the past, HMRC took the view that, in such circumstances, the surrender agreement broke the chain of causation, so the tenant was not quitting in consequence of the notice to quit, but in consequence of the surrender agreement. HMRC's view was that payments made by the landlord were not statutory compensation and that the whole of such payments was chargeable to CGT.

### CGT AND TENANCY SURRENDER

Following on from the above, the surrender of an existing tenancy for consideration, as opposed to compensation, is deemed a disposal of a capital asset for CGT purposes. The tenant could therefore become liable to CGT when they surrender the old tenancy, either where they are connected to the landlord, e.g. if they are family members, or because the agreement with the landlord is not considered to be a 'bargain at arm's length', i.e. a normal commercial transaction between two or more persons. In either case, the tenant is deemed to receive the open market value of the tenancy as consideration.<sup>4</sup> The CGT reliefs available to the tenant range from principal private residence relief on the element of the farmhouse to rollover relief in another asset.

### CONCLUSION

In light of the recently published Bill, farm leases and licences may require review and/or amendments. The tax implications of this must not be ignored, as the ramifications for both landlord and tenant could be significant. As always, a clear understanding of what is happening 'on the ground' is required, and both legal and tax professionals must work together to ensure any updated agreements will not have an adverse effect on other areas of tax planning.

<sup>1</sup> [www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg60370](http://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg60370) <sup>2</sup> It is not always easy to avoid unwanted CGT and SDLT, and this has to be set against the potential IHT saving. <sup>3</sup> *Davis v Powell* [1977] STC 32 <sup>4</sup> ss.17-18 AHA



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