

Under the spotlight

Julie Butler shines a spotlight on agricultural tenancies, focusing on tenant succession and tax protection within the legal requirements.

With the news before Christmas of a ‘half U-turn’ by the government on the 100% business property/agricultural property relief (BPR/APR) allowance to £2.5m, and likewise the transferable spousal allowance of £2.5m, the risk of *not* qualifying for 100% IHT relief is once again of huge significance. This impacts:

- agricultural tenancies only qualifying for 50% APR;
- ‘trading assets’ being proven by HMRC to be ‘investments’ with 0% BPR; and
- ‘non-partnership’ property only achieving 50% BPR, and indeed property that is thought to be owned by the partnership but that perhaps HMRC finds a chance to grant only 50% relief.

Here, we focus on tenancies as a follow on to an article we wrote just over two years ago, ‘Focus on tenancies’, *Taxation*, 29 February 2024, when we highlighted the tax weaknesses of tenancies and also the need to sort out dilapidation of tenant buildings and improvements; the negotiations of ‘who has to pay for what’ on cessation of the lease and the importance of good housekeeping with business records. We now look at tenant succession and the tax protection within the legal requirements.

The landlord’s position

The landlord could be advised (as was part of the focus on 29 February 2024) that tenancies have a negative tax position and bringing the farm back to trading in hand could be positive, especially with all the diversification, environmental and development potential. This must be determined very much case by case.

Key points

- If a tenant’s successor wishes to continue the tenancy, they must pass eligibility tests (close relation and livelihood) and a suitability test.
- If a retirement succession application fails at tribunal, that person cannot make another application and is barred from making an application on the death of the current tenant.
- Landlords who wish to buy out a tenant face several complex areas of tax including capital gains tax, income tax and stamp duty land tax on which they must get specialist advice.



Despite succession tenancies having been in place for many decades, there is still a high level of misunderstanding about them. Only Agricultural Holdings Act 1986 (AHA 1986) tenancies granted before 12 July 1984 automatically carry succession rights, otherwise the written terms of the tenancy have to allow for succession.

An application to succeed to the tenancy must be made to the First-tier Tribunal Property Chamber (Agricultural Land and Drainage) in England, or the Agricultural Land Tribunal in Wales, using the correct processes and notices. Alternatively, succession can be dealt with informally. For either route, professional help is advised.

Payments made by the landlord to a tenant to surrender a lease are considered a capital payment but are not a revenue deduction for the landlord. Obviously, the purchase of farming stock is an allowable income tax expense. Likewise, the purchase of, say, farm machinery and equipment will be eligible for capital allowances.

The tenant’s position

Tenants are likely to have looked at their legal and tax position with the recent loss of the basic payment scheme (BPS), along with general profitability concerns given they are not able to take advantage of some of the ‘financial parachutes’ that the landlord can. The tenant’s successor must assess whether they want to stay or go and, if they choose the former, what are the commercial opportunities? The tests that they must pass to stay are eligibility, which include the ‘close relation’ test and the ‘principal source of livelihood’ test, as well as the suitability test. These are explored below.

The latest provisions, effective since 1 September 2024, were brought in under the Agriculture Act 2020 and require the tribunal to disregard all offers as to rent in relation to the holding.

Eligibility: Close relation

The first stage of the eligibility test is the close relation test. This requires the potential successor to be a close relative of the retiring or deceased tenant – namely a child, sibling, spouse or civil partner, or someone treated as a child of the tenant.

Eligibility: Livelihood

Applicants must show that in at least five of the preceding seven years, more than half of their livelihood (including household living expenses) have been paid for with earnings or benefits in kind on the farming unit, including the holding to which they are applying to succeed. This is about the applicant's share in covering household living costs, not about what anyone earns in absolute terms.

Suitability

If the two eligibility tests above are satisfied, the potential successor must then prove they can also satisfy the newly strengthened suitability test. As before, they will have to demonstrate their experience, training and skills in agriculture and business management, as well as their financial standing and character. However, in addition they must also evidence their capability and capacity to farm the holding commercially to 'high standards of efficient production and care for the environment'. As such, the application is similar to a tender submission for a new letting, just without the other candidates.

The old commercial unit occupation test has been removed, so that land being farmed other than the holding in question will no longer be prejudicial to the succession application.

A succession can be agreed informally, without a tribunal application, but many landlords' agents prefer the formal route so they can show due diligence and that the tests have been met where possible. The informal succession documentation must satisfy certain legal requirements to protect the status of the tenancy.

Applying for succession

Legal, land agent and tax advice is needed *before* a decision is made. Some tenants want to bow out of the tenancy gracefully and others relish the opportunity to maximise the monies and tax relief from being 'bought out'.

Succession can be on retirement, with the retiring tenant serving a notice of retirement and nominating a successor, who in turn must make an application for succession within one month. Alternatively, it can be on the death of the tenant. In this case, applications must be made within three months of the death.

However, if a retirement succession application fails at tribunal, a further application on retirement is not possible,

and although an application can be made on the death of the existing tenant, the person who failed on a retirement application is barred from making an application on death.

Planning for a succession on retirement can also be less stressful than an application on death when the applicant will be grieving and dealing with the formal demands and processes following a death.

It is fairly obvious that if the landlord is making noises about buying out the tenant, they must *keep their position strong* and not let matters slip. Several complex areas of tax are involved including capital gains tax (CGT), income tax and stamp duty land tax.

Statutory compensation and the tax position

Statutory compensation for 'disturbance' under the AHA 1986 can be exempt from CGT provided legal conditions are met. It is therefore essential for legal and tax advisers to work together. Payments for trading stock, such as growing crops or stored produce, are subject to income tax.

Compensation for the surrender of lease rights is generally subject to CGT, so business asset disposal relief and rollover relief can be used if applicable. If the tenant lived in the farmhouse, they should be able to claim principal private residence relief on the portion of the compensation that applies to the house.

AHA tenancy law is very complex and the fundamental position needs to be understood by the tax adviser to ensure that tax reliefs are maximised. As set out in February 2024, a lot of tenancies could again be coming under review. Valuations are key. ●

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