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TAXATION AND LAND OCCUPATION IN NORTHERN IRELAND

CONACRE AND TENANCIES OF AGRICULTURAL LAND

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CONTENTS

NB – This document is substantially the same as the text of 1st February 2017 with only editorial changes.

1. Introduction

1.1 This paper briefly summarises the general tax treatment for the landowner of agricultural land let on conacre and when let on a tenancy. It should not be relied on as specific advice for individual situations which should be considered on their circumstances, including the behaviour of the parties, and not the label given to the agreement.

1.2 The importance of that analysis of the facts was stressed by the Northern Ireland Court of Appeal in the Inheritance Tax case, *McCall*:

> "These cases, as has been pointed out, must be decided on their facts. For example … the deceased did not provide a service to the graziers by fertilising the land but left that to them. Nor might I add did she provide a service of supervising the cattle for the agisters. The provisions of any such services, on the authorities, may well have properly led to a different conclusion than that arrived at by the Special Commissioner here."

1.3 Readers are particularly referred to decisions in the tax cases over property in Northern Ireland:

- *Evelyn* and *Allen* (CGT and so Income Tax)
- *McCall* (also *McClean*) (IHT, Business Property Relief (BPR))
- *Higginson* (IHT, Agricultural Property Relief (APR) and the house)

as well as the leading UK cases on APR and the house: *Antrobus* I, *Antrobus* 2, *Arnander* (also known as *McKenna*) and *Hanson*.

2. Inheritance Tax

Note – *HMRC's recent research project into the reliefs from Inheritance Tax does not appear to have had any policy intention but was rather to assist it answer questions about from the National Audit Office about reliefs. That project's results were published with the November 2017 Budget. While the Office of Tax Simnplifiotn is now doing some work on Inhetiucne Tax, there is no reason to expect any recommendation that land let on conacre be treated in a more favourable way than land let on a tenancy.*

2.1 The Land – Business Property Relief (BPR) - Land let on either conacre or a tenancy will not generally qualify of itself for the BPR that would usually give full relief on its market value, including any development value. The key general point for BPR is that the land is within a business:

- that has been owned for at least two years and
- which does not consist wholly or mainly of investments.

As an asset of such a business, it need not have been owned for the minimum qualifying periods required for APR. Following case law such as *George*, *McCall* and *Pawson*, land on conacre or tenancy will typically be on the investment side of the balance in assessing the availability of BPR for the business.

2.2 The Land – Agricultural Property Relief (APR) - Agricultural land and pasture used by others for the purpose of agriculture throughout the seven years prior to the death will in principle qualify for full APR on its agricultural value if:

- it is let on a tenancy of any length provided that the tenancy is the only obstacle to the landlord having vacant passion (s116(2)(c) of IHTA 1984)
- it is let on conacre for less than a year.

As this relief is on the agricultural value of qualifying property, it would not cover any additional hope value or other value in excess of agricultural value.

2.3 APR is available at the full rate for the landlord of agricultural property let on a tenancy that commenced after 1st September 1995. Agricultural property let on tenancies let from before that date attract APR at a 50 per cent rate on its agricultural value.

2.4 Where, as may occasionally be the case, a conacre agreement is granted to run for more than year and does not allow the landowner to recover possession within twelve months, APR might be allowed at 50 per cent of the agricultural value rather than at 100 per cent.

2.5 For this purpose, the wording of s.116 of IHTA simply refers to a "tenancy" (which has to be of "agricultural property") without qualification, so applying to any tenancy of agricultural property whether under a specifically agricultural tenancy code as found in England/Wales and also Scotland, or any other form of tenancy whether under another code or, as in Northern Ireland without such a statute, by simple agreement.

2.6 That position has now been confirmed to the CAAV by HMRC:

> "I can therefore confirm that Agricultural Property Relief afforded to qualifying agricultural property let on a tenancy granted on or after 1 September 1995 by section 116(2)(c) of IHTA is not dependent on whether the tenancy is under a code of law, but just has to be tenancy of that property. Such tenancies would include those in Northern Ireland." (HMRC e-mail of 25th August 2016).

The more detailed papers, with HMRC's solicitor's advice of 3rd August 2016, setting that out are attached in the Appendix to this paper.

2.7 That HMRC confirmation is consistent with the previous CAAV view that:

- the words used have no such qualification – the critical thing is that the arrangement be a tenancy
- there is no experience in the last 21 years to warrant the concern
- there has been no experience in Great Britain of APR being denied where agricultural property is within another form of tenancy, whether a common law, business or other form of letting.
- there has been no challenge to the increased relief applying from 1995 to tenancies under the separate Scottish agricultural holdings Acts which saw no change in 1995 but rather in 2003.
- with the extension of APR to the agricultural property of UK taxpayers throughout the European Economic Area such any other interpretation could be seen to impede the free movement of capital in the EU's internal market and so be in breach of the CJEU's decision in the *Jäger* case that led to that extension.

2.8 The House and APR - For a house to qualify as a farmhouse for APR it must function as a farmhouse at the date of death

- being whence day-to-day farming is conducted
- being of a character appropriate to the land occupied with (farmed from) it
- if the farming is by the owner then the house must have been used for purposes of agriculture for the two years prior to death.

So far as land is out on either conacre or a tenancy, it will not support the landowner's claim for a house he occupied to qualify for APR.

2.9 Where APR applies, it will typically be available on 70 per cent of the market value of the house (*Antrobus 2*) – subject to the actual facts of the situation.

Warning – Many houses thought of as farmhouses may not qualify for APR under these tests when scrutinised by HMRC.

2.10 The New Relief on the House (Residential Nil Rate Band Amount)

Where a house

- has been lived in by the deceased
- is given to a lineal descendant
- and at the date of death the net value of the estate is £2 million or less
  then a relief increasing to £175,000 is available on that asset (reduced by a taper for estates just over that £2m ceiling)

Transferrable between married couples, that can from April 2020 give £350,000 of relief in such circumstances

- where appropriate, that offers:
  - a more objective relief as an alternative to APR with its tests and dependence on use in the last two years of life
  - a relief that will be more valuable in many cases on houses with a market value of up to £500,000 (applying the *Antrobus* 70 per cent).
- that allows the accompanying farmland to be let without compromising the relief as it would were APR being claimed on the house.

2.11 Conclusions

- There is no IHT advantage to letting land on conacre rather than using a tenancy.
- Where land is let, full APR can be available on the agricultural value, however long the period of the tenancy but, for conacre, only where it allows possession within 12 months (24 months under the ESC)
- Qualification for either APR or BPR is required for Holdover Relief from CGT to be available on any lifetime gifts, as within the family. Thus, a lifetime gift of farmland, which farming families may consider for land intended to be kept in the family may usually be eligible for Holdover Relief if this is desired. That would apply whether the farmland is farmed in hand, on conacre or let on a tenancy. This option may be further encouraged by the limit on estate size for the new relief on houses.
- Taxpayers need to think afresh about the house.

3. Income Tax and CGT

3.1 Income Tax - A strict construction suggests that income from both conacre (if the owner undertakes no significant management of the crop, whether or not he does the property maintenance of boundaries, drains and so forth) and a tenancy will be treated as Property Income not Trading Income.

3.2 Farming is effectively defined for Income Tax (and so CGT) as the occupation of land wholly or mainly for the purposes of husbandry (s.996 ITA 2007) with a view to a profit (s.9 ITTOIA). The conventional approach to conacre lies outside that (save where it is a minor ancillary activity for a business that uses the land before and after or where it constitutes the sale of a crop that has been managed by the taxpayer (*Forsyth Grant*)).

3.3 As agreed in *Evelyn*, if the owner undertakes no husbandry the income is not Trading Income. However, it is recognised that, as argued in *Evelyn*, it is often regareded in Northern Ireland as Trading Income (perhaps leaving the question of whether it is or is not farming income).

3.4 However, changes over the years now mean there is less distinction in practice between the two types of income, perhaps most significantly as regards sideways loss relief, suggesting that this issue, if unresolved, may not be generally material for Income Tax and so be of lesser concern to HMRC.

3.5 Other grazing arrangements, if structured appropriately and honoured, may be seen as yielding Trading Income provided the owner undertakes husbandry.

3.6 CGT - This distinction can though matter more for CGT (with its close dependence on Income Tax definitions). In *Evelyn* the taxpayer accepted that she was not in occupation of the land for the purposes of husbandry. That argument did not reach the Tribunal. Hence the case did not consider

> "whether the Appellant as part of the partnership was engaged in the trade of farming when granting short term lets of the land or about the tax treatment of lettings in conacre in general."

As there was no contention that she was conducting a trade in this case, the only issue was, in the context of discovery, whether declaring it as a business asset was in accordance with prevailing practice. It was found that this was not the prevailing practice where the taxpayer undertook no husbandry, whatever might be the situation otherwise.

3.7 In the particular facts that the Tribunal found and recorded in *Allen*, the owner, fertilising, weeding and grazing the land, was found to be in occupation wholly or mainly for the purposes of husbandry while having a seasonal conacre grazier on the land. On these facts he was found to be undertaking the deemed trade of farming and so his disposal of the land qualified for the now-repealed Business Assets Taper Relief. With those specific findings, this decision is again adverse to the many situations where the conacre owner is not undertaking husbandry. The decision also recognises that the usual practicalities of arable conacre, as for potatoes, exclude the conacre owner from husbandry of the land.

3.8 Land let on a tenancy would, in general, be in the same position for essentially the same reason – the lack of husbandry by the owner.

3.9 The Business Asset Taper Relief at issue in *Evelyn* and *Allen* has since been abolished, but the same reasoning would apply for Rollover Relief and the tests for Entrepreneurs' Relief, save where the conacre or tenancy is a minor use within a larger business.

3.10 Where the land qualifies for APR (or BPR), it should qualify for Holdover Relief where it is the subject of a gift. That is of practical importance to families considering making lifetime gifts of land intended to be kept in the family. This approach may be further encouraged by the limit on estate size for the new IHT relief on houses (the Residence Nil Rate Band Amount being introduced from April 2017). Where continuing land ownership is intended, it may suit the family hoping to use this new relief to make internal gifts of farmland to reduce the net size of the estate (unless it is likely that the land will be sold after death).

3.11 Conclusion – While common practice may be for income from conacre land generally to be treated by taxpayers as Trading Income, there would equally not appear to be an appetite to defend this at Tribunal where the owner cannot show substantive husbandry of the crop. Such issues are more likely to be significant for CGT than Income Tax.

3.12 On that basis, there is no difference in treatment for CGT between the generality of conacre (save where the facts are akin to those found in *Allen*) and a tenancy.

4. VAT

4.1 Under the EU VAT Directive, VAT is generally due at a standard rate where there is supply of goods or services unless there is other provision.

4.2 The supply of land is in principle exempt from VAT unless the taxpayer has waived that exemption. In the UK, that can be done for all land save housing. Where the exemption is waived, tax would be applied at 20 per cent – in this context on rent – but is then recoverable by businesses.

4.3 Thus, rent for an agricultural tenancy would ordinarily be exempt from VAT unless the owner has opted to tax.

4.4 The practice for conacre seems to be that no VAT is applied. It is not understood whether this is because:

- it is seen as a supply of grass for animal feed and so zero rated
- it is seen as income from land and so exempt.

5. Stamp Duty Land Tax (SDLT)

This tax on the taker of the transaction (and so here the tenant) is unlikely to be material here:

- few, if any, tenancies seem likely to be large enough and valuable enough to reach the £150,000 threshold for SDLT at 1 per cent
- the same would hold for conacre if SDLT applied to it but with its gnelaly small scale and seasonal nature it seems unlikely that its liability to SDLT will be tested (as with the question of whether it is a right in or over land? – FA 2003, Sch 17A, para 1).

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APPENDIX 1

HMRC's Confirmation that Agricultural Property Relief from Inheritance Tax Applies to Agricultural Property Let on Tenancies in Northern Ireland

A. Question Put by Jeremy Moody in the CAAV Letter of 19th May 2016 sent by E-mail of 20th May 2016

"The question now raised by the tax advisers who are a very significant key to owners' willingness to let land on tenancies is whether the references in s.116, especially s.116(2)(c) of the Inheritance Tax 1984:

- include and apply to all tenancies of "agricultural property" (as defined by s.115(2)) whether they are under an agricultural holdings statute or otherwise, or
- are somehow limited only to tenancies under a specifically agricultural tenancy code, such as the Acts mentioned earlier and so are only relevant in Great Britain and not Northern Ireland (as it does not have one).

…

"Such a statement, which appears to me to be what the Act says, would give great assurance to owners and advisers in considering the use of a tenancy. Without it, many may believe or be told that it is too risky to let their land on a tenancy and so not let, even if there was no risk. It would also be relevant to considering APR claims for agricultural property in the similar circumstances of the Republic of Ireland and perhaps elsewhere in EEA."

B. HMRC Response by E-mail of 25th August 2016

NB – The emboldening is by the CAAV

"I have now heard from our Solicitor and his opinion, in brief, is that agricultural tenancies in Northern Ireland can be included within the Agricultural Property Relief provisions in section 116(2)(c) IHTA 1984. This is from the point of view of express jurisdiction and because **references to "tenancy" in section 116(2)(c) are not limited to tenancies under an enactment or statutory code.** I attach a note from the Solicitor giving the reasons for his view, which I hope will be helpful. This view is also shared by my technical colleagues who deal with Agricultural Property Relief.

"With reference to your letter of 20 May, **I can therefore confirm that Agricultural Property Relief afforded to qualifying agricultural property let on a tenancy granted on or after 1 September 1995 by section 116(2)(c) of IHTA is not dependent on whether the tenancy is under a code of law, but just has to be tenancy of that property. Such tenancies would include those in Northern Ireland**."

The e-mail was from HMRC's IHT Policy staff handling Assets and Residences and covered the following note.

C. Supporting Opinion of 3rd August by HMRC Solicitor

<u>A note on "tenancy" in section 116 IHTA</u>

The question asked is whether the references in section 116, especially 116(2)(c):

- include and apply to all tenancies of "agricultural property" (as defined by s.115(2)) whether they are under an agricultural statute or otherwise, or
- are somehow limited only to tenancies under a specifically agricultural tenancy code.

As for section 116 generally, the answer to the first bullet is definitely 'yes' since the many mentions of the term "tenancy" include both examples where the term is unlimited and others where it is limited to certain statutory tenancies – see subsection (5B) in particular for the latter.

But I think, although the questioner has included these wider references in the question, the really important reference is the use of "tenancy" in subsection (2)(c). There the tenancy in issue is used in the phrase "the property is let on a tenancy", so what is "the property"? In order to make sense of subsection (2) generally, the term "the property" must refer back to the "agricultural property" in the previous subsection (1).

"Agricultural property" is defined in section 115(2), but more important to the jurisdiction question asked is section 115(5), which provides that the Chapter (of the IHTA dealing with APR) applies to agricultural property only if it is in "(a) the United Kingdom…[etc]".

By Schedule 1 to the Interpretation Act 1978, the term United Kingdom "means Great Britain and Northern Ireland". So section 116(2)(c) IHTA 1984 applies to a tenancy of agricultural property in Northern Ireland.

As to the second part (bullet) of the question, I think it is clear that the term "tenancy" in section 116(2)(c) is not limited to tenancies under a statutory code for two main reasons. First, in subsection (2)(c) itself there is no express limitation on the term, save that the tenancy must begin on or after 1/9/1995. Second, reading further on in section 116, subsections (5A) and (5B) provide for the application of subsection (2)(c) in two different scenarios. The first (in (5A)) is where a tenancy becomes vested in a person who benefits under a deceased tenant's will; the second (in (5B)) is where on the death of a tenant a tenancy is obtained or granted under or by virtue of "an enactment". Although subsection (5A) applies to property in Scotland, it is not expressly so limited and so it may apply to tenancies held otherwise than under a statutory code in other parts of the United Kingdom.

The fact that these two scenarios are expressly contemplated must mean that the tenancy referred to in subsection (2)(c) can be granted, obtained or become vested either under an enactment or not.

James Couchman
3 August 2016

APPENDIX 2

Cases Cited

Allen v HMRC [2016] UKFTT 342 TC
Antrobus 1 (see Lloyds Bank)
Antrobus 2 (see Lloyds Bank)
Arnander v HMRC [2006] SPC 565 *(known as McKenna)*
CIR v Forsyth Grant [1943] 25 TC 369
Evelyn v HMRC [2011] UKFTT 121 (TC)
George v Inland Revenue [2003] EWCA Civ 1763
Hanson v HMRC [2013] UKUT 224 (TCC)
Higginson v HMRC [2002] STC (SCD) 463
Theodor Jäger v. Finanzamt Kusel-Landstuhl (C-256/06)
Lloyds TSB Personal Representative of Rosemary Antrobus Dec'd v CIR [2002] STC (SCD) 468 (*Antrobus 1*)
Lloyds TSB v HMRC Lands Tribunal DET 47 2004 *(known as Antrobus 2)*
McCall and Anor (as Personal Representatives of Eileen McClean, deceased) v HMRC [2008] UKSPC SPC00678; (2009) NICA 12
Pawson v HMRC [2013] UKUT 050 (TCC)