

Mind the gap

Julie Butler looks at what clients who own farmland can do to avoid an increased liability to inheritance tax where the market value of their land is higher than the agricultural value

Farmland can benefit from both agricultural property relief (APR) and business property relief (BPR) for inheritance tax (IHT) purposes. APR is, however, restricted to "agricultural value". The principle of agricultural value is generally understood in relation to the farmhouse.

Section 115(3) of the Inheritance Tax Act 1984 (IHTA 1984) provides: "The agricultural value of any agricultural property shall be taken to be the value of the property if the property were subject to a perpetual covenant prohibiting its use otherwise than as agricultural property."

The agricultural value may well therefore be less than the open market value of the farmland, as a result of planning permission for some form of development potential. Advisers need to consider any increase in value due to development, hope value or mineral value, or because the farm is in a desirable part of the country. In these circumstances, APR might not be available in respect of the difference between market and agricultural value.

HM Revenue & Customs (HMRC) often tries to deny 100% relief on farmland farmed via a farm business tenancy (FBT), on the basis that market value is greater than agricultural value, so only the element relating to agricultural value achieves 100% APR. As the farmland is let, BPR will not apply unless the FBT is part of a large undertaking.

It seems a long time now since the FBT was introduced in September 1995 and heralded as such a positive for farming. The main advantage was that 100% APR could be achieved on land let with an FBT.

"SPECIAL VALUE"

The value of land which represents the difference between market value under section 160 of the IHTA 1984 and agricultural value under section 115 needs the protection of BPR. However, the district valuer may insist that, for an FBT, some "special value" exists that places market value slightly above agricultural value – this slight difference on a large amount of land can lead to a large liability to IHT. If BPR is not available as protection, such a potential attack on the "special value" must be fought and resisted with HMRC.

This "special value" approach could be an effective way for HMRC to collect more IHT from let farmland. It has been accepted for some time that the difference between an Agricultural Holdings Act 1986 tenancy and land farmed with vacant possession is in the region of 50%. There are arguments being promoted that the agricultural value of the land under an FBT is only 70% to 90% of its full market value, so IHT is due on the difference.

Land agents will obviously be presenting strong arguments that market value equals agricultural value. These arguments are

bolstered by the increase in recent years of farmers purchasing farmland for farming, as opposed to the previous trend of farmland being purchased by investors, lifestyle farmers and overseas buyers. However, there remains much debate on the question of agricultural value.

PRACTICAL PLANNING

The main practical step to take is to review all FBTs, and consider the commercial advantages and tax reliefs of the trade of farming, where HMRC could be in a position to argue that farmland has special or development value.

One option if there is potential special or development value is to consider changing from tenancy to "in hand" farming, subject to the current terms of the FBT. The reform of the "active farmer"

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elements of the Common Agricultural Policy reform post-2013 in respect of the single farm payment highlight the importance for landowners of farming "in-hand" as a trade as opposed to a letting activity wherever possible, to ensure the protection of BPR.

In addition, land farmed under an FBT does not qualify for business capital gains tax (CGT) reliefs such as entrepreneurs' relief and rollover relief. This serves to endorse the view that, for tax planning purposes all FBTs need review to try to achieve maximum CGT reliefs and BPR for IHT.

The change from an FBT to trading in hand is relatively straightforward. FBTs have limited security of tenure and, as long as the tenancy is outside its fixed term, the landlord should be able to give a notice to quit, to bring the tenancy to an end. As long as the notice is a valid one and gives the required period of notice, the tenancy will come to an end, and the landowner will be able to obtain possession. Professional help should be obtained from a land agent. ■

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