IHT AGRICULTURAL PROPERTY RELIEF UNDER THE ILL-HEALTH OF THE FARMER

Malcolm Gunn[1]

Agricultural property has long been recognised by successive Governments as deserving preferential treatment for the purposes of death duties. This can be traced as far back as the introduction of Estate Duty in 1894, the legislation at section 115(2) Inheritance Tax Act 1984 being still largely based on the original definition of agricultural property in section 22(1)(g) Finance Act 1894.

The reasons for the tax-favoured treatment of agriculture are self-evident. Agriculture is a vital industry, perhaps one of the most vital of all industries, requiring very substantial capital investment and huge commitment of time but the rewards can be very low.

Hopefully therefore no-one would quibble about the need for generous relief from inheritance tax for the UK farming industry. What they would find less acceptable would be making those same reliefs available to wealthy people in other walks of life who buy a country estate as a weekend retreat and then attempt to cloak it with the appearance of being a working farm, thereby sheltering some of their wealth from liability to inheritance tax.

Distinguishing between these two very different situations is not necessarily as easy as one might suppose. The wealthy owner of a country estate should be able to organise some agricultural activity on the land to generate some profits and thereby create a general impression of a working farm, at least on paper. On the other side of the coin, the full time working farmer may suffer from declining health in the course of time, causing a reduction in activity on the farm and with profits then dwindling to very small amounts, or even losses being incurred. By

1 Malcolm Gunn is consultant with Squire Sanders (UK) LLPand also Butler & Co chartered accountants; E-mail: malcolm.gunn@hotmail.co.uk; Website: www.malcolmgunn.co.uk

that stage, the full time working farmer could perhaps be confused for a hobby farmer if all the circumstances are not carefully reviewed.

Reliefs for working farmers

The inheritance tax reliefs for agricultural property at sections 115 – 124C Inheritance Tax Act 1984 make little attempt to distinguish between the two types of cases described above. On the introduction of capital transfer tax by the Finance Act 1975, there was an intention to restrict relief to full time working farmers. Paragraph 3 of Schedule 8 to the Finance Act 1975 laid down conditions for relief and one of which was that the transferor was, in not less than 5 of the 7 years ending with 5 April immediately preceding the transfer, wholly or mainly engaged in the United Kingdom in any of the capacities mentioned further in the paragraph, the first one being "a person who carries on farming as a trade either alone or in partnership". This condition was treated as satisfied where not less than 75% of the transferor's relevant income was immediately derived from his engagement in agriculture. This became known as the "full time working farmer" relief but it was abolished in 1981 in favour of the more wide ranging agricultural property relief which now appears in the Inheritance Tax Act 1984.

It is somewhat disturbing therefore to encounter cases time after time in which HMRC seem to operate their own ad-hoc full time working farmer condition under their interpretation of the current provisions for agricultural property relief. The problem is most acute in relation to the farmhouse itself, but to a lesser extent it surfaces in relation to the farmland itself where in the two year period up to the relevant time (often the death of the farmer) there has been little or no farming activity due to his ill health.

In this article, I am not concerned with the rate of relief, or with other issues which may arise, such as the character appropriate test in relation to a farmhouse. The situation under review here relates to those situations where HMRC commonly deny any relief for what has been a farm operated by someone who has been in agriculture all his or her life.

Relief for agricultural land

The definition of agricultural property in section 115 Inheritance Tax Act 1984 is unhelpfully tautological. Agricultural property, it says, means "agricultural land or pasture". In itself that tells us nothing which cannot be readily deduced from the term being defined, but Section 117 is of more importance. Under this section, there is to be no relief for agricultural property unless:

> "(a) it was occupied by the transferor for the purposes of agriculture throughout the period of 2 years ending with the date of the transfer; or
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> (b) it was owned by him throughout the period of 7 years ending with that date and was throughout that period occupied (by him or another) for the purposes of agriculture."

The fundamental requirement is therefore that up to the date of the chargeable transfer, one way or the other the land must be occupied for the purposes of agriculture. Furthermore, it must be so occupied throughout the relevant period, either 2 years or 7 years, and if there is any period of time when the occupation test is failed during the relevant period, there is no agricultural property relief for the land at all, even if the occupation test had previously been satisfied for a great many years.

Where farm business activity has dwindled to a low level due to the final illness of the farmer, HMRC will not be reticent about using this as a reason for denying any relief in relation to the land. In these circumstances, any alternative claim for business property relief encounters the difficulty that Section 103(3) Inheritance Tax Act 1984 applies the relief only to a business which is carried on for profit making purposes.

Obviously much will depend on the facts of the particular case, but it may well be that in many of these types of cases, HMRC's view is not always justified.

The essential point is that for those engaged full time in farming, it is not so much a trade as far as they are concerned but more a vocation, a way of life. They are not generally concerned about the slender profits to be made, or the exceptionally long hours of work. They have a natural commitment to that way of life and they may not have any other alternative skills. Once this point is properly appreciated, it may be a reasonably interpretation of the facts of a particular case that the land remains in occupation for agricultural purposes, despite minimal activity in the final period due to the illness of the farmer.

It will be relevant to consider whether the farmer had ever taken the decision to retire completely, or whether on the other hand he had simply fallen into ill health and because of that temporarily discontinued farming the land. If the latter, the purpose in holding the farm will not have changed, nor will the farmer have taken a decision to do something different with the land of a non- agricultural nature.
Instead, he will simply have temporarily discontinued activities hoping to recover from illness and then resume farming. Therefore, the fact that he may tragically not be able to resume farming because the illness turns out to be terminal does not

provide grounds for an argument that the land had ceased to be occupied for agricultural purposes.

The waters get muddied further where there have been no profits from farming, and low turnover in the final period of years. Experience has proved that HMRC will point to this fact in support of their view that the land has ceased to be used for agricultural purposes. One can see that the boundary line between this case and the wealthy hobby farmer, not deserving of IHT relief as already mentioned, may be a little difficult to find, but nevertheless it does exist. In *Arnander v Revenue & Customs Commissioners [2006] STC (SCD) 800* Counsel for the taxpayer pointed out to the Special Commissioner that there was no provision in the current inheritance tax legislation that a farmer has to make a profit in order to qualify for agricultural property relief on the land. The Special Commissioner agreed with that point.

Although HMRC generally accept that the farm does not have to be profit making to qualify for the relief, they will tend to paraphrase the conditions for relief so that the land must be occupied for the realisation of profits over an extended period of time. I am not sure that I can see any justification for that conclusion. There are various statutory definitions of "agriculture", for example in the Town and Country Planning Act 1990 and in the Agriculture Act 1947, but none of them suggest that the term implies a profit making motive. Although the definitions relate to the use of the land, inheritance tax relief relates to the purpose of holding the land. The farmer who stops work because his health fails does not necessarily, by reason of that fact alone, then commence to hold the land for a different purpose.

HMRC gives some recognition to this at IHTM 24083: 'Cases where the owner is absent due to ill health can be contentious and difficult to decide. You will need to ascertain the length of, and reasons for, the absence. Any desire on the part of the transferor to return will be relevant but this should be viewed in the light of how realistic such a return might be.' In practice, given the fact that the matter will often fall to be decided after the death of the farmer, hindsight will be applied by HMRC to say that it was unrealistic to expect any return to work and thus there is no relief.

The Farmhouse

Problems with agricultural property relief in relation to farmers falling into ill health more commonly arise in relation to the farmhouse itself. The fundamental idea behind giving relief for a farmhouse is that it is usually necessary to be on site 24 hours a day and the centre of operations will be the farmhouse itself. Thus

although it doubles as a private residence, the occupation of the farmhouse on a working farm is for the purposes of the farm business. Where the land attached to it in agricultural use is not substantial in relation to the residence, the character appropriate test will prevent relief, or alternatively it may be that the house is primarily used for domestic residential purposes and the agricultural use of the land with it is insufficient for cause the occupation to be for the purposes of agriculture , as in *Dixon v Commissioners of Inland Revenue [2002] STC (SCD) 53*.

A similar conclusion was reached in *Rosser v Commissioners of Inland Revenue [2003] STC (SCD) 311*. In this case, a farm had been in the same family since 1900, initially as tenant farmers but in 1958 the farm was purchased outright and the business was then conducted as a partnership between husband and wife. This continued until they were aged 85 and 80 years respectively, when most of the land was given to their daughter because they could no longer manage the full farm due to their advancing years. They did however retain about 2 acres which remained in agricultural use and this continued until the death of the wife at the age of 92 and the death of the husband at the age of 97. HMRC denied agricultural property relief in relation to the farmhouse on the basis that it was no longer occupied for agricultural purposes, but instead was occupied, as they put it, as a retirement home. An additional argument was that it was not of a character appropriate to the small acreage occupied with it. The land given away to the daughter could not be taken into account because it was now in different ownership (a point which was revisited in the case of *Hanson v HMRC*, as discussed further below). The Special Commissioner came to the following conclusion:

> "*The house on Cwm Farm has a lengthy and proud history as a farmhouse providing a home for generations of farmers and their families. However I am obliged to consider whether it was a farmhouse at the time immediately before the death of Mrs Phillips. The facts found demonstrated that the house changed from a farmhouse to a retirement home for Mr and Mrs Phillips with the transition completed at about the time of the ending of Mr and Mrs Phillips' partnership in 1996.*"

As a result, the farmhouse which had been the centre of farm operations dating back well before 1730 did not qualify for any relief, primarily because the owners had become too old to manage it effectively.

The case of *Arnander v Commissioners of Customs & Excise [2006] STC (SCD) 800* was on a similar theme, but failed for a different reason. This did not however involve a full time working farmer, but instead the deceased and his wife originally purchased a property with 126 acres as a country estate to be a second home, whilst their main home was in London. However when they retired in 1984, the London home was sold and they moved to the property in the country and took a decision to enter into contract farming arrangements over the land. The

contractors work on the land was largely supervised by a professional agent appointed by the deceased and his wife, although they did have some involvement – the decision records that there were about 46 meetings between the agents and the deceased between 1994 and 2003, about 5 a year. The Special Commissioner said that he derived the following principles from earlier decisions:

> "*That a farmhouse is a dwelling for the farmer from which the farm is managed (Rosser v CIR); that the farmer of the land is the person who farms is on a day to day basis rather than the person who is in overall control of the agricultural business conducted on the land (the Antrobus 2 case [2002] STC (SCD) 468 and Lindsay v CIR 34 TC 289); that the status of the occupier of the premises is not the test but the proper criterion is the purpose of the occupation of the premises (CIR v Whiteford 40 TC 379); however if the premises are extravagantly large for the purpose for which they are being used, or if they have been constructed upon some more elaborate and expensive scale, it may be that, notwithstanding the purpose of occupation, they should be treated as having been converted into something much more grand (Whiteford); and that the decision as to whether a building is a farmhouse is a matter of fact to be decided on the circumstances of each case and must be judged in accordance with ideas of what is appropriate in size, content and layout, taken in conjunction with the farm buildings and the particular area of farm being farmed (Korner v CIR 45 TC 287).*"

Accordingly, his conclusion was that the house was not a farmhouse within the meaning of the inheritance tax legislation, but was primarily a rich man's residence. Agricultural property relief was denied.

The Arnander case can be identified as one in which a wealthy person purchased a country estate and where the executors hoped that this would secure inheritance tax relief for the country home. So the outcome seems a correct result and in accordance with the the basic scheme of the legislation. The same cannot unfortunately be said of the most recent case which was *HMRC v Atkinson and Smith [1012] STC 289*. This concerned a bungalow let to a family farming partnership of which the deceased was a member. He had lived in this property until 2002, when he became ill and moved into a care home where he died in 2006. Furniture remained in the bungalow and the deceased had visited it from time to time whilst he was resident at the care home. The executors had initial success at the First Tier Tax Tribunal where it was held that the bungalow qualified for agricultural property relief since it was occupied by the farming partnership which was active up to 2006 and beyond, being operated by the other partners. The Tribunal concluded that as the bungalow was occupied by the partnership, this could only be for the purposes of its business and therefore relief was due.

Unfortunately this success was short lived. The Upper Tax Tribunal made the following point:

> "*It is, we think, important not to attach undue weight to the occupation being that of the partnership rather than Mr Atkinson. In point of fact, when Mr Atkinson still lived at the bungalow, it was he, not the partnership, who was in physical occupation and the partnership's occupation, such as it had, was through him. We must not lose sight of the fact that the function of the bungalow was to provide a home for Mr Atkinson, not to provide accommodation for some purpose of the partnership. It might be said, as a general point, that a building such as the bungalow, just like a farmhouse, might be used to some extent for the purposes of the farming business and not solely as a residence, for instance, the farm office might be in the building. But there is nothing in the present case to suggest – and it does not appear to have been argued before the Tribunal – that the bungalow was ever in fact used for any purpose other than a residence for Mr Atkinson.*"

The Upper Tax Tribunal went on to say that in any event the partnership ceased to occupy the bungalow for the purposes of agriculture when the deceased moved to the care home with no reasonable prospect of ever returning home. It was accepted that the property was not totally unoccupied since furniture and possessions remained there. However it was not occupied as a dwelling and although that in itself did not mean that the occupation could no longer be for agricultural purposes, a significant change came about when the deceased moved to the care home. After that time, the retention of furniture at the bungalow was a convenience to him not in any way connected with the farm or the partnership business. Hence agricultural property relief was not available in respect of the bungalow.

The latest case concerning agricultural property relief on a farmhouse is *Hanson v HMRC [1012] UKFTT 95 (TC)* which concerned the farmhouse held on interest in possession trusts for the appellant's late father. The father had moved out of the farmhouse in 1978 and from that time on it was occupied by the appellant and his family and used by them as the base from which they conducted farming activities on land in the ownership of the appellant. The fact that the father, life tenant of the trust, was not in occupation of the property was not an issue in the appeal because agricultural property relief is available where throughout the period of 7 years ending with the relevant date the property concerned was occupied by the transferor or another for the purposes of agriculture. In this case it was occupied by another, namely the appellant. What was an issue was the fact that the farmland was not held within the trust, but was in the ownership of the appellant. It had previously been decided in the *Rosser* case already referred to that both the farmhouse and the farmland forming the complete units must be in the same

ownership and occupation. However in the *Hanson* case the First Tier Tax Tribunal took a different view on this point and decided that there was no requirement that the farmhouse and the land should be in the same ownership. They need only be in the same occupation, which was the case here, so that agricultural property relief was allowed.

Preserving Relief for the Farmhouse

What these various decisions show is that it is dangerously easy for any farmer to lose the benefit of agricultural property relief on the farmhouse when he is no longer able to conduct farming operations on an active basis. The *Atkinson* case is particularly worrying because the scenario of the farmer being taken into a care home in his final days is one which nowadays is far more likely to arise than in times past. Equally, if the farmer continues to live at the farmhouse but no longer plays any active part in the farm operations it is likely that relief for the property will be denied.

The solutions to this problem are not necessarily easy to find. A contract farming agreement in relation to the land will not necessarily help – see the *Arnander* decision mentioned above, and there is no certainty that a different conclusion would have been reached in that case if the contract farming had been supervised by the taxpayer himself up to the time of his death rather than by the agent. HMRC looks for a degree of 'day to day' involvement with the farming (see IHTM 24082). Joining the elderly farmer into a partnership with younger members of the family who conduct the farming operations will not in itself solve anything – see that *Atkinson* decision. Whether the result in *Atkinson* would have been any different if the junior partners had used the vacant bungalow as the farm office is hard to tell, but there is a chance that it might have done. The best solution is for the farmer to vacate the farmhouse completely and to move into a smaller property on the estate so that whoever runs the farm actively can move into the farmhouse, as in the *Hanson* case. However not all elderly people are prepared to move out of the residence which they may have occupied for most of their lives simply to improve the tax position on their death.

A much better solution is for the legislation itself to be reviewed by the Government. If one accepts the proposition that it is intended to provide full relief from inheritance tax for farmhouses in the occupation of those who have been engaged in agriculture, but not for farmhouses purchased by the wealthy as weekend retreats, then it is failing to achieve the correct result. The fundamental problem is that it works well enough for the farmer who dies suddenly and unexpectedly, but it does not work satisfactorily for the farmer who lives on suffers from progressively failing health. The fundamental problem is that it tests

the use of the property for the purposes of agriculture throughout the periods of either 2 years or 7 years up to the date of death and completely ignores all previous history outside those periods of time. In doing so, it places the required standard to be reached at the highest level possible with the requirement that occupation for the purposes of agriculture must be in strictness continue up to the final moment, otherwise the relief earned over a lifetime is lost completely.

The defects in the legislation could be cured by allowing the 2 or 7 year period to be taken up to some suitable earlier date within a permitted period. Without such a provision, the availability of agricultural property relief on farmhouses will remain somewhat capricious depending on how quickly the health of the farmer declines in his final years.