Line of country

In the first of a two-part series, Julie Butler and Fred Butler provide a beginner's guide for conveyancers to some key issues relating to agricultural property


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Most conveyancers will find themselves, at some point, advising or acting on transactions with an element of agricultural property. Below, we outline some key issues property lawyers may encounter, and what advice should be given to clients.

Purchase of farm property – IHT

Business property relief (BPR) for inheritance tax (IHT) of 100% is currently available (subject to the correct trading or agricultural conditions being met) in respect of: a business carried on by a sole trader; a partnership interest; and/or any unquoted shares in a company. IHT relief of 50% is available in respect of land, buildings, machinery or plant owned by an individual and used by a company which they control, or by a partnership of which they are a partner, or by a quoted company of which they control shares. With farmland values currently remaining high and the housing development potential remaining strong with the need for large numbers of houses, the 100% IHT relief as opposed to 50% IHT relief is critical. A large amount of farm property can achieve 100% agricultural property relief (APR), but with more and more diversification, BPR is needed.

Most farmers trade as a family partnership, and all farm landowners and their advisers must fully understand whether the farm is held as partnership property or property owned outside the partnership.

The key to achieving 100% rather than 50% BPR is to ensure the property is partnership property. This can be achieved with beneficial ownership retained through the partnership agreement, and protection through land capital accounts.

When any farmland is purchased, the purchasers should be advised to consider:

- taking tax advice on the exact ownership structure for IHT and capital gains tax (CGT)
- entering a partnership agreement or updating the partnership agreement for the purchase if it is to be held in partnership
- updating their wills as part of the above.

Some property lawyers would consider it enough to refer a client to the farm's tax team or check that they had taken tax advice regarding the most tax-efficient ownership structure and tax planning approach. However, the loss of tax relief through ownership in the wrong structure could cost millions, and it is essential to warn the client about such potential negatives. Obviously, the legal position of partnership and non-partnership property requires further advice; ownership through partnership might not always be the best route.

Letting via a grazing agreement

Once the farm has been purchased, the trading arrangement needs to be considered. It could be that the farm is let by a grazing agreement licence. Such arrangements have come under of scrutiny with *W Charnley and M Hodgkinson as executors of the estate of Thomas Gill (deceased)* (TC7425).

The facts of this case were that Mr Gill died in November 2013. On his death, he owned Woodlands Farm, which comprised: the house in which he lived; a yard, brick barn and outbuildings; 21 acres of bare agricultural land (permanent pasture); and a range of buildings and a yard let for the storage of commercial grass cutting equipment. He also owned some land with storage buildings, and a residential property which was let. He did not own livestock, but allowed farmers to graze animals on his agricultural land under annual grazing licences. He grew vegetables on his farm and bartered them in the local shop.

He claimed the single farm payment. The executors of Mr Gill claimed APR and BPR, although not on the let residential property. HM Revenue & Customs (HMRC) refused the claim for the IHT reliefs, except for APR on the agricultural land. HMRC refused the whole claim for BPR, on the ground the business was one of investment in land rather than farming.

The First-tier Tribunal, however, found against HMRC and stated that the activities carried out by Mr Gill were and always had been those of a farmer, working an active farm. He may have gradually ceased to rear animals, but this was not enough to alter the 'true nature' of his farm work. The letting was undertaken to let the land or prepare it for letting, or to improve it so as to increase income, and would therefore be more akin to the activities of an investor or a business in the letting of land. Many grazing agreements / licences are drafted by land agents as opposed to the legal profession. Some of the agreements and licences refer to the work and services that the landlord should carry out, and others do not cover the subject of landlord responsibility which is important.

In reality, Mr Gill checked the livestock daily and carried out husbandry and maintenance to the land. The tribunal's decision was that the farmhouse and other buildings were occupied for the purposes of agriculture and qualified for APR and the business was that of farming and not wholly or mainly of the holding of investments. The executors' appeal was allowed, so APR on the farmhouse and BPR on the land were achieved.

For tax planning, it is essential that the grazing agreements do not prevent the success of the tax reliefs, and allow these duties to be carried out where appropriate.

Many positives have been talked about the successful grazing licence case of *Gill*.

However, in reality, in his final years, it is likely the owner of the land was much less of a 'working farmer' and involved with checking the cattle. Agricultural property lawyers who draft grazing agreements before death should stress the benefits of active involvement prior to death.

Property lawyers must warn clients to take good tax advice, not only when buying a farm, but also when sorting out legal agreements for the trading situation.

Farm workers' cottages

Agricultural employees have traditionally been provided with living accommodation by their employers, and the question as to whether the provision of this accommodation becomes a taxable benefit has recently been brought under the spotlight by the large number of changes to the farming industry. The question of incorporation and the fact that directors do not always qualify for the exemption to the benefit-in-kind should be considered. There are changes to the benefit-in-kind rules from 6 April 2021, so this is an ideal time to review the occupation of agricultural accommodation.

The position on retired employees is complex, in terms of both the taxable benefit and the IHT relief for the cottage. Under section 24 of and Schedule 3 to the Housing Act 1988, 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 a period of two years. So does the continued provision of the accommodation to a retired agricultural worker who enjoys protection as an assured agricultural occupant give rise to a taxable benefit under section 401(1) of the Income Tax (Earnings and Pensions) Act 2003? This section imposes a charge on "payments and other benefits... in connection with... the termination of a person's employment". If this does apply, a taxable benefit would arise following retirement, even when during the employment, the employee was exempt from the 'basic' charge. HMRC has now clarified that if accommodation is provided after retirement to an employee who was exempt from a benefit charge prior to retirement, that employee is excluded from the benefit-in-kind charge under section 401, provided the property has not been materially improved in the period beginning five years before retirement.

Many land agents are proposing assured shorthold tenancies for farm workers, so that landlords do not face the problems caused by continued occupation by retired workers, with little contribution to farm profit. The potential rental income of farm cottages is currently high, and a valuable contribution towards farm profitability.

Selling farm cottages

Any farmers selling farm cottages will need to declare any potential gain on the new residential CGT return, which has been required since 6 April 2020 and which must be submitted within 30 days of the completion of the disposal. Details of the original purchase and improvements to, for instance, paddocks and barns need to be kept to calculate the gain.

Many UK property owners think that the new CGT returns apply only to taxpayers with more than one residential property; in fact, any property which does not qualify for main residence relief in full must be included on the return. This could catch many taxpayers who are not currently within the self-assessment system. Examples include residences with big gardens (outside the normal half hectare / reasonable enjoyment rules); pony paddocks included as part of the residence and garden; and individuals with a lack of evidenced quality occupation, which could lead to a liability. Farmers deciding to sell / let cottages to reduce the investment element of the farm trading operation for BPR purposes could also be caught here

Recent tribunal decisions have shown HMRC's enthusiasm to 'hunt down' non-compliance with main residence relief. Some estate agents and solicitors may take a 'not my problem' approach to the new CGT return, so responsibility appears to fall more with tax advisers and accountants.

For IHT purposes, where the cottages are not let to agricultural workers, IHT qualification for BPR can be achieved, provided the conditions are met (see *Commissioners for HMRC v AM Brander (as executor of the Will of the late 4th Earl of Balfour)* [2010] UKUT 300 (TCC), which considered the IHT treatment of mixed farming estates). Where cottages are occupied by agricultural workers, qualification under APR should be checked. There is further uncertainty here, in that the 2019 IHT review by the Office for Tax Simplification talked of bringing the IHT 'trading mix' in line with CGT (that is, to qualify for BPR, the trading element of businesses would need to be more than 80%). Many farmers must look to improve the mix of their farming operations in the years ahead (known as the *Balfour* mix), and reducing the 'investment' activity by selling cottages, to increase the likelihood of their estates qualifying for BPR.

Farms tend to include a lot of residential property, and farmers are constantly trying to 'create' more residential property through planning permission. Property lawyers must advise clients to consider the tax on the sale, together with the tax on holding the residential property at death.

Rollover buyer

Land agents and the farm property press classify 'rollover buyers' as those purchasing farms and seeking rollover relief for CGT from their development gains. The tax rule is that the gain from the development of houses on the whole or part of a farm can be rolled over into another qualifying business asset, generally a farm. The tax adviser acting for the 'rollover buyer' has to be careful that the sale of development land does qualify for rollover relief and does not become caught in any income tax traps such as 'slice of the action' schemes, for instance where the landowner benefits from the developer's profits. If the sale of the development doesn't qualify as CGT, it cannot qualify for rollover relief.

The property development potential for landowners and farmers is very positive. The current aims of farmers owning potential development land are generally to maximise the use of all tax reliefs, especially rollover relief and entrepreneurs' relief (now business asset disposal relief (BADR)). Careful structuring with this in mind can reduce the tax payable to 10% under the BADR provisions, or gains could be rolled over into other business assets so that all potential CGT liability is deferred. Because death is not a chargeable event, it is possible to erase potential CGT liabilities at that point.

The property lawyer must be fully aware of all availability of CGT reliefs, including rollover relief and BADR. Development land is a very specialist area of property law, and it is key for those acting on these transactions to have an understanding of the basic tax reliefs.

Farm business tenancies

Tenancies commencing after 1 September 1995 (except succession tenancies under the Agriculture Holdings Act 1986 (AHA 1986)) qualify as 'farm business tenancies' (FBTs) under this act, provided they satisfy various conditions. These conditions are that: the land is farmed as a trade or business; and that the use of the land and the character of the tenancy are primarily or wholly agricultural. It is important to note that FBTs do not carry security of tenure beyond the agreed contractual term, provided the relevant notices are served. FBTs of two years or less expire automatically at the end of the term, but fixed tenancies of two years plus continue as yearly tenancies until brought to an end by notice of between one and two years, expiring on the contractual date. A criticism of FBTs is the length of term offered for new tenancies. Due to high land and rent values, FBTs tend to be offered for shorter periods, typically two to five years. From a farming perspective, it can hinder 'proper farming' and maintenance and repair of a property, as farmers do not want to undertake improvements without receiving the benefit (if the farm is put up for tender again at the end of the term). It also takes time to build up a business, which is why tenancies of 10 years or more are favoured by farmers. All agricultural tenancies are complicated, and the tax planning around them even more so.

FBTs should achieve APR as long as agricultural activities are carried out on the land. APR is restricted to the agricultural value (section 115(3) of the AHA 1986), which currently can be much less than market value. However, there are problems with rollover (see above) when selling a farm with a FBT, as FBTs do not qualify for rollover or BADR. FBTs are often drafted by land agents, but there are many who consider that they should be brought firmly within the responsibility of the property lawyer.

Sale of the farm

Most property solicitors will act on the sale of a farm at some point. It is our view that, due to the complexity of the agricultural elements, this work should only be undertaken by those with the agricultural expertise.

It might be that the farm has to be sold on the death of one of the farming parents or farming siblings. It could be that the only way that family members can receive their inheritance is through a sale – perhaps just of some of the residential property, but possibly the whole farm. Vacant possession will generally be needed for sale; a review of the farm's liveries, tenancies, grazing agreements, contract farming arrangement and so on will be necessary to achieve this as some tenancies will form part of the sale. The tax position should be carefully considered to ensure that the position of all family members is optimised.

A sale may arise from a sudden death or a death without tax preparation, in which case work must be carried out to ensure that any favourable tax position is protected. It is extremely likely that anyone wanting to buy the farm would be a rollover buyer, as described above, and would therefore need to roll over the gain from a business disposal or farm development land into the purchase. If, for rollover purposes, there are non-qualifying tenancies or grazing agreements in place, the rollover claim could fail, and the purchase would be less attractive for the family, because they would not be able to achieve such high sale proceeds.

Farming families must ideally be prepared for the death of farm owners and try to make sure that the trading arrangements are as tax efficient as possible after death as during life. There is a lot of work for the executor and their legal advisers, and they will need the help of strong tax advisers as well as excellent agricultural property lawyers who can advise on both the legal status and how to solve uncertainties and inconsistencies in the legal status. It is likely that the elderly farmer did not take good legal and tax advice, so action will be needed as soon as possible – before the farm is sold.

Looking ahead, the Agriculture Bill 2019-21, which is currently in 'ping pong' stages, proposes significant changes to agricultural tenancies; this presents another challenge for property lawyers acting on agricultural transactions. The motto will continue to be "think tax".

In our next article, for the September edition of *PIP*, we will consider other issues agricultural property, with a focus on tax – for example, lifetime gifting, holdover relief, overage, natural capital and the net biodiversity gain, as well as property identification for the partnership agreement.