



IN THIS ISSUE... Agricultural and Business Property Relief Update

Reflections by the editor



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It is now approaching four years since landtax was formed from A B Edwards & Co. Whilst it would be wrong to say that everything has gone completely smoothly, we are largely meeting the objectives I have had since I started my practice in 1991 by offering a knowledgeable but personal service.

A key reason for the change to landtax was to enable expansion, not for the sake of it but because this gives greater strength in an ever more technical world. The rapid expansion which has occurred causes its own difficulties but I am pleased that we have managed to retain the 'ethos' of ensuring there is one consultant in the practice dealing with most of a family's affairs. It is this that distinguishes us from other firms and I still firmly believe it is only by this approach that it is possible to have sufficient 'attention to detail' that is essential now in seeking to minimise difficulties if enquiries by H M Revenue & Customs ('HMRC') occur. This is especially true of Inheritance Tax enquiries where it is increasingly important to see the 'wood from the trees'.

Bits and pieces...

Woodlands

Do you expect Inheritance Tax relief on your woodlands? If they will not qualify for Agricultural Property Relief as ancillary to the farmland then you will need evidence to show they are run on a commercial basis to qualify for relief for Business Property Relief (unless they will form part of a larger business where they will still fail to qualify if they are not 'used' at all or if they are only used for private purposes).

In my last A B Edwards & Co newsletter in December 2007, my main theme was 'respect'. I said *'Respect may seem an odd heading for a tax article but unfortunately the present state of tax legislation is symptomatic, in my view, of the problems with modern society. Wherever you look now, from litter in the streets, through loutish behaviour to casual violence, I believe many of the problems in society stem from a lack of respect. Ultimately this is a lack of respect of other individuals but it may manifest itself in a lack of respect of law and order and the legislation which governs our society.'*

It would be nice to say that matters have improved but recent events suggest otherwise. In the article I wrote for the December 2008 edition I reported on the extension to the HMRC powers and the expected increase in penalties. In the minutes of the Committee of Public Accounts, Monday 28 January 2008,

Mr Hartnett said 'The third issue is that the new rules introduced by Parliament to provide the penalties which come in for events during 2008 and tax returns after April 2009, will make it much easier to obtain a penalty where a corporate or anyone else does not take sufficient care, or worse.'

One then reads the following report in the Telegraph on 12.10.2011 - Dave Hartnett, permanent secretary for tax at HMRC, was forced to defend revelations that he supervised and signed off a deal that saved Goldman £10m of tax – when he told MPs just a month ago that he did "not deal with Goldman's tax affairs". Margaret Hodge, chairman of the Public Accounts Committee, said to him: *"It seems to me you lied when you told the Treasury Select Committee on 12th September that, and I quote, 'I do not deal with Goldman's tax affairs'... we had access to a meeting on 8th December in the offices of your lawyers where it is stated that you had settled and had in fact shaken hands on a deal on their tax affairs."* *"I did not lie," Mr Hartnett said. "I did not deal with Goldman Sachs tax affairs in the normal sense."* *Ms Hodge said that Mr Hartnett was "playing with words" and his denials were "laughable."* *She told him: "It appears that £10m was lost to the taxpayer because of a deal you did with Goldman Sachs. We were ripped off."*

It would seem that if you are involved with the books of your business and

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HMRC find there is a mistake you should be in a position to deny this by saying you did not deal with them 'in the normal sense'. (You may then though need to employ some very expensive advisers who can ask to negotiate with Mr Hartnett personally.)

Many dealings with HMRC can be described as a 'war of attrition' now (and, sad to say, I cannot see it getting any better). This ranges from the seemingly simple, getting incorrect penalties issued by the HMRC computer removed where many calls can be necessary as the people you initially deal with do not know the actual rules, to HMRC refusing to constructively engage in meaningful dialogue as they pursue their objective of simply collecting more tax, whether really due or not.

Bits and pieces...

What is your company's 17 digit corporation tax reference?

The person who is paying a company's corporation tax liability online needs to know the relevant 17 digit corporation tax reference. These 17 digits comprise:

- the 10 digit UTR,
- the sequence 'A001',
- a two digit number (representing the year in which the company's year end falls), and
- the letter 'A'.

Nowhere is there more 'attrition' being practiced than by HMRC Inheritance Tax whose tactics include:

- Asking many questions (and keeping asking them on the basis the answers you have supplied are inadequate).
- Asking irrelevant questions (to 'pad out') the already many vaguely relevant questions.
- Insisting that if something is not documented you do not have any 'evidence'.
- Saying (even after documents that exist

have been produced) what has been supplied is not 'evidence'.

- Ignoring the whole picture to concentrate on minor points they think they can use to their advantage.
- and essentially doing everything they possibly can to persuade executors to give up their entitlement to a relief by making it both expensive and time consuming to continue the argument.

A key area of difficulty is with Agricultural Property Relief on houses. I was told recently by HMRC on the telephone, when discussing a particular case, that their view was that:

1. A farmhouse only qualified for relief if it was occupied by a 'proper working farmer'.
2. A cottage only qualified for relief if it was occupied by an employee and before you could have a cottage you had to have a farmhouse.
3. That (and rather bizarrely) they thought if there were only land and buildings then that was not a farm.

Whilst I was assured by another District Valuer (who I was in the process of agreeing a discount below 20% with) that there was no such instruction, I was told by one District Valuer, when discussing non agricultural value, that his instructions were that in no case could he accept a non agricultural value below 20%. Clearly each case must be looked at on its own merits but if you can ensure your structure can give you an argument for 100% Business Property Relief on the farmhouse then (whilst HMRC will not concede the point) it does put you in a strong position to minimise the non agricultural value.

So what are the qualifications for Agricultural Property Relief on a house? In fact, the legislation does not refer to 'houses' but seemingly only give reliefs on *'such cottages, farm buildings and farmhouses, together with the land*

occupied with them, as are of a character appropriate to the property'

Bits and pieces...

Do you want 100% Business Property Relief on your partnership share ?

100% relief is only available on assets 'within' the partnership 'wrapper' (as opposed to being owned by a partner personally).

With the attack on Agricultural Property Relief by HMRC gathering momentum, 100% Business Property Relief has never been more important. It is possible to avoid gifts (for Inheritance Tax and Capital Gains Tax) when a partner introduces asset to a partnership but careful drafting of the partnership agreement is essential.

If you have not had your family and business structures reviewed by a specialist within the last 5 years a 'health check' would be very sensible – perhaps this should be your New Year's resolution ?

The question that needs to be addressed initially is if you can have a 'house' which, even though it is occupied for the purposes of agriculture, does not qualify for relief because it is neither a farmhouse or a cottage. I would argue that, as manor houses were specifically removed some time ago, it must be the intention of the legislation that, as long as the occupation condition is met, then whatever the nature of the residence (whether it be a house, bungalow, semi detached property) it must be included in the words farmhouse or a cottage. There seem to be two possibilities:

1. A farmhouse is simply a description of any house that is the house on a farm occupied by a person who is actively farming the land. In this case a cottage must include all other residential properties on a farm, whatever the nature of their occupation.

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Bits and pieces...**Restriction of loss relief for genuine commercial losses**

Further attacks are expected as HMRC continue to make it more difficult to set losses against other income. In addition, losses are often the subject of HMRC enquiries, we assume generated by exception reports on the electronic processing of the data on the return. If loss relief has been claimed and cannot be substantiated then you can expect HMRC to seek to levy penalties.

A structural review of the business may help reduce losses. Borrowing is often better structured as being 'outside' the business, rather than being taken by the business itself. Not only does this reduce the chance of losses but can also increase the amount of Business Property Relief available for Inheritance Tax by using suitable security.

- The legislation is not trying to be as prescriptive as existing case law would suggest and the words are simply descriptive of the nature of the house on the holding in that the farmhouse, whatever the activity of the person living in it, is the main house on the farm. In this case a cottage must include any other residential property.

The cases do not really address this distinction but there is no basis for the HMRC argument that before you can have a cottage you must have a farmhouse. The HMRC view of what a farmhouse and a cottage is (as expressed by them above) is simply taking the facts of particular cases before the Tribunal or the Courts. The cases inevitably consider the facts of that specific case and how these are tested against the legislation. They do not in themselves set boundaries in the way HMRC seek to suggest. The HMRC argument is rather like saying 'all dogs are animals therefore all animals are dogs'. For example In IRC v John M Whiteford & Son (1962) 40 TC 379 at p 384. The Lord President (Lord Clyde) said--

'It appears to me without justification to suggest that the quality of this house is determined by the status of the individual who occupies it. For on the Crown's argument, if the ... house was occupied by a tractorman it would become a cottage for the purpose of the Act, but if it happened to be occupied by somebody engaged in the management of the farm it would by some mysterious sleight of hand be converted from a cottage into something else. In my view the status or employment of the occupier of the premises is not the test, and the proper criterion is the purpose of the occupation of the premises in question. Here, indubitably, the purpose of the occupation of this ... house is husbandry, for under the partnership agreement the son for whom it was built and who occupies it must give his whole time and attention to the business of the partnership. Upon that test, therefore, it seems to me clear that the ... house in question is an agricultural cottage ... and the conclusion to which the General Commissioners came is a sound one'.

Bits and pieces...**CAP Reform**

In order to iron out a number of legal loopholes, the Commission is proposing to tighten the definition of active farmers. Only 'active farmers' will qualify for direct payments. Applicants would need to demonstrate that their direct payments represent at least 5 per cent of any non-agricultural income (ie if direct payments are £500, they must not earn more than £10,000 outside farming). They must also carry out a minimum level (to be set by the member state) of farming activity on their land. There is then the issue of capping to consider for larger producers.

This has the prospect of more bureaucracy and whilst there may be delays in implementation it is expected that, subject to provisions for new entrants, only those who made claims in 2011 will be eligible.

Subsidies form a crucial element of the income of most farms and it is important restructuring proposals for tax purposes do not put these at risk.

So I would suggest any form of residential property can qualify but occupation for agricultural purposes is clearly essential. Whilst I was writing this article, the result of the HMRC appeal in the Atkinson case was published. Although the taxpayer (unrepresented due to costs) lost on appeal, in fact the Tribunal analysis is very supportive of the above position (and not the restrictive approach taken by HMRC).

However, do you first need to decide on the character appropriate test or is this not necessary if the occupation test is failed because the house owner is not a 'proper' farmer. The reference to land occupied with cottages, farm buildings and farmhouses is a reference to land on which they stand and goes with them, not to land occupied in the technical sense of the term; see the case of Harrold v IRC [1996] STC (SCD) 195 at 202b: *I have come to the conclusion that Barwick Hall falls within part 3 of the definition of agricultural property. In my opinion the reference to 'the land occupied with them', ie the cottages, farm buildings and farmhouses, extends the definition of agricultural property so as to embrace the land upon which they stand, their gardens and so forth, the curtilage as Mr Hayes expressed it. The parenthesis in the definition in the Finance Act 1894 could conceivably have been confined to 'mansion houses' - and also includes such cottages, farm buildings, farmhouses, and mansion houses (together with the lands occupied therewith) as are of a character appropriate to the property'. To that extent it may be said that the present definition is clearer, but nevertheless in my view 'the land occupied with them' connotes going with them, not that the cottages etc, should be occupied in the technical sense.*

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Bits and pieces...

Should you have a corporate partner?

This can be considered to help reduce tax costs but you should make sure there are some commercial reasons and that you have thought through an exit strategy. Look at this in conjunction with restructuring of borrowing or to increase Business Property Relief for Inheritance Tax.

What you need to do is distinguish between forming a view as to if the property is of a character appropriate to the land in the deceased's estate and deciding if, as a matter of fact, the property is occupied for the purposes of agriculture. They are separate tests and it does not help to regard them as a single test. The difficulty in respect of meeting the occupation condition is if the occupier has to move out of the house due to illness in the days leading up to their death. On appeal, in the case of Atkinson, the Upper Tribunal concluded, even though both parties had accepted that the partnership was in occupation, that occupation by the partnership was not sufficient (and indeed the decision could be construed as implying this was not greatly relevant) and there needed to be a 'qualitative' aspect to the occupation for the purposes of agriculture. Interestingly, the Upper Tribunal made it clear that physical work on the holding was unnecessary and, whilst HMRC were successful on the facts of this particular case, I think there is more in this decision to hearten the taxpayer than HMRC.

So, what is the most practical solution to obtaining Agricultural Property Relief on a house on a farm? It must be to make sure the house is part of the property of the partnership (and if you have not already got a partnership then if at all possible set one up!) and whilst

the partnership is in occupation by virtue of it being partnership property the occupier is required by the partnership agreement to occupy it. If the occupier has to move out then a simple solution (albeit on occasions it may not be the ideal family solution) may be to simply rent the house on an AST. This could, if the structure is right (and you must make sure at all times that the business does not become 'wholly or mainly an investment business' or Business Property Relief is lost entirely) give 100% Business Property Relief, so making the question of the non agricultural value of the farmhouse irrelevant as the house no longer qualifies as a farmhouse. In some ways the result in the Atkinson case could represent an 'own goal' for HMRC as, even if the house is not let until after death of the individual previously in occupation, with suitable paperwork showing the necessity of the property for the business it may still be possible to secure Business Property Relief.

Bits and pieces...

VAT partial exemption

Bearing in mind most of our clients have to contend with this, it is not a simple topic. On being asked recently as to how most of our clients managed this I said that I did not know as I usually left it to them to sort out (on the basis it was too much like hard work for a simple tax adviser to deal with). More seriously, this can though be a useful saving if the rules are applied properly. Any restructuring should take account of the effect on the VAT partial exemption position.

When it comes to the submission with the Inheritance Tax Account, make sure a proper analysis is done and submitted with the form. The historical context and the state of the property are often not given sufficient attention. I was asked to advise in a case where the farmyard and house were situated in the middle of a Berkshire town, some considerable

distance from the land. When I looked into this it transpired that the intervening land had originally been owned with the house but had been compulsorily purchased in the 1960s. Do not have a valuation report including photographs more suitable for a 'des res' sales brochure. Pre-empt the list of 500 questions (which immediately puts you on the 'back foot') by analysing the availability of the reliefs before the Inheritance Tax return is submitted and then including sufficient information with the return to make it plain why the reliefs shown on the forms are available. HMRC still seem happy asking questions where they already have the information but you can then suggest they read the information they have already been sent to find the answers. Agricultural Property Relief and Business Property Relief are reliefs (not claims) and the approach now must be to provide sufficient evidence with the return to show why the relief is available to support the position taken on the forms. This will, potentially, mean submitting material amounts of information initially but the subsequent time (and cost) then saved should be welcomed by the beneficiaries.

Bits and pieces...

A magic bullet?

Is there a 'magic bullet' to maximise Inheritance Tax reliefs (whilst minimising other taxes on the way)? There is no simple solution that will work for all but there is a formula that will.

- First you need the right structure
- Then you need the right documents
- Then you need to monitor this and make sure annual accounts and returns 'keep you on track'

and finally, as we all die at some point, when this happens make sure specialist help is obtained before the Inheritance Tax account is filed rather than waiting until you are mired in the HMRC version of 20 (in their case 500) questions.