

Agricultural property relief

Introduction

This information sheet sets out briefly for general guidance the main features of the Inheritance Tax ("IHT") relief applicable to agricultural property. This is known as Agricultural Property Relief ("APR"). It is relevant to transfers both during a person's lifetime or on death (and in either case this information sheet refers to a "transferor").

Agricultural Property

APR can only apply to "agricultural property", which includes the following:

- a agricultural land or pasture;
- b woodland and any building used in connection with the intensive rearing of livestock or fish, if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary to that of the agricultural land or pasture;
- c such cottages, farm buildings and farmhouses, together with the land occupied with them, as are of a character appropriate to the property.

These are considered in turn below.

APR will also be available for controlling shareholdings in farming companies.

1 Agricultural Land or Pasture

The land must be used for agricultural purposes. This would not include, for example, a paddock used for grazing horses. However, if land is let under a grazing agreement relating to cattle or sheep, this can qualify as an agricultural purpose.

The definition includes land dedicated under wildlife habitat schemes and land on which "short rotation coppice" is cultivated.

"Agriculture" is not defined for IHT purposes but includes, for example, activities such as horticulture, fruit growing, seed growing, dairy farming and livestock breeding.

2 Woodland and Buildings

The occupation of woodland must be ancillary to that of the agricultural land or pasture. This may include coppices and amenity woodland. There are other reliefs available for woodland.

Buildings are not "agricultural land", so must fall within this heading or the next one if they are to qualify for APR. The occupation of a building must be with agricultural land and ancillary to it. For example, broiler houses can only qualify if they are occupied as a subsidiary part of a larger agricultural enterprise carried out on other land with which they are occupied.

3 Farmhouses

Two tests must be satisfied. Firstly, is the property in question a farmhouse? Secondly, if it is a farmhouse, is it of a character appropriate to the property to which the transferor is beneficially entitled?

The IHT rules do not contain any definition of "farmhouse". In broad terms HM Revenue & Customs ("HMRC") consider that a farmhouse is a dwelling for the farmer from which farming operations or management are conducted.

There have been a number of recent cases on the issue of whether a farmhouse is of a "character appropriate" to the property. HMRC consider that, in determining this issue, the main factors are as follows:

- a Is the farmhouse appropriate (by reference to its size, layout, content, style and quality of construction) in

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- relation to the associated land and buildings?
- b Is the farmhouse proportionate in size and nature to the requirements of the agricultural activities conducted on the agricultural land?
 - c Within the agricultural land, does the land predominate so that the farmhouse is ancillary to the land?
 - d Would a reasonable and informed person regard the property simply as a house with land or as a farmhouse?
 - e Does the house pass "the elephant test"? That is, although you may not be able to describe a farmhouse which satisfies the "character appropriate" test, you will know it when you see it.
 - f How long have the farmhouse and agricultural property been associated and is there a history of agricultural production?
 - g Would the house attract demand from a commercial farmer who has to earn a living from the land, or is its value significantly out of proportion to the profitability of the land?
 - h Considering all other relevant factors, including whether any land is let out and on what terms, is the scale of the agricultural operations in context?
 - i There must be some connection or common ownership between the farmhouse and the property to which it must be of a character appropriate.

Analysis of the relevant case law is beyond the scope of this information sheet.

4 Farm Cottages

Farm cottages, together with the land occupied with them, will qualify for APR if they are of a character appropriate to the property. In addition, they must be occupied for the purposes of agriculture. This test will be satisfied if the cottage is occupied by employees working on the farm

or in certain situations where occupied by a retired farm worker or his/her widow(er).

Agricultural Value

APR is available only in respect of the "agricultural value" of property referred to above. This is defined as the value which the property would have if it were subject to a perpetual covenant prohibiting its use otherwise than as agricultural property. Any enhanced value attributable to development potential is therefore not subject to APR. In the case of farmland, any development value would usually qualify for a separate IHT relief known as Business Property Relief ("BPR"), subject to satisfying the relevant conditions. However, BPR will not normally apply to a farmhouse (except for any part used exclusively for business purposes).

The agricultural value will normally have to be negotiated with District Valuers instructed by HMRC. In practice, the agricultural value of a farmhouse is often considered to be around two-thirds of open market value, but this will vary.

APR can be available on the whole value of a qualifying farm cottage, not just the agricultural value, if the occupier is solely employed in agriculture.

In cases where both APR and BPR are available, APR takes priority. BPR can potentially apply to a gift of an asset (for example, land) that is part of a business, and is not limited to a gift of the business itself.

The Ownership and Occupation Requirements

In order for a transfer during a person's lifetime or on death to qualify for APR,

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the agricultural property must have been either:

- 1 occupied by the transferor for the purposes of agriculture throughout the period of two years ending with the date of the transfer; or
- 2 owned by the transferor throughout the period of seven years ending with the date of the transfer and, throughout that period, it must have been occupied (by the transferor or someone else) for the purposes of agriculture.

For the purposes of these provisions, if the property is occupied by a partnership in which the transferor was a partner, or by a company controlled by the transferor, it is treated as having been occupied by the transferor.

If the transferor has inherited agricultural property on the death of a previous spouse*, the period of occupation or ownership of the deceased spouse can be added to the transferor's own period for the above purposes. There are also rules relating to successive transfers.

APR can apply to agricultural property owned by trustees. For the purposes of the APR provisions, the transferor of the property will be the beneficiary (if any) with an interest in possession or, if none, the trustees.

APR will be lost if the transferor has entered into a binding contract for the sale of the agricultural property prior to the transfer, unless the sale is made for the purposes of reconstruction or amalgamation.

Rates of Relief

Where APR is available, the agricultural value (referred to above) is reduced for IHT

purposes. The reduction is 100% (so the agricultural value is exempt from IHT) where:

- 1 the transferor has vacant possession or the right to obtain it within the next 12 months (which has been extended, by concession, to 24 months); or
- 2 the property is let on a tenancy which began after 31 August 1995; or
- 3 the transferor has owned his interest in tenanted land since before 10 March 1981 and certain conditions are satisfied (which are outside the scope of this information sheet).

In all other cases, the agricultural value is reduced by 50%.

Where IHT is payable on property which qualifies for APR, the tax can be paid by ten annual interest-free instalments.

Lifetime Gifts

Where a person makes a lifetime gift of agricultural property to another individual, it will be a potentially exempt transfer ("PET") for IHT purposes. The gift will be exempt from IHT if the transferor survives for seven years after the gift. If he dies within seven years, APR can apply to the gift only if the following conditions are satisfied:

- 1 the agricultural property must have been owned by the transferee during the period from the date of the gift until the transferor's death (or, if earlier, the transferee's death) and must not be subject to a binding contract for sale at the end of that period; and
- 2 the property must have been occupied (by the transferee or someone else) for the purposes of agriculture throughout the above period; and

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- 3 where the agricultural property consists of shares in a company, the land must have been owned by the company and occupied (by the company or another) for the purposes of agriculture throughout the period mentioned above.

Where the transferee sells the property and replaces it with other agricultural property, which is occupied for agricultural purposes through the relevant period, APR will also be available.

A gift of agricultural property to most types of trust would be a chargeable transfer for IHT purposes. This is immediately chargeable to IHT, subject to the availability of APR. If the transferor dies within seven years, APR can only be available if the conditions mentioned earlier in this section apply. If not, a chargeable transfer would be treated more favourably than a PET. This is because it is only the additional IHT payable as a result of the transferor dying within 7 years which will not be reduced by APR. The IHT payable on the chargeable transfer when made and the transferor's cumulative total of gifts will be unaffected. So the clawback of APR, if the transferor dies within 7 years and the conditions applying to the transferee are not met, is worse following a PET than a chargeable transfer.

Although Capital Gains Tax issues are outside the scope of this information sheet, a lifetime gift of property qualifying for APR can also attract holdover relief for Capital Gains Tax purposes.

Tax-Efficient Wills

Where a person dies with an estate including property qualifying for APR, the

relief could be wasted if the property is left to the deceased's surviving spouse.

Assets passing to a surviving spouse would be exempt from IHT in most cases, but may not qualify for APR when he or she subsequently dies. Accordingly, it may be preferable for the agricultural property to be left to other beneficiaries (such as children) or to a Discretionary Trust. Further details of such trusts are contained in our information sheet 'Nil Rate Band Discretionary Trusts in Wills for Spouses or Civil Partners'.

Disclaimer

This information sheet is written as a general guide. As any course of action must depend on your individual circumstances, you are strongly recommended to obtain specific professional advice before you proceed. We do not accept any responsibility for action which may be taken as a result of having read this information sheet.

NOTE: The law is stated as at 6 April 2010.

If you require further information, please contact Mark Politz or Simon Brown on 01892 510000 or by email at mark.politz@ts-p.co.uk or simon.brown@ts-p.co.uk

* All references to the term "spouse" include a civil partner as defined by Section 1 of the Civil Partnership Act 2004.