The better half

Julie Butler discusses the important role of a spouse or civil partner for farm inheritance tax planning.

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With the proposal that heterosexual couples should be able to form civil partnerships, it is important to consider inheritance tax and will planning around marriage and civil partners. This can affect matters such as death in quick succession, replacement property, inter-spouse transfers and will claims. The focus of the farming industry is currently on the impact of the Agriculture Bill and Green Brexit together with the resultant serious changes to farming structures that such drama will bring . There is also speculation about the potential future loss of agricultural property relief (APR) so now is a key time to review all farm succession plans.

The advantage of the exemption for transfers to a surviving spouse (IHTA 1984, s 18) is clear in any inheritance tax planning, but it must be used as part of a well-thought-through strategy, not just to buy time. There are many examples of the advantages of transfers between farming spouses and civil partners – both referred to as spouse hereafter.

Ownership period advantage

IHTA 1984, s 120 ('Successions') provides a distinct benefit to farming spouses for both agricultural property relief (APR) and business property relief (BPR) purposes. Typically, if someone becomes entitled to any property on the death of another person, they are deemed to have owned it from the date of death. However, if the recipient should die soon after inheriting this land, they would not have fulfilled the two or seven-year ownership requirement to achieve APR. Consequently, s 120 provides that, if the recipient was the spouse of the transferor, they are deemed to have owned the property from the time their spouse acquired it. This allows the survivor to meet the occupation and ownership requirements themselves.

There are specific conditions of this APR benefit, but these are reasonably straightforward as follows.

1) The whole or part of the value assigned by the earlier transfer from the spouse must have been eligible for APR.
2) The whole or part of the property that would have been eligible for relief:
   a) became, through the earlier transfer, the property of the subsequent transferor or their spouse; and
   b) is, at the time of the subsequent transfer, occupied for the purposes of agriculture either by the subsequent transferor or by the personal representatives of the earlier transferor. In other words, at the time the property passes to the spouse it is still used for agriculture. Thus, there is no gap between date of death and transfer.
3) That property or part or any property that has replaced it would be eligible for relief on the subsequent transfer, apart from the occupation and ownership tests.
4) The earlier or the subsequent transfer was or is a transfer on death.

This provision can be useful if, say, a wife dies soon after her husband. As long as the farm is still used for agriculture, it will ensure that the wife meets the ownership test and APR is achieved on both transfers.

Key points

- The spouse exemption should not override other inheritance tax considerations.
- IHTA 1984, s 120 provides tax relief if a recipient dies soon after inheriting property.
- Possible use of deeds of variation.
- Replacement property and lifetime transfers.
- Maintain accurate property values.

Tax planning and wills

In some cases, the farm is bequeathed to a spouse even though they are not a partner in the farming business. Here, advisers have not considered the inheritance tax implications. Although the spouse exemption in s 18 precludes immediate payment of inheritance tax, this is not tax-efficient.

One planning tool available in such instances is a deed of variation. If there are children, the surviving spouse could execute a deed in their favour. This allows the farm to pass to the next generation and makes use of the available APR or BPR, which might be lost in future. Alternatively, all the assets could be put into a discretionary trust that could then be terminated under IHTA 1984, s 144.

If the will does leave the farm to the spouse, it makes sense that they should be a business partner with a strong partnership agreement. If they are involved in the farm before death, not only will they know how it works but such activity can help with APR (s 117, occupation of the farmhouse) and BPR (s 105(3), not holding investments). The spouse who inherits the farm should ideally meet the criteria of active involvement as good general practical protection at a number of levels.

Replacement property

With many farms or parts of them being sold for development, the replacement property provisions and occupation test must be considered. Again, these conditions are relaxed if the agricultural property transferred has replaced other agricultural property. The two-year occupation test is treated as satisfied if the two (or more) properties concerned were occupied by the deceased or transferor for the purposes of agriculture for an aggregate period of at least two of the five years immediately before the transfer (IHTA 1984, s 118(1)). The seven-year ownership condition is treated as satisfied if the properties were both owned by the deceased or transferor and occupied (by them or another) for agricultural purposes for an aggregate period of at least seven of the ten years immediately before the transfer (s 118(2)). Further, the APR must not exceed the relief that would have been available had the claim not been made. In other words, the claim is limited to the amount of relief available on the original holding.

Inter-spouse transfer before death

Transferring property to a spouse before death can have disadvantages if there is to be a future sale but, because tax planning must be considered on a case by case basis, it may be the best option. With many advisers worried about the loss of APR should there be a change of government, thoughts are moving to lifetime gifts. It is more likely that gifts will be to the next generation, thereby 'skipping' the spouse and being left to farming children instead.

Traditionally, farms have passed down the male line through the generations. In today's world, with an emphasis on equality, many farming wives will have part of the property passed to them. This could be the farmhouse alone or the whole farm. Of course, in a lifetime transfer, the spouse will take on the husband's base cost for capital gains tax purposes which, for tax purposes, is less beneficial than a probate value that will probably be higher. Again, there will have to be checks on the costs of improvements to ensure that the correct base costs of the individual property assets and types are understood.

As an example, a husband might transfer a half-share of a farm to his wife during his lifetime and she may inherit the other half or the farmhouse when he dies. In such a case, her base cost of the whole property will comprise two elements:

- half the husband's 'inherited' base cost from when he bought or acquired the farm; and
- the probate valuation of his remaining half share.

Controlling the base cost

It is important to focus on the need to control and record the correct base cost, but tax planning considerations – such as determining when transfers can be made tax efficiently during lifetime or on death – will come into play when restructuring is being considered. Regard must always be had to capital gains tax in inheritance tax planning; indeed, all taxes must be considered in succession planning and these factors should be linked to future plans. Such tax planning will be eased by robust and well-recorded capital gains tax base costs to identify the potential liabilities that could arise on any transactions. After these have occurred, updated valuations and costs can be carried forward in readiness for future planning opportunities.

Lifetime or death transfers?

The transfer of assets on death combines favourable inheritance tax reliefs with the capital gains tax advantage of an increased base cost due to the tax-free uplift to probate value. This simplifies the capital gains tax base cost register kept by accountants for all farms. Any development potential could be useful because the probate value would include hope value. If business property relief can be obtained, the future base cost is the very tax-efficient probate value.

Reasonable provision

The Inheritance (Provision for Family and Dependents) Act 1975 (IPFDA 1975) allows specific family members, including the spouse and dependents of the deceased, to apply for reasonable financial provision from a deceased's estate if the terms of the will do not. Likewise, if there is an intestacy, there is also the opportunity to make such a claim.

There is a time limit in IPFDA 1975 for such claims of no more than six months from the date on which representation (a grant of probate or letters of administration) is taken out for the deceased's estate. Anyone wishing to make a claim after six months must apply to the court for permission.

In *Sargeant v Sargeant* 2018 EWHC 8 (Ch), Mrs Sargeant had been married for 45 years. She issued a claim for reasonable provision from her late husband's estate more than ten years after the grant of probate. The court refused permission. Ironically, had Mary sought legal advice when probate was granted, she would have been advised of her rights under IPFDA 1975 and been able to bring a claim within the deadline. The longevity of her marriage, 45 years, would have put her in a strong position to claim a significant award for reasonable provision. This case is a timely reminder for relatives and dependents to consider whether they should take professional advice as to their legal rights as soon as representation has been taken out on the estate of a deceased relative.

The message from *Sargeant* is to take legal advice early on. The same applies to tax and a deed of variation may also need to be considered then. Many farming wives are left 'all or nothing', so tax planning must be always considered. This could be through a deed of variation to pass down assets to the next generation or by way of an IPFDA 1975 case. The action suggestions are to plan ahead mindful of all the subsidy changes that farming is currently faced with and for farming spouses to talk through estate and tax planning sooner rather than later.

Author details

Julie Butler FCA of Butler & Co is the author of *Tax Planning for Farm and Land Diversification* (Bloomsbury Professional), *Equine Tax Planning* and *Stanley: Taxation of Farmers and Landowners* (LexisNexis). Julie can be contacted by phone on 01962 735544 or email: j.butler@butler-co.co.uk.