

Optimum use of Agricultural and Business Property Relief in farm diversification

Julie Butler FCA highlights the most important considerations

Farm diversification is simply alternative use of agricultural land and buildings. However, with a move away from agriculture there is a risk of the loss of Agricultural Property Relief (APR) for inheritance tax purposes. Examples of farm diversification are sporting rights, horse livery, developing agricultural land and changing buildings into residential dwellings or offices and workshops.

As many landowners have to diversify to survive and also to make full use of "out of date" or redundant buildings, including cottages, does the diversification activity qualify as agriculture for APR? Diversification is as stated "alternative land use" but the activities that qualify as agriculture and those that do not can be quite complex.

What is agricultural property?

The question has to be asked, what is agricultural property that qualifies for APR? Definition is found in section 115 IHTA 1984 and further explained in Inspectors' Manuals.

Agricultural land or pasture (IHTM24042), which includes woodland (IHTM24043) and any building used in connection with the intensive rearing of livestock or fish (IHTM24044) if the woodland or building is occupied with agricultural land or pasture (IHTM24111), and the occupation is ancillary to that of the agricultural land or pasture.

It also includes such cottages (IHTM24045), farm buildings (IHTM24046) and farmhouses (IHTM24047) together with the land occupied with them, as are of a character appropriate (IHTM24036) to the agricultural land or pasture.

What is a farmer?

It is also important to understand the

definition of farmer in relation to APR.

To be classified as a farmer for inheritance tax purposes, a taxpayer must satisfy two tests: the taxpayer must be in occupation of land, and the purpose of the occupation must be at least mainly for husbandry. The actual use of the land will normally be indicative of the purpose of occupation, but is not necessarily conclusive. Nor does the occupation need to be to the exclusion of others. Share farming is an example in which two persons may occupy land and each be farmers. "Husbandry" is specifically said to include hop growing and the breeding and rearing of horses and the grazing of horses in connection with those activities (ITA 2007 section 996(2)) together with short rotation coppices and energy crops.

If the claim for APR fails then the representative for the landowner has to turn to the protection of Business Property Relief (BPR). The attempt by HMRC to disallow BPR on mixed estates has been well documented with the attacks under the "wholly or mainly" cases, e.g. *Balfour* and *Farmer* (see below). There are some tax advisers who consider all agricultural property should have the back-up of the availability of BPR as protection.

What activities are not farming and therefore need the protection of BPR?

- the letting of cottages
- the letting of farm buildings
- equine activities that are not the breeding of horses
- market gardening and Christmas trees
- commercial woodland
- music concerts, raves etc

It is interesting to note that if the woodland or Christmas trees are ancillary to the main activity of farming then they do qualify for APR.

The concerns of the investment business

The case of *Brander* [2010] UKUT300 (also known as *Balfour*) considered entitlement to BPR of a mixed agricultural estate in Scotland. The question was whether, having decided that the estate was operated as a single composite business, the business operated of a combination of agricultural activity and let property was mainly investment activity, i.e. BPR could be denied under s105(3) IHTA 1984.

Various factors were taken into account: the overall context, turnover and net profit, time spent on the various activities, and capital value. Although the capital value of the let properties (£4.3 million) exceeded the value of the other properties (£2.3 million), the judge confirmed that this was generally immaterial and would only be relevant if the business were to be sold, which was not the case here. BPR was therefore allowed on the estate including the let property.

The decision extends the decision in *Farmer (Farmer's Executors) v IRC* [1999] STC (SCD) 321. Many consider that it is important that the volume of investments in a mixed estate do not "tip the balance" and therefore transferring investment assets to the next generation should be reviewed.

Why is APR important – why not just claim BPR?

One of the unique points of APR is the ability to claim IHT relief on farmhouses. Farmhouses are entitled to APR if they are used for agricultural purposes; and of a character appropriate to the holding of which it forms part.

APR is limited to agricultural value: "the agricultural property shall be taken to be the value which would be the value of the

property if the property were subject to a perpetual covenant prohibiting its use otherwise than as agricultural property.' (Section 115(3) IHTA 1984).

Active husbandry

'Active' has become the important word in order for farming enterprises to succeed in a claim for inheritance tax (IHT). As already shown, the IHT case of *Balfour* shows how important it is for the deceased person to have been both involved in the business and active in the farming enterprise.

The IHT farmhouse case of *Arnander v HMRC* [2007] RVR 208 shows the importance of being an active farmer in order to qualify for APR on the farmhouse. In this case the contract farming agreement was considered weak and the deceased's farming involvement was not mentioned in the obituary. Contract farming agreements should be reviewed and there is no time like the present (or after a very wet harvest) to tackle the question of documented activity and make sure that clear proof of activity is available.

For those landowners who have other sources of income and who spend their time on activities in addition to farming, there is an immediate and ongoing need to document active involvement in the farming business. The deceased cannot present arguments themselves to HMRC once they die and therefore it is important to keep photographic evidence, minutes of meetings and, where necessary, diaries of hours worked.

Hope value needs BPR

Hope value is the difference between market value and agricultural value – APR only applies to agricultural value. Therefore BPR is needed to protect the hope value at the date of lifetime transfer or death. To achieve BPR there must be commerciality.

Section 160 IHTA 1984 dictates that probate assets, i.e. assets held at death, are valued at market value – the price that would be achieved between willing buyer and willing seller. When looking at what is the market value it can be argued that not many lenders would be prepared to lend monies to purchase speculative blocks of potential development land as they can be difficult to resell thus pushing development land values down.

APR and farmhouse (again)

The recent case of *Golding* [2011] UK FTT 351 has highlighted the benefits of APR. The First-Tier Tax Tribunal (FTT) has held that lack of profit does not stop a farmhouse from being 'character appropriate'. It decided that a 3 bedroom farmhouse on 16.29 acres of agricultural land did meet the 'character appropriate' test set out in s115(2) IHTA 1984 and so is eligible for APR.

The facts of the case were that Dennis Golding had lived and worked at Blue Gates Farm from 1940 until his death in 2007. Mr Golding had kept some 600 free range hens and 7-10 cattle and grew apples, vegetables, wheat, barley and oats for sale. Farming activity decreased from this through the 1980s and 1990s, but at the time of his death in 2007, aged 81, Mr Golding still kept perhaps 70 hens, grew vegetables for his own consumption and baled hay, having bought a tractor and baler a couple of years before he died. Declared taxable profits were between £1,000 and £1,600 in the four years prior to death. No Single Payment or other subsidies were claimed. Mr Golding lived primarily on other income. The 3 bedroom listed house was in a poor state of repair.

HMRC argued that "the relevant factors... are the level of farming activity and the functional requirement or otherwise of the dwelling house". There had been little in the way of real farming activity on the property for the last decade. The taxable earnings did not appear to take into account spending on electricity, water, machinery expenses and repairs, and if they did the farm might well have made no profit. It could be argued that this would have turned the position into a loss. The work required on the farm amounted to 11 days a year. There had been no functional requirement for it as a "farmhouse". If sold, it was unlikely to be used as a farm.

The FTT did not express its decision in terms of a detailed review of each of the tests summarised in *Antrobus* or *Arnander* with regard to the farmhouse. It found on the facts before it that the farmhouse was of character appropriate, despite the lack of profitability. It said that the question to be asked was "was the deceased farming?" and, in answering that in the affirmative, considered that at an age of 80 "it would be unreasonable to expect that to be an

extensive activity". On the specific point of finance it stated:

"We do not accept that the lack of a substantial profit is detrimental to a decision that the farmhouse is 'character appropriate'."

In addition, the Tribunal believed the property would only be bought (at a discount reflecting its condition) by someone who would develop its potential as a farm.

Business matrix and business records

One key point arising from *Golding* is perhaps the need to keep records for longer than the statutory time, ideally it would seem from the start of trading. When looking at the business matrix and the general position in *Golding* it wasn't just a question of looking at what happened in the last two years – the history was a key point, and how can the history of the farm business be argued to help the taxpayer unless the accounts and the accounting records and other information are available to present that history? A large number of decades were actually considered and therefore there must be the records for this time, ideally from the start of the business – in the case of *Golding* his father transferred ownership in 1965.

The cases of *Balfour* and *Farmer* both looked at eight years' records to establish the eligibility of the claim for BPR so that HMRC could review the questions of capital, profitability, turnover and number of employees and the split of all these items between the investment side of the business and the trading side of the business. This again argues the need to keep detailed business records to maximise both BPR and APR.

Atkinson

Another recent case has looked at the question of agricultural occupancy of the farmhouse – *Atkinson v HMRC* [2010] UK FTT 108. What are the facts? Mr Atkinson was a partner in a farming business until he died in 2006. Until four years before his death he lived in a bungalow on the farm. Was this occupied for the purposes of agriculture in the seven years before his death? No one else occupied the property during the last four years of his

life and his partners regularly visited the property to collect post and deal with any other matters requiring attention there. Mr Atkinson remained a partner and took part in discussions relating to the business. The test in section 117(b) IHTA 1984 that the property was occupied 'by him or another' (in this case, the partnership) was held to be satisfied. The decision is subject to appeal. This case highlights the advantages of the occupation rules of APR and indicates how they can be effectively used.

Many landowners do not want to pass to the next generation and they must therefore ensure that all is in place to robustly protect their eligibility for APR and BPR.

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Office of Tax Simplification (OTS) and *Mirlees* – what if APR and BPR disappear?

On 8 November 2010, the Office of Tax Simplification (OTS) published a complete list of tax reliefs that were due to be reviewed. The OTS was set up as an independent office within HM Treasury on 20 July 2010 '... to advise the Chancellor on delivering a simpler tax system, providing independent advice on options for addressing existing complexity in the tax system...'

Pass to the next generation

The OTS March 2011 Final Report states IHT will be reviewed in general not in aspect.

Part of the proposed simplification is that IHT APR is removed or simplified. (This would be from section 115 IHTA 1984 et seq.) The same applies to BPR for the same reason (section 103 IHTA 1984 et seq).

The clear action point or consideration is with the strong (some would say generous) tax reliefs currently in place but currently at potential risk, is this the time to consider passing estates to the next generation? Does the recent pre-nuptial case *Radmacher* possibly present greater confidence to the farming community to review this course of action?

BPR/APR audit

Within the current format of APR there are arguments to say that every claim for APR should have the support of BPR to protect attacks on areas of a mixed estate that do not qualify for APR. Should APR be "simplified" or "disappear" this protection should be considered in advance of any change. There are arguments to say that every farm and/or mixed estate should look to a "BPR audit" with emphasis on commerciality, trading and "active husbandry".