

Welcome

Welcome to our latest issue of **Agricultural Law Quarterly** on which we focus on inheritance tax and farmhouses, included are questions and answers on common situations, which we hope you will find of use.

“The McKenna decision raises the bar and requires the farmer to be farming on a day-to-day basis.”

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Inheritance Tax and Farmhouses

Do you qualify?

Last year’s Lands Tribunal decision in *Antrobus 2* suggested a narrowing of the interpretation of who is a farmer and when a house is a farmhouse for the purposes of inheritance tax. The Lands Tribunal’s view was that unless a house is lived in by a farmer who farms the land on a day-to-day basis the house cannot be regarded as a farmhouse and would therefore be ineligible for inheritance tax relief. This raised concerns that the use of contract farming agreements as well as some other farming structures could cause the loss of IHT relief on some farmers’ houses.

One view was that the Tribunal had strayed beyond its brief in pronouncing on these issues. However the Lands Tribunal’s suggestions have now largely been adopted in the Special Commissioner’s decision of *McKenna* which concerned the Rosteague estate in Cornwall (see the next page for the detail of the case). The Special Commissioner confirmed the principle that:

“...a farmhouse is a dwelling for the farmer from which the farm is managed [and] that the farmer of the land is the person who farms it on a day-to-day basis...”

She went on to say that one should look at why the house is occupied and it should not be extravagantly large. Having done that one should look at the size, content and layout of the house in the round in deciding whether it is a farmhouse.

Therefore in the future to secure Agricultural Property Relief (APR) for IHT on a farmhouse it will no longer be enough to show that the house is of a character appropriate to the holding and it is occupied for agriculture. It will also have to be shown that the house was occupied in order to farm the land and most importantly the occupier **farmed the land on a day-to-day basis**. Being in overall control of the agricultural business is not sufficient. In *McKenna* the use of contracting agreements led to the conclusion that the deceased was not farming on a day-to-day basis.

In the future the use of contracting agreements must be viewed with **extreme caution** if relief on a farmhouse is hoped for - particularly where contractors carry out all the farming operations. Even contracting agreements that are run more rigorously than those used at Rosteague (which were akin to tenancy agreements) are unlikely to reserve to the owner the day-to-day decision making. The wish to delegate such decision making is after all one of the reasons for appointing a contractor.

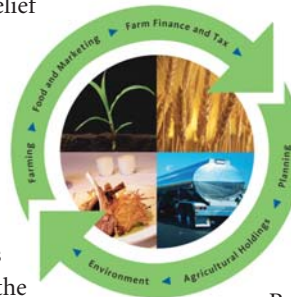
The need to have day-to-day responsibility means that alternative trading structures such as partnerships or share farming agreements are likely to suffer the same drawbacks unless the owner is responsible for day-to-day decision making.

Another area of concern is grazing licences. Even before this decision the Revenue would look closely at grazing

licences to see whether it was the farmer or the grazier who was carrying out husbandry activities on the land. If the farmer was doing little or nothing to produce the grass crop then the farmer might be treated as not occupying the land for agriculture himself or that the licence might be found to be akin to a tenancy. Either interpretation could result in the farmhouse failing to qualify for APR. The *McKenna* decision raises the bar and requires the farmer to be farming on a day-to-day basis. Active grassland management by the farmer is likely to be needed in the future to limit the chances of a grazing licence prejudicing APR on a farmhouse.

There are also likely to be implications for landlords where their tenants are employing contractors – which could put at risk the landlord’s IHT relief on let farmhouses. This could have implications for many landlords and landed estates.

Use of farm managers or agents should not in itself create any new difficulties provided the owner still has day-to-day control. But if the manager has a significant degree of delegated authority the position may need to be looked at.



The facts of the McKenna case

The Rosteague estate comprised 110 acres of agricultural land, a large mansion house including library, music room and 6 acres of gardens including an Elizabethan knot garden. There were farm buildings (both traditional and more modern).

Mr McKenna bought the estate shortly after the War. Aside from a short period of pig breeding the land was let to farming tenants until September 1984. In October 1984 Mr McKenna and his wife went into partnership to farm the land. They did this by employing contractors. There were 4 contracting agreements between 1981 and 2003, the year when Mr McKenna died, followed by his wife a few months later.

All the contracting agreements reserved sole

On the other hand Mr McKenna walked the farm and inspected it on a regular basis. He kept the cash book and records and composed and submitted the farm census. However the involvement of an agent meant that the use of Rosteague House for farming matters was much reduced.

In other words the contracting agreements at Rosteague were run on the basis that much of the responsibility for farming decisions fell to the contractor. Also, although this is not entirely clear from the judgment, it seems some or all of the financial risk of trading may have passed from Mr McKenna to the contractor also.

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“The Commissioner found that the house was “primarily a rich man’s residence rather than a farmhouse”. Mr McKenna it was found did not occupy the house to undertake day-to-day farming activities as the day-to-day management was carried out by a contractor.”



Rosteague House

responsibility for providing machinery and farming policy decisions to the contractor. Day-to-day management was also reserved to the contractor after consultation with Mr McKenna.

However the manner in which the agreements were drafted and run was similar, in many respects, to a tenancy. For example in negotiation over the last contracting agreement there was talk of the contractor paying a “rent”; Mr McKenna’s return was paid to him quarterly (like many farm rents); in later years the contractor claimed and kept the arable area aid payments; the contractor bought the crop (sometimes standing); the contractor was a co-signatory to a Woodland Grant Scheme application as “occupier”.

farmhouse”. Mr McKenna it was found did not occupy the house to undertake day-to-day farming activities as the day-to-day management was carried out by a contractor.

The Commissioner went on to say that even if she was wrong and Rosteague was a farmhouse it would still fail to qualify for relief because it was not of a character appropriate to the holding. To put matters beyond doubt she went on to say that if she was wrong on both these points and Rosteague was a farmhouse of a character appropriate to the holding then it would still fail to qualify for relief because neither Mr McKenna nor his widow occupied the house for purposes of agriculture in the two years leading up to their deaths.



Common Situations - questions and answers

Q: I purchased a farm with a modest house 5 years ago. I employ a contractor to farm the land. I commute to a city where I work during the week. I was advised when I bought the farm that I should get inheritance tax relief on the farmhouse on my death. Is that still the position?

A: Because you are not occupying the house to farm the land day-to-day your house is unlikely to qualify for IHT relief.

If you wish to maximise your chances of relief you will need to become an active farmer and farm the land with your own equipment/labour – or perhaps employ contractors on an operation by operation basis where you direct what work is required.

Q: I have an excellent farm manager who lives in a cottage on my farm. In the last few years he has taken on most of the responsibility for directing farm operations. We now only discuss matters a few times a month.

A: It may be difficult for you to show that you are farming the land on a day-to-day basis because that role has been delegated to your manager. In which case you may not qualify for relief on your house. Relief on your land and farm buildings used for agriculture and the manager's house should be unaffected.

You may wish to become more involved in the farming on the land. For example you could consider daily meetings with your farm manager.

Q: I have been a farmer all my life but I am now at an age when I would like to wind down and I am contemplating selling my machinery and employing a contractor. Will this upset the chances of getting relief on my farmhouse on my death?

A: Yes it could. The risk of employing a contractor is that your house could cease to be a farmhouse and therefore would be ineligible for relief. Your land and farm buildings (provided they are still used for agriculture) could still qualify.

Q: I have granted a neighbour a farm business tenancy of my farm which includes my farmhouse and buildings. He has employed a contractor to farm the land. Should I be concerned about my IHT position?

A: As a landlord you could be eligible for 100% APR. However if your tenant is using a contractor he may not be farming the land on a day-to-day basis – in which case you may fail to qualify for relief on the let farmhouse.

Many tenancy agreements do not prohibit tenants from employing contractors and this could be a future issue for many landlords.

Q: Due to my age I am doing much less on my farm. I have sold my livestock and I am granting annual grazing licences to my neighbour over my land. Am I affected by this decision?

A: It depends on whether you are still involved in your farm to the extent that you are farming on a day-to-day basis. Anything less may mean that your chances of securing APR on your house are prejudiced.

“I have granted a neighbour a farm business tenancy of my farm which includes my farmhouse and buildings. He has employed a contractor to farm the land. Should I be concerned about my IHT position?”



Is it of appropriate character?

To obtain agricultural property relief on a house, not only must the house be a farmhouse occupied by a farmer, the house must also be of a character appropriate to the property. This might seem a somewhat whimsical and arbitrary test, but over the years case law has established guidance on what it means. In *Antrobus 1* the Special Commissioner set out 5 key issues to consider. In *McKenna* the same Special Commissioner looked again at her 5 key issues and modified them somewhat. She said it was not appropriate to compile an exclusive list of relevant factors (although that seemed to be her earlier intention). The issue is always going to be case specific and any factor could be relevant, although the case law indicated factors that had been relevant in earlier cases.

In *McKenna*, the relevant factors for the Special Commissioner were the historic association, the size, the content and layout of the house, the farm outbuildings, the area being farmed and whether the house was proportionate to the land being farmed, the view of the educated rural layman and the relationship between the value of the house and the profitability of the land. On all counts, Rosteague House failed to be of an appropriate character. The last factor merits particular careful

scrutiny given current low profit levels of farming in the UK and current high property values in the UK.

The Special Commissioner considered whether the land or the House was predominant in the estate. She concluded that the “value of Rosteague House was well out of proportion to the profitability of the farm”. Rosteague House was valued at about £2million out of the £3million sale price for the entire estate in 2004. The net profitability of the farm would have been between £11,000 and £16,000 per year. Accordingly, it would not provide a living income to support a person living in Rosteague House. The conclusion was that a pure commercial farmer would not buy the Rosteague Estate. If this factor were to be considered relevant in other cases, one wonders how many pure commercial farmers making a sensible return on the value of their assets would be found in UK agriculture in 2007?

However if it is possible to show that a commercial farmer would buy a particular farm that will be useful evidence to rebut any suggestion that relief be disallowed on the amount by which market value exceeds agricultural value (in *Antrobus 2* a 30% discount was applied).

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Narrow Quay House
Narrow Quay
Bristol BS1 4AH
tel: 0117 939 2000
fax: 0117 902 4400

Holbrook House
14 Great Queen Street
London WC2B 5DG
tel: 020 7405 4343
fax: 020 7405 6788

www.burges-salmon.com

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A list of members, all of whom are solicitors, may be inspected at our registered office: Narrow Quay House, Narrow Quay, Bristol BS1 4AH.



The Burges Salmon Team

The Burges Salmon Tax and Trusts Team work for a wide range of land owning and farming clients.



Tom Hewitt

Partner

0117 902 2717

tom.hewitt@burges-salmon.com



Martin Mitchell

Partner

0117 902 2792

martin.mitchell@burges-salmon.com



Charles Wyld

Partner

0117 902 2773

charles.wyld@burges-salmon.com



Melanie Robinson

Associate

0117 902 7192

melanie.robinson@burges-salmon.com

Don't forget to visit our website at www.burges-salmon.com