Foreign Affairs

Extension of Agricultural Property Relief to the European Economic Area

RUSSELL-COOKE SOLICITORS

Beth Norton*

Solicitor, Russell-Cooke LLP

Agricultural property relief; Channel Islands; European Economic Area; Farms; Houses; Inheritance Tax; Interests in possession; Isle of Man

This article examines the expansion of agricultural property relief (APR) to the European Economic Area (EEA) which was introduced in the Finance Act 2009 (FA 2009). The amendments to the Inheritance Tax Act 1984 (IHTA 1984) introduced by FA 2009 in effect create the fiction that relevant laws of any part of the United Kingdom have effect in the states of the EEA. This article examines the amendments themselves and the potential difficulties to claiming APR outside the United Kingdom, the Channel Islands and the Isle of Man which centre on the difficulties of superimposing UK rules onto the applicable law in foreign jurisdictions.

Before the 2009 Budget, APR for IHT was limited to property situated within the United Kingdom, the Channel Islands and the Isle of Man. On January 29, 2009, the European Commission issued a press release in which the Commission stated that it considered the legislation to be incompatible with the free movement of capital provided by the EC Treaty art.56 and the EEA Agreement art.40.[1]

This concern was addressed in the 2009 Budget in April 2009, in which it was announced that APR would be extended to property within the EEA. This was enacted in FA 2009, which amended IHTA 1984 s.115(5) to this effect.[2] At the same time, it was also announced that property qualifying for APR in the EEA would qualify for hold-over relief for CGT purposes.

Making a claim for the repayment of inheritance tax already paid

The extension of APR came into effect on April 22, 2009. At the time, it applied to IHT due or paid on or after April 23, 2003. In order to claim a repayment of IHT already paid, taxpayers had to make a claim to HMRC. On receipt of a claim, HMRC will repay the overpaid IHT, together with interest.

In order to receive a repayment, a deceased taxpayer's personal representatives (or a taxpayer himself where IHT has been paid in respect of a lifetime chargeable transfer) must make a claim for repayment by the later of either the last date that such a claim can be made under IHTA 1984 s.241(1), or April 21,

* *Beth Norton* is a solicitor in the Private Client department at Russell-Cooke LLP. She specialises in trust law and taxation, personal taxation and estate planning. Tel: 020 8394 6229; fax: 020 8788 6552; email: elizabeth.norton@russell-cooke.co.uk.

[1] Reference IP/09/170. The press release also concerned woodlands relief which, by being limited to property in the United Kingdom, was also considered to be incompatible with the free movement of capital.

[2] Amendments inserted by FA 2009 s.122.

2010.[3] Since April 21, 2010 has now passed, it will be necessary for claims to be made within the time limit pursuant to IHTA 1984 s.241(1) namely, within six years after the payment, or last payment, of IHT was made.

The effect of extending APR to the EEA

The Finance Act 2009 amendments to IHTA 1984 were intended to ensure that APR would have the same effect in the other states in the EEA that it had in the United Kingdom, the Channel Islands and the Isle of Man. The IHTA 1984 s.115(3) states that the agricultural value of a property shall be taken to be the value if it were subject to a perpetual covenant prohibiting its use other than for agricultural purposes. This was amended to say:

> "(or, in the case of property outside the United Kingdom, the Channel Islands and the Isle of Man, if it were subject to provisions equivalent in effect to such a covenant)."

A new IHTA 1984 s.116(8) was also inserted which states:

> "In its application to property outside the United Kingdom, the Channel Islands and the Isle of Man, this section has effect as if any reference to a right or obligation under the law of any part of the United Kingdom were a reference to an equivalent right or obligation under the law governing dispositions of that property."

These two amendments in effect create the fiction that relevant laws of any part of the United Kingdom have effect in the states of the EEA. Potential difficulties to claiming APR outside the United Kingdom, the Channel Islands and the Isle of Man centre on the difficulties of superimposing the rules on foreign jurisdictions.

For a claim to be made for APR in relation to property in the EEA, it would be necessary for the deceased to have died whilst domiciled in part of the United Kingdom (or for the taxpayer to be domiciled in any part of the United Kingdom at the time of making a lifetime chargeable transfer).[4] In summary, in order for a valid claim for APR to be made, the deceased must have occupied the property over which the claim is made for a period of two years before the transfer or to have owned it for the seven years before the transfer and for it to have been occupied for agricultural purposes throughout that period.[5] Whether the property will be considered to be agricultural in nature for the purposes of the relief is a question of fact. In relation to a claim made for a farmhouse, it will be necessary for the building to be of a "character appropriate" for the property. The relief extends to the agricultural value of the property only and will not generally be available where the property is subject to a binding contract for sale. APR will be available at a rate of either 100 per cent or 50 per cent.

Where APR applies and the deceased is entitled to 100 per cent relief, it will have the effect of ensuring that no UK IHT is payable in relation to the agricultural value of the property, in the same way as though the property was in the United Kingdom. It will also be possible for a property in the EEA to qualify as a replacement property where a deceased has sold one property and purchased a second agricultural property, providing that the properties were together, (a) occupied for at least the required period of two out of the previous five years by the deceased, or (b) owned by the deceased (and occupied for agricultural purposes) for at least the required period of seven out of the previous 10 years.[6] It will, of course, be necessary for both properties to satisfy the strict requirements for an agricultural property.

[3] FA 2009 s.122(8).

[4] For simplicity, the taxpayer is referred to as the deceased, but it should be noted that APR can also be claimed in the event of a lifetime chargeable transfer.

[5] IHTA 1984 s.117.

[6] IHTA 1984 s.118.

Potential areas of concern

The extension of APR to the EEA is too recent for any major difficulties to have come to light. However, it is conceivable that, in some areas, the legislation may still not be as straightforward as it would be in relation to a UK property.

Tenanted properties

One area of difficulty is likely to be in relation to tenanted properties. Although FA 2009[7] inserted s.116(8) into IHTA 1984 in an attempt to ensure that APR could be effective even in countries with a legal system not compatible with that in the various parts of the United Kingdom, it is conceivable that there may be difficulties over just what constitutes a valid tenancy. Each member state of the EEA will have its own legal system but, using the example of France, it is possible to see that simply transposing the APR rules to the EEA might not be as straightforward as first envisaged.

In order for a property to qualify for relief at 100 per cent, it is necessary for one of three conditions to be satisfied: (i) that the transferor has the right to vacant possession on the transfer, or the right to obtain it within 12 months (extended to 24 months by extra-statutory concession F17); (ii) that the transferor has been beneficially entitled to the interest since before March 10, 1981 and satisfies the transitional provisions contained in IHTA 1984 s.116(3); or (iii) that the property is let on a tenancy beginning on or after September 1, 1995. All other properties which qualify for APR will be subject to relief at 50 per cent.

In France, for example, tenancies are considered to be long term. There are a number of potential types of tenancy that can be entered into over agricultural land but they have a number of features in common. The minimum term for a lease over agricultural property is nine years and, at the end of a tenancy, the tenant will have the right to renew. Very strict notice periods apply and, barring a few limited events that allow for termination, to obtain vacant possession the landlord needs the tenant's consent.

Given the protected nature of French tenancies, it is very unlikely that the personal representatives of a deceased would be able to recover vacant possession within 24 months of a death. Where land is tenanted, it would therefore depend on the date that the tenancy began to determine whether or not APR would be available at 100 per cent rather than 50 per cent. It may be possible to argue that, where a tenancy has been renewed after September 1, 1995 that this is a new tenancy but, given that the renewal will be on the same terms as the original lease, this is uncertain. Given the long-term nature of French tenancies, it is also likely that many will fall into the period between March 10, 1981 and September 1, 1995 when the right to vacant possession is the only way that they can secure relief at 100 per cent. Many tenancies will have been entered into before March 1981 and it will therefore be necessary for the transitional provisions to apply.

Tenancies over agricultural land in France are therefore, potentially, very different in character from those in the United Kingdom. Although the legislation has been amended to extend APR to the EEA, no real attention has been paid to adjusting it to take into account the varying forms of land ownership and tenancies that will be encountered in the states of the EEA.

Trust law difficulties

One further area where there may be difficulties in claiming APR in the EEA concerns trust law, which is not widely recognised outside the United Kingdom. IHTA 1984 s.116 confirms that a trust beneficiary with an interest in possession can claim APR. Where an agricultural property is purported to be held on behalf of a beneficiary in an EEA state which does not recognise the existence of such a beneficial interest, it is unclear what the position would be in relation to APR. It is possible that IHTA 1984 s.116(8) could

[7] FA 2009 ss.112(1) and (4).

be interpreted to ensure that, from a UK point of view at least, any claimed beneficial interest over a property in the EEA would be interpreted as a valid beneficial interest. However, this is very uncertain and it is difficult to envisage a situation where someone who does not have any recognised, valid interest in property in a state in the EEA could claim that they had a valid beneficial interest for the purposes of UK taxation.

It may be possible for a taxpayer to structure his interest in property in an EEA state to ensure that it approximates to a recognised interest for UK taxation purposes. For example, IHTA 1984 s.43(2) confirms that a French *usufruct* will be considered to be a settlement for IHT purposes. It would, however, be necessary specifically to create such an interest, in accordance with French law where a French property is concerned in order to ensure that any potential APR is protected. This exercise will in itself have tax consequences under French law. Taxpayers should also be wary of making a lifetime chargeable transfer in this way, which will have UK IHT consequences.

Whilst it is clearly highly inadvisable to set up a trust in the United Kingdom which purports to hold non-UK property without ensuring that it complied with the rules for property ownership in the jurisdiction in which the property is situated, it is not inconceivable that a claimed beneficial interest could arise accidentally. For example, a donor might make a gift of a share of a property outside the United Kingdom, without ensuring that the formalities were met. Notwithstanding that HMRC Inheritance Tax would not allow APR to apply in relation to a beneficial interest claimed in this way, it must be added that the taxpayer would be unfortunate to find that his interest was still considered to be chargeable to IHT. However, it is conceivable that, where a purported beneficial interest over a property in a Member State of the EEA is not recognised, the taxpayer who is, in fact, considered to be the owner, will not fulfil the requirements for APR in the event of their own death or on a transfer.

Farmhouses

Other difficulties may arise in relation to the farmhouse itself. In order for a farmhouse to satisfy the conditions for APR, it is necessary for it to be of a "character appropriate" to the property. This is a question of fact and will vary depending on local conditions. General factors that will be considered include, amongst others, whether the farmhouse is proportionate in size and nature to the agricultural activities on the property, whether it would be recognisable as a farmhouse and whether it would be considered to be simply a house with land rather than a farmhouse. In the well-known case of *Lloyds TSB Bank Plc (Personal Representatives of Antrobus (Deceased)) v Inland Revenue Commissioners*[8] *(Antrobus I)*, concerning a property in the United Kingdom, a substantial residence was held to be a farmhouse of a character appropriate to the land due to a number of factors, including the use and visual presentation of the property and the effect that the farm buildings had on the character of the house. With regard to property in the EEA, a conventional house on a working farm is likely to be considered to be a farmhouse. More unusual properties, such as a villa on a vineyard, however, are not. This is especially likely to be the case if the villa is particularly large in relation to the vineyard itself, the vineyard is unprofitable or the style of the villa is such that it is not considered to be appropriate for the agricultural nature of the land. *Antrobus I* demonstrates that it is not impossible for a more substantial house to be considered to be a farmhouse, but it will be considerably more difficult to demonstrate that such a building satisfies the character appropriate test for the purposes of APR. The application of the character appropriate test to the EEA may be a particular difficulty due to the diverse nature of activities that may have the potential to be considered to be agricultural in states outside the United Kingdom, the Channel Islands or the Isle of Man.

[8] *Lloyds TSB Bank Plc (Personal Representatives of Antrobus (Deceased)) v Inland Revenue Commissioners* [2002] S.T.C. (S.C.D.) 468; [2002] S.T.I. 1398 SC.

Conclusion

The extension of APR to the EEA is still relatively recent and the potential difficulties in claiming the relief outlined above are likely to be mainly theoretical in nature. In most cases, it should be relatively simple to make a claim. Attempting to apply and interpret tax law where there is a foreign element often involves the interpretation of non-UK concepts to fit with the law in England and Wales and other areas of the United Kingdom. Difficulties in relation to the extension to APR are therefore likely to be minor. Accordingly, it can be said that, on the whole, the extension of APR to the EEA has addressed the European Commission's concerns and that the confines of the relief are no longer a disincentive towards the free movement of capital around the European Union.