Where there's muck...

...there's money, or at least agricultural property relief. But the landowner must be spreading the muck, says **JULIE BUTLER**.

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Recent debate with HMRC has shown that, in certain circumstances, being the person who carries out the task of fertilising ("muck spreading") the farmland can help decide whether a taxpayer can claim agricultural property relief (APR) on the farmhouse and business property relief (BPR) on the land. Advisers need to be aware that HMRC are looking more closely at claims for inheritance tax reliefs and the department's Capital Taxes Office seems to be paying close attention to this fertilisation question and whether the farmhouse and land are "occupied by the transferor for the purposes of agriculture" as required by IHTA 1984, s 117.

Income from grass lands

One of the best practical examples that shows where the border lies between farming and land ownership is the treatment of income from the grazing of pasture.

The owner of pasture, who manages to secure agreement from HMRC that the income from it should be taxed as farming income, can obtain several advantages. These will include the treatment of the grazing income as farm trading income, rather than as non-trading (investment) income from a property business.

KEY POINTS

- The availability of the valuable inheritance tax reliefs on agricultural property can be influenced by the nature of the income received from it.
- The cultivation of grass can be a farming activity.
- Care should be taken that the minimum period of occupation or ownership requirements of IHTA 1984, s 117 are met.
- The importance of ensuring that the grazing agreement is not a tenancy.
- The landowner, not the grazier, should be responsible for growing the grass and actively performing some activity.

A key factor will be how the grazing income will be reflected on the individual self-assessment tax return. The tax advantage of farm trading income is that the landowner will be able to claim that the pasture is an asset occupied and used for the purposes of his farming business and qualify for capital gains tax rollover relief. The pasture or grass lands will be a "relevant business asset" and potentially qualify for entrepreneurs' relief. This will be an important consideration for the farmer who, after the cessation of more intensive farming activities, allows others to graze his land while he perhaps looks for a permanent place to live in his retirement. He should still be able to obtain entrepreneurs' relief on the original disposal. The trading status will also have the advantage of being eligible for farmers averaging for income tax purposes.

Non-investment business

Where the owner of the grass lands is treated as farming this land it is likely that the owner will be conducting a trading or "non-investment" business for inheritance tax business property relief purposes (see *McCall (personal representatives of McClean, dec'd) v CRC* [2008] STC (SCD) 752). HMRC have accepted that a landowner who continues to occupy a farmhouse on a farm where the land is grazed by others may still be in agricultural occupation of the farmhouse. This is provided that the income from grazing is farming income and the landowner conducts some activity on the land in connection with the provision of the grazing rights. Such land can qualify for the relief by satisfying the "minimum period of occupation or ownership" requirements of ***IHTA 1984, s 117***. If, on the other hand, the grazing income is classed as rental income and the landowner conducts no other farming activities, HMRC can argue that his continued occupation of the farmhouse is not for agricultural purposes.

The result would be that any previous entitlement to agricultural property relief on the farmhouse could be lost. Tax reliefs must therefore be protected and all accountants must check how any income from grazing is disclosed in the trading accounts. The accounts will be used as evidence in an HMRC enquiry into eligibility for inheritance tax reliefs.

For VAT purposes, grass lands which the landowner is regarded as farming himself will normally result in the supply of grass being a zero-rated supply.

The grazing agreement

The landowner who wishes to secure these capital gains tax and inheritance tax advantages for a trading activity must pay scrupulous attention to the nature of the grazing agreement and the activities he contracts to perform in association with it. The statutory definition of "farming" for both income tax and corporation tax purposes requires that, for the landowner of grass lands to be farming, he must show he is in occupation of the pasture and that this is for the purposes of husbandry. Because all farming is treated as the carrying on of a trade (ITTOIA 2005, s 9(1) and CTA 2009, s 36(1)) a landowner who establishes that he is farming land is treated as carrying on a trade with the land as a capital asset employed in it.

In deciding whether land is being occupied by a farmer, the approach of the courts has been to determine the paramount use of the land and then to ascertain the identity of the person who had that use (see *Back v Daniels* (1924) 9 TC 183 and *Dawson v Counsell* (1938) 22 TC 149).

Seasonal grazing

In the case of seasonal grazing of grass lands, the courts have been prepared to accept that the landowner can be the person with paramount use of the land. Hence, as long as the landowner conducts some activities which are husbandry in connection with that use, the landowner can be regarded as farming the land. Thus in *CIR v Forsyth-Grant* (1943) 25 TC 369 it was noted by Lord Carmont (at page 379) that "...the laying down of grass in suitable parks, the manuring of the land so as to produce a good crop, and the arranging for the seasonal eating-off the grass by cattle brought on to the land are operations of husbandry. The parks ... are ... being used for the purposes of husbandry ... by the proprietor who is occupying them..."

IHTA 1984, S 117

Minimum period of occupation or ownership

Subject to the following provisions of this Chapter, s 116 above does not apply to any agricultural property unless:

(a) it was occupied by the transferor for the purposes of agriculture throughout the period of two years ending with the date of the transfer; or

(b) it was owned by him throughout the period of seven years ending with that date and was throughout that period occupied (by him or another) for the purposes of agriculture.

Similarly, Lord Fleming (at page 376) observed: "The growth of grass on a grass park does not require cultivation in the same sense as grain crops do, but such agricultural operations on the lands as are necessary to promote its growth, namely, manuring, are performed by the [landowner] and not by the grazier. On the assumption that the [landowner] is the occupier, the agreement between him and the grazier may be regarded as the sale of a growing crop rather than as a let of the lands..."

In the *Forsyth-Grant* case the landowner was regarded as being in occupation. He was growing a crop (the grass), he performed actions of husbandry in connection with growing that crop such as manuring and the laying down (seeding), and only seasonal rights were granted so that the grass could be eaten as animal food.

Let without any restriction to use

By contrast to *Forsyth-Grant*, in two further Scottish cases (*Mitchell v CIR* (1943) 25 TC 380 and *Drummond v CIR* (1951) 32 TC 263) the courts held that the landowner was not farming the grass lands.

In *Mitchell v CIR* (heard on the same day as *Forsyth-Grant*) the court held that the landowner was not the occupier of the land because it was let without any restriction as to use. Consequently, whatever agricultural activities the landowner performed, he could not be a farmer in respect of the lands in question.

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In *Drummond* it was noted that top-dressing was not applied to the land by the owner. It was found that the landowner was not a farmer primarily because the grazing agreements were, in reality, a species of tenancy rather than merely seasonal lets of grazing. Certainly, if the courts hold that the grazing agreements are a tenancy, this will result in the landowner not being regarded as a farmer.

This point was emphasised in *Bennion v Roper* (1969) 46 TC 613. There, the court was influenced by a document that did not form part of the stated case and concluded that the grazing agreement was "...a perfectly ordinary tenancy agreement..." Clearly the drafting of the agreement by a competent lawyer to ensure that there is no tenancy together with the identification of farming activities are key here.

Grass sown as a crop

The *McCall* case, cited earlier, also establishes the work that the landowner must carry out to be proved to be the "farmer". This was a business property relief case, and consideration was given to the question of when land used for grazing might be regarded as qualifying as a non-investment business.

It was noted in this case that the grass being grazed had not been sown or grown in the manner of a crop. There were no acts of husbandry commensurate with growing the grass as a crop and accordingly no occupation for the purposes of husbandry. Under the agistment (grazing) agreement used, the landowner merely performed such acts of maintenance that were necessary to successfully exploit the land for grazing. In particular, it was noted that only the grazier, not the landowner, was permitted to fertilise the land and thereby maximise the growth of the grass.

Among other considerations, care must be taken in drafting all agreements on the point of who fertilises the land; that is to say, who is allowed to "spread the muck".

Landowner responsibilities

It would appear from the above precedent cases that there are essential ingredients of a grazing agreement that result in the landowner qualifying as a farmer. These are that the landowner, not the grazier, should be responsible for growing the crop of grass and actively performing some activity on the land. The landowner should therefore be responsible for acts of husbandry in that connection, ie fertilising, seeding and weeding the grass lands. These are activities performed on the land and are commensurate with the husbandry operations of growing grass as a crop. The landowner should actually go onto the grass lands to perform these functions as well as being responsible for maintaining boundaries and water supply. Although he may do all these activities through agents acting on his behalf under agreements that are *separate* to the grazing agreement, care is required as suggested below.

> ***"It is preferable for tax efficiency that the contract should be a pasturage agreement."***

The grazing agreement must have the hallmarks of a seasonal letting. It is preferable for tax efficiency that the contract should be a pasturage agreement. Certainly, a farm business tenancy (FBT) for grazing should *not* be employed if the landowner wishes to be a farmer and take advantage of the various tax reliefs already described. The reason behind this is that such a tenancy will confer rights of exclusive possession on the grazier and thus the landowner will not be in occupation of the grass lands. A tenancy also means that the landowner is not occupying the farmhouse for the purposes of agriculture, and care over carrying out dedicated farming duties should be considered in order to protect agricultural property relief on the farmhouse.

The role of the agent

A further question arises as to how far the landowner can contract his husbandry duties to an agent who performs them on his behalf. Perhaps this might be considered the ideal arrangement for many ageing farmers.

A landowner should approach the idea of using agents with caution. Where the landowner is actively farming other land, and provides only some of his land for seasonal grazing, he will probably be regarded as a farmer on the grass lands, even where he contracts for others to fertilise, weed and seed the land, and allows the grazier to cut the grass.

On the other hand, where a landowner only allows land to be grazed by others, it would be better if they performed these duties themselves. If they do not do this, there is a danger that the occupation of the land could be regarded as so minimal that the grazier is regarded as the paramount user and occupier. In the *McCall* case, the concept of an agent was considered workable if the landowner conducts some of the significant activities, mainly fertilising the land, therefore the "muck spreading". If the agent is the grazier there must be separate agreements for the separate roles.

The grazing of horses

It is suggested that the Special Commissioner's decision in *Wheatley's Executors v CIR* [1998] SSCD 60 should be approached with care. In that case, grazing by horses was held not to be an agricultural purpose within IHTA 1984, s 115(2). It has subsequently been argued that too much emphasis has been placed on the nature of the horses that grazed the grass (they were not working farm horses) rather than on the main purpose of occupation of the land. Was the land occupied to grow the crop of grass for grazing or, for example, was it for the purposes of the recreational activities connected with the horses that grazed on it? Thus it is considered that the *Wheatley* decision was "flawed" where the landowner is growing a crop of grass for the horses to graze. It is clear that activities connected with the growing of a crop of grass are an agricultural operation; what does not follow automatically is whether the main purpose of occupation is to conduct those agricultural operations.

In the case of *Hemens v Whitsbury Farm and Stud Ltd* [1987] 1 All ER 430, it was noted by Balcombe LJ (at page 445) that zebras and bison grazing land at a zoo were not an agricultural operation. Therefore, it is equally clear in that example that the land was not occupied for the purposes of agriculture. There are many who consider that the growing of the crop of grass is agriculture irrespective of which animal species eats it.

Action points

With increased land prices, the significance of the grazing agreement as a "tool of tax protection" has become significant both with regard to agricultural property relief on the farmhouse and business property relief on potential development land. The key points are not just about a well drafted legal document, but about understanding what is really happening on the land. Yes, this would include the question of who spreads the muck or fertilises the land and the nature of any other agricultural activities undertaken by the landowner. ■

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