[2013] UKUT 0224 (TCC)
FTC/44/2012

INHERITANCE TAX – deemed transfer on death – deceased's estate included a farmhouse –whether the farmhouse was agricultural property within section 115(2) Inheritance Tax Act 1984 – nature of the nexus required between a farmhouse and the agricultural land or pasture etc. in the definition – whether such nexus was occupation and ownership or only occupation – held, the nexus is only occupation – Special Commissioner's decision in Rosser v IRC [2003] STC (SCD) 311 not followed – appeal from Tax Chamber dismissed

UPPER TRIBUNAL

TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Appellants

- and -

JOSEPH NICHOLAS HANSON
(as Trustee of the William Hanson 1957 Settlement)

Respondent

TRIBUNAL: Mr Justice Warren, Chamber President
Judge Nicholas Aleksander

Sitting in public in the Royal Courts of Justice, the Rolls Building, London, 15 April 2013
Jonathan Davey, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants
Toby Harris, Toby Harris Tax Consultancy, for the Respondent

Introduction

1. This is an appeal against a decision of the First-tier Tribunal (John Walters QC and John Ritchie ("**the Tribunal**")) released on 31 January 2012 ("**the Decision**") concerning agricultural property relief from inheritance tax. The Appellants ("**HMRC**") were represented before us by Mr Jonathan Davey of counsel. The Respondent was represented by Mr Toby Harris of the Toby Harris Tax Consultancy.

2. The appeal to the Tribunal was made by the Respondent as the trustee of a settlement known as the William Hanson 1957 Trust ("**the 1957 Trust**"). Joseph Charles Hanson ("**the Deceased**") was the life tenant under the Settlement from the time of its creation in 1957 until his death on 9 December 2002. In relation to the chargeable transfer taking place on the death of the Deceased, the Respondent claimed agricultural relief under section 116 Inheritance Tax Act 1984 ("**IHTA 1984**") in respect of a house, together with its adjoining land, known as 11 The Green, Great Horwood, Milton Keynes, Buckinghamshire ("**the House**"). By a Notice of Determination dated 3 October 2005, HMRC determined that the House was not agricultural property within the meaning of section 115(2) IHTA 1984. By the Decision, the Tribunal allowed the Respondent's appeal against that determination, holding that the House was indeed agricultural property.

3. The relevant facts can be stated shortly as follows (although a fuller picture is given in the Decision which was concerned, as well as with the issue before us, with other matters):

    a. For several decades up to 1942 the House was lived in by the Deceased's father, William Hanson ("**William senior**"). The extent of the land farmed by William senior extended to some 800 acres.
    b. In 1947 the Deceased and his wife, Daphne, moved into the House. At this time, the House was owned by William senior.
    c. By a deed dated 2 April 1957, William senior created the 1957 Trust, by which he settled the House which was to be held on trust: (i) for the

Deceased for life and (ii) thereafter, in the events which happened, for the Respondent absolutely.

d. In 1960 William senior died. Following his death, the family farming business was run by the Deceased and his brother, William Hanson ("**William junior**") in partnership.

e. In 1978 the Deceased and Daphne moved out of the House and into 11A The Green, Great Horwood ("**11A**"), and the Respondent and his family moved into the House. There was, at this stage, no change in the ownership of the House.

f. In 1986 the Respondent and his brother, Andrew Hanson ("**Andrew**"), joined the farming partnership.

g. In 1991 the Deceased and William junior decided that they could no longer work together and negotiated a partition of the various family landholdings. As a result, the Deceased became owner of certain parcels of land and became joint owner with William junior of certain other parcels of land.

h. Following the 1991 partition, the parcels of land part-owned and occupied by the Deceased amounted to some 280 acres. From that time, the partnership between the Deceased, the Respondent and Andrew continued and carried on, on that land, a business of mixed farming, consisting of the keeping of cattle and sheep and some arable farming.

i. Sometime in the 1990s (but subsequent to the partition) the partnership between the Deceased, the Respondent and Andrew was dissolved. That was the occasion for further partition of the family assets. Andrew ceased to farm but the Respondent continued in control of the farming activities. The Respondent took into his own ownership about 128 acres of farmland comprising two parcels of land to the west of Great Horwood. He continued at that time living at the House from which he ran the farming operations, farming those 128 acres together with a parcel of land comprising about 25 acres remaining in the part ownership of the Deceased and another parcel of about 42 acres. He also farmed about 20 acres rented from a third party. This was the position at the death of the Deceased.

4. It is accepted by both the Respondent and HMRC that the House was a "farmhouse" within the meaning of section 115(2) IHTA 1984. It is conceded by HMRC that if the 128 acres is to be taken into account for the purposes of judging whether the House was "of a character appropriate to the property" for the purposes of that section, then the House was of such a character. On the other side, it is conceded by the Respondent that if no account is to be taken of that land, then there was insufficient supporting land to bring the House within section 115(2).

5. This appeal therefore turns on an issue of construction about the meaning of section 115(2).

The legislation

6. It is convenient at this point to set out the relevant provisions of IHTA 1984.

   a. Section 4(1):

      'On the death of any person tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death.'

   b. Section 5(1) (so far as relevant):

      'For the purposes of this Act a person's estate is the aggregate of all the property to which he is beneficially entitled, …'

   c. Section 49(1):

      'A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists.'

   d. Section 115(2):

      'In this Chapter [IHTA 1984 Part V, Miscellaneous Reliefs; Chapter II, Agricultural Property] "agricultural property" means **[1]** agricultural land or pasture and includes **[2]** woodland and any building used in connection with the intensive rearing of livestock or fish if the woodland or building is occupied with agricultural land or pasture and the occupation is ancillary

to that of the agricultural land or pasture; and also includes **[3]** such cottages, farm buildings and farmhouses, together with the land occupied with them, as are of a character appropriate to the property.'

We have added the numbering in square brackets for ease of reference to the three apparent limbs of the subsection.

e. Section 116(1):

'Where the whole or part of the value transferred by a transfer of value is attributable to the agricultural value of agricultural property, the whole or that part of the value transferred shall be treated as reduced by the appropriate percentage, but subject to the following provisions of this Chapter.' [The 'appropriate percentage' is defined in section 116(2).]

f. Section 117:

'Subject to the following provisions of this Chapter, section 116 above does not apply to any agricultural property unless-

(a) it was occupied by the transferor for the purposes of agriculture throughout the period of two years ending with the date of the transfer, or
(b) it was owned by him throughout the period of seven years ending with that date and was throughout that period occupied (by him or another) for the purposes of agriculture.'

The Issue

7. The issue on this appeal concerns the relationship between limb [1] and limb [3] of the definition of "agricultural property" in section 115(2) IHTA 1984. Both parties are agreed that "property" referred to at the end of limb [3] is a reference back to the land or pasture referred to in limb [1] (or possibly limb [2] as well – but that does not arise on the facts of the present case). We also agree, as did the Tribunal at [71] of the Decision.

8. HMRC contend that there must be common ownership of (i) the property (*ie* the agricultural land or pasture with in limb [1]) by which the appropriate character of the cottage, farm building or farmhouse within limb [3] is to be judged and (ii) the cottage, farm building or farmhouse itself. The Respondent, whilst accepting that

some nexus is required between a cottage, farm building or farmhouse within limb [3] and the agricultural land which is necessary to support a conclusion that the cottage, farm buildings or farmhouse is of "a character appropriate" to that land, contends that it is enough that the land and the building are in common occupation.

9. On HMRC's approach, the House is not agricultural property because the Deceased did not own or have an interest in possession in sufficient agricultural land within limb [1] for the House to satisfy the requirement of limb [3], it not being suggested that there was any relevant property within limb [2] which could affect the position. On the Respondent's approach, since he was in occupation of both the land which he farmed (including the 128 acres) and the House, there was sufficient land within limb [1] to bring the House within limb [3].

The Decision

10. The Tribunal accepted the Respondent's approach and rejected HMRC's approach. It considered the issue of whether or not the House was agricultural property within the meaning of section 115(2) in [57] to [93] of the Decision. It addressed very much the same arguments on each side as were addressed to us and which we will consider later in this Decision. In accepting the Respondent's approach, the Tribunal gave five reasons (in [88] to [92]) for reaching the conclusion which it did, each of which reasons HRMC says is incorrect. We return to those reasons at paragraph 43*ff* below.

The Arguments and Discussion

11. We agree with Mr Davey that section 115(2) cannot be construed in isolation but must be construed within the context of IHTA 1984 as a whole and, as he puts it "with regard to the conceptual building blocks of the inheritance tax regime including their application in the context of agricultural property"; but the starting point is the wording of the definition. We do not think that the Tribunal was taking a significantly different approach in expressing its second reason as sent out in paragraph 43 below. We have, following Mr Davey's helpful approach, divided section 115(2) into its three limbs. We must, however, be careful not to

let that division distract us from the exercise of construction which is to establish the meaning of section 115(2) taken as a whole in the context of relevant provisions of IHTA 1984 with each limb informing the meaning of the others.

12. Mr Davey made some submissions based on the history of the definition of "agricultural property" since 1894 (as it applied to estate duty) to 1975 (as it originally applied for capital transfer tax) and to 1984 (as it first applied in its current form for inheritance tax). On the basis of those submissions, his suggestion was that limb [2] does not provide any reliable guidance to the meaning of limb [3]. We do not, however, find this exercise of legislative archaeology of assistance and doubt, in any case, that this is an appropriate area in which we should even admit the earlier definitions as an aid to construction. Capital transfer tax (and inheritance tax which developed it) was a tax with a totally different structure from that of estate duty which it replaced. The definition of "agricultural property" was differently worded in significant respects. Further, the old wording is not itself free from the very same difficulty with which we are concerned in the present case: there is no clear meaning which can be prayed in aid as a pointer to the meaning of the current definition.

13. Having referred us to sections 2, 3, 4, 115, 116 and 117 of IHTA 1984, Mr Davey expressed the position, entirely uncontroversially, in short as follows:

    a. inheritance tax is charged on non-exempt transfers of value;

    b. a transfer of value is a disposition made by an individual which results in a reduction in the value of that individual's estate;

    c. on death, there is a deemed transfer of value equal to the value of the deceased's estate immediately prior to death;

    d. where, on death, a deemed transfer of value is (wholly or partly) in respect of agricultural property, liability to inheritance tax is reduced.

14. In relation to section 115(2), Mr Davey submits that it is clear, when consider limb [3] that the "farmhouse" referred to must be owned by the deceased. Otherwise the possibility of agricultural property relief would not arise since there would be no transfer of value attributable to its value.

15. That is correct provided that it is made clear what is meant by ownership. As a matter of English land law, what individuals or companies actually own are legal estates or equitable interests in land or they may possess lesser rights such as contractual licenses over land. It is not entirely clear, therefore, what is meant when it is said that a person "owns" land, for instance in section 117(b) when it is stated that relief is not available unless the agricultural property "was owned" throughout the relevant period. Mr Davey accepts, and we think this must be right, that a person who owns a legal or equitable freehold estate can be said to "own" the property. The same applies in relation to a leasehold interest: a valuable lease of a farm must surely attract agricultural relief just as much as a freehold interest and that is so whatever the duration of the lease. Whether something less than a legal or equitable interest of that sort amounts to ownership is not something we need to decide although we would suggest that anything which the law recognises as an interest in land and which would give rise to an inheritance tax charge on death as an asset of the deceased's estate ought, in principle, to be capable of attracting relief. We therefore think that Mr Davey's proposition would be better expressed if it had said that the deceased must have a legal or beneficial interest in the farmhouse, which interest forms, or is treated as forming (*eg* in the case of an interest in possession terminating on death) an asset of his estate.

16. Turning to the question whether, in a situation which engages limb [3] (*ie* when looking to ascertain whether a cottage, farm building or farmhouse has a character that is appropriate to "the property"), "the property" must be owned by the deceased, Mr Davey correctly pointed out that section 115(2) does not expressly deal with the point, so that it is appropriate to consider the context in which section sits. He also pointed out, again correctly, that the context, both generally and in the sphere of agricultural property, is one of a taxing regime centred on

dispositions of property (or deemed disposition on death or termination or interests in possession we would add) owned by individuals.

17. He referred us to *Starke v IRC* [1995] 1 WLR 1439 ("***Starke***") to support the proposition that there must be some nexus between "the property" referred to in limb [3] and the agricultural property falling with limb [1] (and possibly limb [2]). At 1446-1447, Morritt LJ (*obiter*) said this in relation to the issue with which we have to deal:

> "It is necessary to emphasise that the question for this court was confined to the proper construction of [limb [1]]. Thus the question whether the property with which this appeal is concerned is excluded from [limb [3]] because there is no other property in the same ownership to which its character may be appropriate does not arise for decision. Counsel for the Crown indicated that the official view is that there must be some nexus between the property alleged to fall within [limb [3]] and other agricultural land or pasture and that such nexus must be derived from common ownership as the structure of the inheritance tax legislation deals with the diminution in the value of the estate of the transferor. The alternative view might be that the nexus, which must surely be required, may be provided by common occupation without common ownership thereby recognising the reality of the agricultural unit of which, as in this case, the buildings evidently formed part."

18. Morritt LJ appears agnostic on the correct answer, but acknowledges that some nexus is required between "the property" and agricultural land within limb [1] (or possibly limb [2]). We do not disagree with that but would venture to suggest that if common ownership is to be rejected as the nexus, occupation is not the only alternative.

19. A different nexus might be established by seeing what agricultural land the cottage, farm building or farmhouse actually serves. We do not think that it is impossible to envisage a situation where a farm building or a farmhouse serves a particular farm but where an individual who owns and occupies the farm building or farmhouse is neither the owner nor the occupier of the farm land and yet where the farm building or farmhouse still continues to serve the farm land. For instance, a farmer may own and occupy a farmhouse which is attached to, and serves, farm land which is in the ownership and occupation of a family company

of which the farmer is a minority shareholder and managing director. There is no common occupation, but it is at least arguable that there is a sufficient nexus between the farm land and the farmhouse for the purposes of section 115(2) and that the farmhouse is, indeed, a farmhouse satisfying the condition of limb [3] notwithstanding that the farmer is not farming on his own account or as a partner but as director of the company. We do not need to say anything more about this point because, in the present case, there is common occupation and the facts establish that the House does indeed serve the entirety of the farmland (including the 128 acres).

20. Mr Davey also relies on *Rosser v IRC* [2003] STC (SCD) 311 ("***Rosser***"), a decision of Mr Michael Tildesley sitting as a Special Commissioner. That case was concerned with whether a house and a barn owned by the deceased attracted relief. It was held that the barn was of a character appropriate to a particular parcel of 2 acres of agricultural land so that relief was in principle available (and was in fact available applying the occupation and ownership requirements of section 117). The house was held not to be a farmhouse at all, even if "the property" referred to in limb [3] included an additional 39 acres no longer in the ownership of the deceased. In the course of his decision, Mr Tildesley dealt with the issue whether the relevant property was the entire 41 acres or just the 2 acres, concluding that it included only the 2 acres. It seems to us that his decision on the point formed an essential part of his reasoning for holding that the barn attracted relief. Thus, having decided the point, he then considered whether the barn was appropriate to the 2 acres, holding that it was. He could simply have said that, whether or not the property included the additional 39 acres, the barn was appropriate to the property: but he did not take that course.

21. As to the identification of "the property" within limb [3], Mr Tildesley decided that the required nexus was one of ownership. He cited the passage from *Starke* which we have set out and then referred to the submission of Mr Twiddy, the representing officer of HMRC, to the effect that the nexus must be derived from common ownership rather than common occupation. Mr Twiddy had presented very much the same argument as Mr Davey has presented to us based on the

structure of IHTA 1984. Having referred to sections 2, 3 and 4, Mr Twiddy's submission was summarised in the following terms:

> "The common denominator throughout this charging regime is the word *estate* [and] the value by which it has decreased during lifetime transfers or its value at death will provide the reference point for the amount of tax charged. It follows from this that the farm buildings and the property referred to in s 115(2) must be part of the estate of the person at the time he makes the disposition, including a deemed disposition at death.

22. As to that, Mr Tildesley said this:

> "I agree with Mr Twiddy's analysis. I conclude, therefore, that the nexus between the farm buildings and the property in s 115(2) is that the farm buildings and the property must be in the estate of the person at the time of making the deemed disposition under s 4(1) of the 1984 Act. The alternative view that the farm buildings are in the estate but the property to which they refer is not is untenable. This view would seriously undermine the structure for inheritance tax and create considerable uncertainty about when tax is chargeable and the amount of the value transferred…"

23. We are unconvinced by this reasoning whether or not the actual result is correct. First of all, (and assuming that Mr Tildesley has accurately summarised the thrust of Mr Twiddy's submission) we do not see why it follows from the common denominator identified by Mr Twiddy that not only must the farm buildings (and the same would go for a farmhouse or cottage) be comprised in the estate (which of course must be the case otherwise there would be no charge by reference to them in the first place) but also, as Mr Twiddy is recorded as saying, that "the property" must also be within the estate. It does not <u>follow</u> at all although, on one view, it may be a pointer to the conclusion. Secondly, apart from adopting an argument which we consider is flawed, Mr Tildesley gave no explanation why the alternative view would seriously undermine the structure of inheritance tax or create considerable uncertainty.

24. Mr Davey's next point is that had it been the intention of Parliament that the nexus between a farmhouse (limb [3]) and the property in relation to which the appropriateness of its character falls to be judged need not be one of common ownership but instead mere common occupation, it is reasonable to assume that the provisions of IHTA 1984 would provide some indication in such regard. However, those provisions of IHTA 1984 give no such indication. On the

contrary, he submits that such indications as the legislation does provide point in the opposite direction. Before turning to those suggested indications, we note that the argument that Parliament would provide some indication applies equally to HMRC's preferred construction. Mr Davey relies on four suggested pointers.

25. The first pointer relates to what he refers to as the primacy of agricultural land in section 115(2). The point was put the Tribunal at [84] of the Decision:

> "Mr Davey [then as now counsel for HMRC]….. adopted a suggestion by the Tribunal that his case assumed that the purpose of agricultural property relief was to give relief for land, not houses, and that relief was only given for houses in so far as they are appurtenances to land for which relief is given. On this basis sufficient agricultural land or pasture needs to be transferred by a transfer of value to enable any relief to be given for a farmhouse, and then the farmhouse must be of a character appropriate to the agricultural land or pasture transferred."

26. The Tribunal rejected this contention at [85]:

> "…….. We consider that the meaning discernible from the words of the definition in section 115(2) IHTA is that cottages, farm buildings and farmhouses in the third limb of the definition must be of a character appropriate to agricultural land or pasture (including woodland and any building within the second limb of the definition) in the same occupation, but that it is not required that the cottages, farm buildings and farmhouses should be in the same ownership as the agricultural land or pasture (as expanded by the second limb of the definition). Furthermore, we consider that such meaning is wholly consistent with the scheme and purpose of the inheritance tax legislation in general and of agricultural property relief in particular."

27. Mr Davey submits that the Tribunal was wrong to reject this contention, a contention which he says is squarely in line with the observation of Morritt LJ in *Starke* at 1446E-F:

> "…I think it is necessary to stand back and consider the structure of the definition [*ie* section 15(2)] as a whole. With the exception of the inclusion of "woodland" all that follows the words "agricultural land and pasture" is concerned with the buildings of one sort or another which are to be included. In such a context it would be surprising to find that buildings were already included in the phrase "agricultural land or pasture." It is as though the draftsman had started with the land and then dealt with what should be treated as going with it."

28. Mr Davey relies on the last sentence of that quotation. It is, however, important to remember the issue which Morritt LJ was addressing in making those observations. It was whether buildings and other structures were already included within the meaning of land as a result of section 5 Interpretation Act 1978; it was held that the context was sufficient to exclude section 5 in the case of section 115(2). Quite apart from that, we do not consider that what Morritt LJ said lends support to HMRC's construction since Mr Davey's reliance on it assumes the very point in issue in the present case. According to Mr Davey's reading of Morritt LJ, one starts with agricultural land and then asks what buildings go with it; unfortunately for Mr Davey, Morritt LJ give no hint in that paragraph of his judgment about how one identifies "the land" which he is referring to. Is it land owned by a person making a transfer of value or land occupied by that person or some other land with which the buildings may be said to go?

29. The second pointer which Mr Davey detects is the contrast between limb [2] and limb [3]. Limb [2] emphasises the notion of occupation. The woodland *etc* must be occupied "with agricultural land" and the occupation must "be ancillary to that of the agricultural land". The absence of the definite article between "with" and "agricultural land" lends textual support to the conclusion that any woodland will potentially qualify for relief as agricultural property provided that it is occupied with (and thus, we suppose, by the same person) some agricultural land whoever that agricultural land is owned by. The inclusion of the definite article in the phrases "ancillary….. the agricultural land" does not detract from that conclusion: the first step is to identify the woodland in relation to which relief is sought and to ask whether that woodland is occupied together with some agricultural land; if the answer is yes and the agricultural land is identified, the next step is to is establish whether the common occupation is such that the occupation of the woodland is ancillary to that of the agricultural land (*ie* the agricultural land with which the woodland is occupied).

30. In contrast, Mr Davey notes correctly that limb [3] contains no wording, unlike limb [2], which establishes expressly the required nexus. In giving permission to appeal, Judge Walters QC said that it would seem odd that the position in respect

of the limb [2] might be different from that in respect of the limb [3]. Mr Davey submits that there is nothing odd about this at all. The language of the second limb differs from that of the third limb: regard has to be paid to the particular words employed, read within their proper context. He relies on the fact that limb [2] was introduced into the statutory definition of "agricultural property" some decades after limb [1]. We have already given our reasons for being unable to place any reliance on such a submission (see paragraph 12 above). That leaves the submission that the language is different. It cannot be denied that it is different. Mr Davey was, however, unable to give us any policy reason for a distinction, in terms of a requirement of ownership, between, on the one hand, the agricultural land relied on to satisfy the "character appropriate" test for a cottage, farm building or farmhouse and, on the other hand, the agricultural land identified for the purposes of limb [2]. We agree, therefore, with Judge Walters QC's comment that the result for which HMRC contend would be odd.

31. The third pointer which Mr Davey detects is found in the practical application of the rival contentions. First, it is said that if the requisite nexus is common ownership, then the legislation is straightforward in its practical application. The only property to which regard can be had in determining whether a farmhouse is of a character appropriate is property in the deceased's estate.

32. In contrast, as he puts it in his skeleton argument:

> "if the requisite nexus can be provided by mere common occupation, then the legislation is not straightforward in its practical application (as noted in *Rosser* at [50]…). A range of questions would arise relating to the occupation in point: What sort of occupation is required? Will a bare licence suffice? Must the occupation be for a particular period? If so, how long? Must the occupation bear particular hallmarks other than in relation to duration? And so on. The provisions of IHTA 1984 do not provide answers to these questions."

33. We have several comments on those submissions. First, although the last sentence of that quote is true, it does not follow that the legislation will be straightforward in its application. It may still be difficult to establish whether the cottage, farm building or farmhouse concerned is of a character appropriate to the property owned by the deceased. If common occupation is the touchstone, it may,

depending on the facts of the case, be far easier to deal with the "character appropriate" test in relation to the area of land occupied than in relation to the area of land owned. Indeed, it may be entirely straightforward to see that the relevant building has a character appropriate to the land occupied but difficult to see whether that is so in relation to the land owned.

34. Secondly, the relevant concern expressed in *Rosser*, as we have already noted, related to undermining the structure for inheritance tax and the creation of considerable uncertainty about when tax is charge and the amount of the value transferred. As we have also noted, *Rosser* does not explain why the adoption of a common occupation nexus would have these consequences. Mr Davey did not provide us with a satisfactory explanation either. We do not consider that the concerns expressed in *Rosser* and again relied on by Mr Davey are made out.

35. Thirdly, we accept that, at the margins, there may be issues about whether the nature of the occupation by the person occupying both the cottage or farm building or farmhouse within limb [3] and the agricultural land within limb [1] is such as to give rise to a sufficient nexus. But questions of that sort could arise in relation to the application of section 117 – is the relevant property "occupied?" - and in relation to the question whether a house is a "farmhouse" – is the occupation of the house such as to justify the description of it as a "farmhouse". Such questions could, it seems to us, also arise even on HMRC's approach.

36. Overall, we do not consider that the third suggested pointer is established.

37. The fourth pointer is what is said to be the inherent implausibility of the Respondent's construction. The point is put by Mr Davey in this way. If the requisite nexus can be provided by common occupation, then an estate could be in a position to benefit from agricultural property relief notwithstanding that it included no agricultural land whatsoever. That is true. Thus suppose that in the present case, the Deceased had retained in his ownership no farmland at all but had retained only the House and its garden. On the Respondent's construction, the House would retain its status as farmhouse because it was occupied by the Respondent as the farmhouse relevant to the entirety of the farmland farmed by

him. Further, as was common ground, the House satisfied the "character appropriate" test by reference to that land. The conditions of section 117(b) were satisfied. Therefore relief would have been available even if the Deceased had retained no farmland at all.

38. Mr Davey submits that it is inherently unlikely that this was the intended effect of the legislation, particularly in circumstances where:

    a. As the Court of Appeal observed in *Starke*, it appears that the draftsman of the legislation "started with the land and then dealt with what should be treated as going with it" (see paragraph 27 above).

    b. As the Tribunal itself acknowledged at [67] of the Decision, agricultural land is "the core of the definition" of agricultural property under section 115(2).

    c. The purpose of agricultural property relief is "to facilitate the continuance of the farming after the death of the farmer" (see Special Commissioner O'Brien in *Higginson's Executors v Inland Revenue Commissioners* [2002] STC (SCD) 483 at [12]).

39. Dealing with those points in turn, we have already explained why we do not consider that HMRC are assisted by what Morritt LJ said: see paragraph 28 above. As to point b, we do not dissent from the proposition that agricultural land is at the core of the definition of "agricultural property". But that takes one nowhere since agricultural land is at the centre of the identification of the land required to support the "character appropriate" test on either construction of section 115.

40. As to point c., we would agree that one of the purposes of the relief is to facilitate the continuance of the farming after the death of the farmer. But that is manifestly not its only purpose. Agricultural relief is available in relation to a lifetime chargeable transfer thus reducing the chargeable amount of any transfer of value which is a chargeable transfer. The relief is not restricted to the charge to inheritance tax on death.

41. Further, the relief is not restricted to the charge levied on the estate of the farmer when he dies or on the trustees of a settlement where the interest in possession of the farmer comes to an end. Relief can be available where the relevant agricultural land is not in the occupation of the deceased or transferor in relation to the transfer of value, for instance where the land is subject to a long lease or to a tenancy at a market rent. Suppose that a freeholder, A, owns a farm including a farmhouse of a character appropriate to that farm. The farm has been let to a tenant, T, for many years; T has occupied the farmhouse for the duration of his tenancy and operates the farm from the farmhouse. On A's death, agricultural relief is, in principle, available and this is so on both the approach of the Respondent and HMRC. The farmhouse is a "farmhouse" within section 115(2) (we enlarge on what is required for a house to be a farmhouse in paragraph 47 below) and is on the assumed facts of a character appropriate to the farm. The agricultural land and the farmhouse thus fall within section 115(2). The condition of section 117(b) is satisfied since A has owned the farm for many years (albeit subject to the tenancy) and it was, throughout the relevant period, occupied by T for the purpose of agriculture.

42. Accordingly, we do not consider that it is correct to describe the purpose (rather than simply a purpose) of the legislation as being to facilitate the continuance of farming after the death of the farmer. The relief given to A in the example has nothing to do with the continuance of farming let alone the continuance of farming by T whose status as tenant and occupier of the farm is wholly unaffected by A's death.

43. We now return to the reasons given by the Tribunal for its decision and to deal with Mr Davey's criticism of those reasons. We have already dealt with most of the arguments, but a few points can usefully be added or emphasised. The reasons, in summary, are as follows:

    a. Its preferred construction is the correct literal construction of the definition of agricultural property.

b. The definition is found in a self-contained definition, suggesting that the meaning is intended to be found from a construction of the words of the definition rather than by inferences drawn from other areas of the legislation.

c. By reference to two readings of the legislation which it had earlier put forward (Version A and Version B in [81] to [83]), the Tribunal was unclear what particular inference should properly be drawn.

d. The purpose of the relief is to reduce the tax burden on agricultural property, including farmhouses, which have been occupied for the required periods for the purposes of agriculture (see section 117) being farmhouses of a character appropriate to the property occupied for those purposes. The statutory purpose does not require that such a farmhouse must be part of a larger agricultural estate whose value is being charged to inheritance tax at the same time and by reference to the same transfer.

e. The Tribunal disagreed with the reasoning of Judge Tildesley in *Rosser*. The meaning of the definition which the Tribunal preferred was, it said:

> "not untenable. Indeed, it was suggested as an alternative view, by Morritt LJ in *Starke*."

44. The Tribunal did not consider it relevant to the question of construction of the definition of "agricultural property" that the word "estate" appears in the charging provisions, a word which does not appear in definition itself. It rejected the assertion on behalf of HMRC that the Respondent's construction would "undermine the structure of inheritance tax" or "create considerable uncertainty about when tax is chargeable and the amount of value transferred", making reference to Rosser at [50].

45. Mr Davey submits that the first reason is wrong because limb [3] is, on its face, silent on the specific point in issue. We agree with the Tribunal. We accept that limb [3] is silent on the point in issue in the sense that it does not say, expressly, that common occupation is the touchstone for the identification of the relevant

nexus. But nor does it say that common ownership is the touchstone. Reading the definition in isolation, neither ownership nor occupation features. If it is possible to identify some agricultural land, whoever owns or occupies it, and to say that an identified cottage, farm building or farmhouse is appropriate to that agricultural land, then at first sight the definition is satisfied.

46. We accept, however, that there must be some nexus between limb [1] and limb [3]. If that were not so, unacceptable results could follow. For example, suppose that A owns some farmland and a farmhouse on that land where the farmland is insufficient to enable the farmhouse to satisfy the "character appropriate" test; suppose that there is neighbouring farmland, there being no farmhouse relating to it; and suppose, finally, that had A owned the adjoining farmland as well, his entire holding of farmland would have been sufficient to satisfy the test. It cannot, we accept, be right that A (or rather his executors on his death) can rely on the mere existence of the neighbouring land to justify obtaining relief. The reason that it is not right, it seems to us, is because the farmhouse is not a farmhouse <u>in relation to the adjoining farmland</u>. It serves no function in relation to that farmland being neither owned nor occupied in common with it. The same would apply in relation to a farm building or a cottage which served no function in relation to the adjoining farmland. Accordingly, it is right that there has to be some nexus which establishes that the agricultural land within limb [1] is connected in a relevant way with the cottage, farm building or farmhouse within limb [3]. Given the references to occupation in limb [2] and the reference to occupation in section 117, we consider that the literal – or at least the more natural – construction is that for which the Respondent contends.

47. At this stage, is it convenient to say something about the meaning of "farmhouse" in section 115(2). In giving our own gloss, we do not intend to depart from the description given by Dr Brice, sitting as a Special Commissioner, in *Arnander (executors of McKenna) v IRC* [2006] UKSPC 00565 at [88] of her decision. The word is not defined in the legislation. Its primary focus was in the past, we think, on the house on, or close by, an identifiable farm where the farmer responsible for the operation of a farm lived with his family and from which he operated his farming activities. For a house to be a "farmhouse" there had to be some

functional connection between the house and the farm. If that connection ceases to exist, we consider that the house ceases to be a farmhouse. Thus, suppose that the farmer sells the house to a third party who has nothing at all to do with farming and who moves into the house as his family home. The house might well remain of a character appropriate to the farm so that if the farm and the house were again to fall into common ownership with the new owner both farming the land and residing in the house, operating the farming business from it, the house might once again become a farmhouse. In the example, it is clear that the house would not attract agricultural relief on the death of the new owner since, even if it remained a "farmhouse", the conditions of section 117 would not be satisfied. However, we prefer the conclusion that the reason the house does not attract relief is because it ceases to be a farmhouse. The focus of section 117, after all, is on land which clearly is agricultural land (*eg* arable fields) but where the period of occupation or ownership is insufficient. In contrast, section 115(2) is concerned with identifying property which is capable of attracting relief. The question whether or not a house attracts relief falls more naturally to be dealt with in the first place under section 115(2) and only if it is capable of attracting relief is it appropriate to move on to section 117 to see if the occupation and ownership conditions are satisfied.

48. In the present case, it is accepted by HMRC that the House is a farmhouse. We understand this to be on the basis that, even on their construction of section 115(2), the House was properly to be described as a farmhouse by reference to the operation by the Respondent of the farming activities carried out by him on the land owned by the Deceased and thus excluding the 128 acres. The reason that relief is not available, on HMRC's construction, is because, as is common ground, that land (*ie* excluding the 128 acres) is insufficient to justify the description of House as being of a "character appropriate to the property".

49. The Respondent of course contends that the House is a farmhouse. But the primary reason he would say that this is so is because it is the house which he occupies as farmer of the entire landholding including the 128 acres and from which he operates the farming enterprise. It is a "farmhouse" by reference to its functional connection with the entire landholding. The reason that relief is then

available, on the Respondent's construction, is because, as is again common ground, that landholding taken in its entirely is sufficient to justify the description of House *qua* farmhouse, as being of a "character appropriate to the property".

50. The Respondent's argument would apply with just the same force had the Deceased owned no farm land at all himself: the status of the House as a farmhouse would again be established by reference to the entire holding (on this hypothesis, wholly owed by the Respondent, the Deceased having no interest) with the necessary nexus between limb [1] and limb [3] (as well as satisfaction of the section 117 conditions) being provided by the occupation by the Respondent of both the land and the House.

51. We now want to say something more about the nature of the nexus which must, on HMRC's case, exist. Mr Davey has referred, by way of shorthand, to the nexus as ownership. He recognises that there may be different sorts of ownership as we have explained in paragraph 15 above. The question then arises what sort of ownership constitutes a sufficient nexus between limb [1] and limb [3]. For example, suppose that a working farmer is tenant of, and occupies, a farm including a farmhouse of a character appropriate to the farmland. He has farmed the farmland and lived in the farmhouse for a number of years. Suppose that he then acquires the freehold of the farmhouse (as might happen in the context of a family situation). He continues to farm and live in the farmhouse. He unfortunately dies unexpectedly a month after acquiring the freehold. Relief is not precluded by section 117 since the farmer has occupied the agricultural land and the farmhouse for several years so that section 117(a) is satisfied. [In relation to that, it is to be noted (a trite point perhaps) that the farmer has occupied the land and house. It is not correct to describe his occupation as occupation of the tenancy or of the freehold.]

52. On HMRC's case, the farmer's estate is only entitled to relief if the common ownership nexus is established. The question then arises whether ownership of the agricultural land as tenant is sufficient to constitute a nexus resulting in agricultural relief in respect of the value of the freehold interest in the farmhouse. Mr Davey accepts that relief would be available in this sort of case. The type of

ownership does not matter. Indeed, a tenancy at a market rent with no capital value would be good enough. Mr Davey has not told us where he sees the dividing line as being drawn. If ownership of a legal or equitable tenancy is good enough, why would not some other right, at least one recognised under English land-law as an interest in land, be good enough? We do not need to determine where that line is to be drawn, but we do comment that it seems to us to raise similar difficulties to those posed by Mr Davey in his rhetorical questions in relation to the Respondent's test as mentioned in paragraph 35 above.

53. We consider that Mr Davey is right to accept that relief is available in that sort of case. Section 115(2) is focused on the nature of the land and not on the estates or interests which subsist in that land. Once the agricultural property referred to in limb [1] has been identified, the question is whether a farmhouse is of a character appropriate to that property. Even if HMRC are right in saying that the nexus is ownership (which might differ between the limb [1] property (*eg* a lease or tenancy) and the limb [2] property (*eg* freehold ownership)), that nexus is relevant only to ascertaining the relevant agricultural property as a physical piece of land.

54. We now wish to consider another example. The freehold owner of a farm and farmhouse which would all qualify for agricultural relief on his death, decides to hand over his enterprise to his son, A. F gives most of his farmland to A. He moves out of the farmhouse but retains ownership of it, together with some farmland. He allows A and his family to move into the farmhouse from which A operates the farming business just as his father had done. F dies a year later. The gift of the farmland which becomes a chargeable transfer on the death attracts agricultural relief. But on HMRC's case, the house does not attract any exemption on the death because, even assuming that it continued to be a "farmhouse", there would be no ownership nexus at the date of death between the agricultural property necessary to satisfy the "character appropriate" test and the farmhouse. However, if F, instead of giving the farmland outright to S, had granted him a 999 year lease at a peppercorn rent, F would have retained an interest in it, namely his (next to valueless) reversionary interest. This interest would be sufficient on HMRC's approach to provide a nexus between the property in limb [1], that is to say the property subject to the 999 year lease in which F

retained his reversionary interest, and the property in limb [3] with the result that the farmhouse would attract relief. Mr Davey, rightly in our view, conceded this point when we put something like this example to him. The result is a complete difference in treatment between two transactions which, in economic terms and in terms of the right to control the land both in the short and in the long term, are virtually identical. We do not suggest that such a different in treatment is not conceptually possible. But it is not easy to think of any sensible policy reason which would require these two transactions to have radically different results so far as agricultural relief on the farmhouse is concerned and leads us to question whether HMRC's approach to the legislation is correct.

55. Another example, and a variation of it, helps to throw some light on the issue of construction. Consider a case where the freeholder, A, of a farm and farmhouse has owned them for many years. Assume that the farm and the farmhouse are subject to a lease to a leaseholder, L. And assume that both the freehold reversion and the lease each have significant values. Assuming that the farmhouse is of a character appropriate to the farmland, agricultural relief would clearly be available on the death of L in respect of the value of the lease. Further, even on HMRC's view, relief would be available on the death of A in respect of the value of the reversion since the necessary ownership nexus is present.

56. Now alter the example slightly so that A only owns the reversion on the house, with the reversion on the entirety of farmland being owned by his brother, B. This is not a far-fetched example. It could happen in a family that freehold interests become split in this way with a lease vested in some family members to the exclusion of A. What, then, in this altered example is the status of the house? Viewed from L's perspective, the house is clearly a farmhouse: it is occupied by him together with the farmland and he operates the farming business from the farmhouse. The assumption in the example is that the farmhouse is of a character appropriate to the farmland comprised in the lease. Accordingly, if L were to die, the value of the lease would be reduced by agricultural relief in relation to the agricultural property which would include the farmland and the farmhouse.

57. On the Respondent's approach, the house is a farmhouse from the perspective of A as well. In order to test whether a house is a farmhouse, it is necessary, on this approach, to investigate what is happening on the ground. The answer has nothing, or very little, to do with ownership and everything to do with use and occupation. The house is a farmhouse because it is occupied (by L) together with the farmland and is the base from which L conducts his farming business. It is a matter of fact whether the farmhouse is of a character appropriate to the farmland, the assumption being, for the purposes of the example, that it is. The Respondent would say that it cannot possibly be correct that the house is, at one and the same time, both within and without section 115(2) depending on whether one is considering the position of L or the position of A.

58. But that is precisely the result which flows from HMRC's construction. HMRC say that in the case of the charge to tax on death, the property referred to in limb [1] must be property which is in the ownership (or, as we prefer to put it, an asset of the estate) of the deceased at his death. Since, in the example, there is no property within limb [1], the house, even if it is a farmhouse, cannot satisfy the "character appropriate" test. In fact, the logic of HMRC's arguments seem to us to lead to the conclusion that the house, in this altered example, would actually cease to be a "farmhouse" in A's estate since he has no interest in any farmland at all. If it is right to have regard only to farmland in which he did have an interest in deciding whether there is "property" within limb [3], then surely it must be right to have regard only to such farmland in assessing whether a house is a "farmhouse".

59. The result, therefore, is that the house in the altered example would at one and the same time be a farmhouse and not a farmhouse depending on whose estate and whose death was under consideration. This result is more than curious. It is one which we consider that we should reject unless the legislation clearly points to that conclusion.

60. A similar point can be made by considering our final example. Suppose that a farmer, F, owns a farm with a farmhouse on it in which he lives. The farmhouse satisfies the "character appropriate" test by reference to all of the farmland.

Wishing to wind down his activities and having no family, he lets the greater proportion of his farmland to a neighbouring farmer. He retains the farmhouse and the remainder of the land, but the farmhouse does not satisfy the "character appropriate" test by reference to the retained land. F dies. Does the farmhouse attract relief? On the Respondent's test, it does not because the farmland and the farmhouse are not in the same occupation. But if ownership alone is the test, it does attract relief. The farmhouse, the retained land and the land let to the neighbour are in common ownership since the farmer owns the freehold of the house and retained land and has a reversion on the tenancy of the farmland which amounts to sufficient "ownership" for the purposes of the test; and the farmhouse remains of an appropriate character to the entirety of the land which is "owned". It seems odd to us (i) that relief should be available (as in this example) in respect of a farmhouse which is not used in connection with or occupied together with the land which supports its character as appropriate when at the same time (ii) relief is not available in relation to a farmhouse which <u>is</u> used in connection with and occupied together with land which supports its character as appropriate but where that land is not owned in common with the farmhouse. HMRC could avoid that conclusion by contending that the nexus has to be both ownership and occupation. But once it is accepted that common occupation forms part of a nexus test, we see no reason why common ownership should also be required.

61. We detected a hint in Mr Davey's submissions that it was somehow relevant that, because the charge on the Deceased's death related only the House and a small number of acres (and did not relate to the additional 128 acres), the extent of the land available to support the "character appropriate" test should be restricted to the property subject to the charge. If we were wrong to detect that hint, we hope that he will forgive us. But if he was making such a point, we reject it. It can be seen to have no merit if one considers this example. A farmer owns a farm with a farmhouse in relation to which the "character appropriate" test is satisfied. His son farms an immediately adjoining farm which has no farmhouse. The farmer decides to retire. He gives the farmhouse to his son and subsequently sells his farmland. Immediately upon the making of the gift, the son moves into it and thereafter operates from it his own farming business on his adjoining farm until his father's death 2 years later when the potentially exempt transfer on the making

of the gift becomes a chargeable transfer. The transfer of value attracts agricultural relief (the example being intended to fall within section 124A(3) IHTA 1984) but none of the land owned by the farmer which supports the "character appropriate" test in relation to the farmhouse at the time of the gift features at all in the transfer of value. There is, therefore, no requirement, in relation to a lifetime charge, that the land within limb [1] must be subject to the charge. The position should in principle be no different in relation to the charge on death.

62. Mr Harris, who appears on behalf of the Respondent, has made a number of submissions in support of a nexus based on occupation. We have taken account of those points in addressing the arguments of HMRC. We do not propose to make this long decision even longer by dealing with his submissions point by point. However, we do refer to what we see as the main thrust of his argument, with which we agree, that it is appropriate to look at the situation on the ground in order to establish the reality of the farming unit. A single farming unit is likely (at least it is not easy to envisage a case where this is not so) to be in a single occupation. And that is why occupation can be taken as a reliable touchstone for identifying "the property" referred to in limb [3].

Conclusion

63. Our conclusion is that the ownership nexus for which HMRC contend is to be rejected. Instead, on the facts of the present case, the common occupation of the entire land holding (including the 128 acres) and the House (the House being occupied by the Respondent as a farmhouse in the sense in which we have described that word so that there is a functional connection between the House and the farmland) provides the nexus between limb [1] and limb [3] by which the "character appropriate" test is to be assessed.

64. We consider that this reading of section 115(2) is entirely consistent with the scheme of the legislation and, indeed, reflects a more natural construction of that section than HMRC's reading. Our reading does not, we consider, undermine the scheme of the legislation or produce difficulties or uncertainties such as to lead us

to a different conclusion. HMRC's reading has the unsatisfactory consequences which we have identified in paragraphs 58 and 59 above.

65. We would only add that we do not decide that common occupation will always and necessarily constitute a sufficient nexus. It may be right that there can be situations in which, although there is common occupation of agricultural land and a cottage, farm building or farmhouse, there is not a sufficient nexus. We have not thought of an example where this would be so, but do not rule out the possibility. In any case, it is unlikely that such an issue would ever arise since the "character appropriate" test might itself not be fulfilled in such a case.

Disposition

66. HMRC's appeal is dismissed.

Mr Justice Warren
Chamber President

Nicholas Aleksander
Upper Tribunal Judge

Release date: 17 May 2013