GOLDING AND JULIE MIDDLETON (EXECUTORS OF DENNIS GOLDING) V HMRC: WORKING FARMS AND THE "CHARACTER APPROPRIATE" TEST[1]

by Marika Lemos*

This article examines the "character appropriate" test in IHTA 1984 s.115(2) as applied to farmhouses with small holdings of land, by reference to the recent decision of the First-tier Tribunal in *Arthur Golding and Julie Middleton (executors of Dennis Golding) v HMRC* [2011] UKFTT 351 (TC).

The decided cases on whether a farmhouse is of a "character appropriate" to the land tell us that the way to approach the question is to consider all relevant factors in the round and to come to a judgment based on the broad picture. This was the approach adopted in *Lloyds TSB v IRC*[2] (*Antrobus I*), in *Rosser v IRC*[3] (*Rosser*) and in subsequent cases.

The five familiar principles governing the "character appropriate" test are summarised by the Special Commissioner in *Antrobus I*:[4] first one should consider whether the house is appropriate by reference to its size, content and layout, with the farm buildings and the particular area of farmland being farmed; second, one should consider whether the house is proportionate in size and nature to the requirements of the farming activities conducted on the agricultural land or pasture in question; third, although one cannot describe a farmhouse which satisfies the "character appropriate" test, one knows one when one sees it (sometimes called "the elephant test"); fourth, one should ask whether the educated, rural layman would regard the property as a house with land or a farm; finally, one should consider the historical dimension and ask how long the house in question has been associated with the agricultural property and whether there is any history of agricultural production.

In the later case of *Arnander (executors of McKenna, deceased) v HMRC*[5] ("*McKenna*"), the Special Commissioner emphasised that the question is one of fact and degree, that any factor could be relevant and that no one factor is determinative. She went on to add to the list of potentially relevant factors, the relationship between the value of the property and the profitability of the business.[6] This last factor has proven controversial, particularly in the manner that it has been applied by HMRC in practice to working farms with small holdings of land.

HMRC's published approach to the "character appropriate" test[7] is to look at all factors in the round. But in practice, particularly where the profit from farming activities before death is small either because the area of land farmed is not substantial or because the intensity of the farming activities carried out by the farmer has reduced significantly over time, HMRC have (in the author's view) been placing undue reliance on profitability of the farming operations, and in particular, on the relationship between profitability and the value of the property. That was HMRC's approach in *Golding*.[8] That approach has (so far) proven to be unsuccessful.[9]

The facts in *Golding* in outline

Dennis Golding had been living at Blue Gates Farm near Lichfield, when he died. Right up to the date of his death (aged 80) and for more than 65 years, he had farmed a small holding of 16.29 acres. In earlier years the farming activities had been intensive, but the level of activity had reduced over time. In later years, much of the produce from the farm was for his own consumption, though he had continued to make modest profits each year (i.e. between £1,047 and £1,600 of taxable profits in the four years leading up to his death). On

his death agricultural property relief (APR) was claimed on the farm. HMRC accepted the claim in respect of the land and buildings, but denied it in respect of the farmhouse. The farmhouse was a small, run-down three-bedroom house, but this did not stop HMRC from arguing that it was not of a character appropriate to the land. The notice of determination stated that it did not qualify as agricultural property for the purposes of APR.[10] The tribunal found in favour of the executors.

Profitability and the intensity of farming operations

HMRC does acknowledge that there is no requirement for a farmer to be making a profit, in order for a farmhouse to qualify for APR. But it is arguable that where the farmhouse has been attached to a working farm right up to the time of the farmer's death, the profitability or intensity of the farming operations has very little application to the "character appropriate" test. This already seemed reasonably clear from the way that the Special Commissioner evaluated the relevance of profitability in *Antrobus I* (a case where losses had been realised prior to death) and has become abundantly clear since the decision in *Golding*, where the judge rejected HMRC's emphasis on the evidence of lack of profit, focusing more on whether the farmer had continued to work the land.

The following points illustrate the unreliability of profitability as a relevant factor:

1. Profitability necessarily depends on an almost infinite number of different factors (including good/bad fortune) and is not necessarily related only to the area of land being farmed, or the size of the farmhouse.

2. On any particular farm, the same farmhouse could be used to farm both in-hand land and land belonging to other farms. Farmers that have taken advantage of such arrangements may be running more profitable operations, but the question of whether their farmhouse is of a character appropriate to the land still has to be measured by reference only to the in-hand land.[11] This also illustrates that great care has to be taken with evidence of profitability of comparable holdings.

3. It is neither unusual nor surprising that the intensity of farming operations reduces over time, as the farmer grows old and is less able to carry on the physical work that most farming requires.

These points are picked up by the judge in *Golding*, in the following passage:[12]

> "...As Dr Brice indicated in the [*Antrobus I* decision,] the fact that the farm only made a small profit does not in our view alter the position. In Dr Brice's case, the farm made substantial losses. It seems to us that the question to be asked is "was the deceased farming"? At 80 years of age, it would be unreasonable to expect that to be an extensive activity. In fact, if one did, there would be very few farms which would qualify as 'character appropriate'. ... We suspect that as farming is very much a vocational activity, farmers are prepared to forego luxuries. Farms do make losses from time to time for a variety of reasons; crop failures; low market prices; over production; amongst others, and capital expenditure set off against the small profits. We do not accept that the lack of a substantial profit is detrimental to a decision that the farmhouse is 'character appropriate'."

It is interesting in this context also to note the following passage from the decision in *Lloyds TSB Private Banking Plc v Peter Twiddy*[13] ("*Antrobus II*"):[14]

> "... we do not consider that a farmhouse would automatically cease to be a farmhouse for the purposes of section 115(2) [IHTA 1984] if, for instance, the farmer who had lived there for many years retired but continued to live in the house or if he died and his widow continued to live there ... [though] there could come a point at which, because of the length of time that had elapsed since a retirement or a death, the house could no longer be considered to be a farmhouse or a cottage."

The Lands Tribunal was happy to accept that a house continues to qualify as a "farmhouse" for the purposes of the test in s.115(2) IHTA 1984 even after farming has ceased, at least for a period. Presumably this analysis is apposite where the farmhouse remains attached to the land it has historically been associated with, i.e. the same analysis may not apply in cases such as *Rosser*, where the farm in question originally consisted of a certain acreage, most of which was given up by the time the farmer had died.[15] By analogy, if the same land is farmed from the same farmhouse, then whether or not farming activities actually continue, it is difficult to see how the farmhouse would cease to be of a "character appropriate" to the land that has always been farmed with it, at least until the house could no longer be considered to be a farmhouse by virtue of the farmer's retirement or death.

This analysis is consistent with the fact that APR is a relief from inheritance tax, i.e. a death tax. As such it must operate in the real world where farmers often do grow old and do slow down before they die, and where there is often little choice but to continue to rely to a greater or lesser extent on income from their farming activities, even if it is simply because farming has become a vocation or a way of life. It cannot have been intended that the availability of APR should *automatically* be knocked out simply because the intensity of farming operations has slowed down over time, certainly not in the case of a farmer who continued actively to farm the land notwithstanding that his (or her) ability to farm the land as intensely as in previous years had diminished over time.

This view that APR operates in the real world underlies the statements from *Antrobus II* and in *Golding*, quoted above.[16]

The relationship between the value of the land and the profitability of the farming business

Commentators have frequently doubted the relevance of the relationship between the farming income and the value of the property and have pointed out that the relationship has (at the very least) not been fully explored.[17] The author agrees with these views.

The relevance of this criterion is unreliable, both because the relevance of profitability itself is doubtful (for the reasons set out above), but also because it is not clear what the relationship between value and profitability would have to be: is the test that a house can only be a farmhouse and of a character appropriate to the land if it is capable of being maintained out of the farming profit? This begs the question, maintained to what standard? Or, is the test that the house will only qualify if required by the actual farming operations carried on? And if so, given that a farmer must have somewhere to live, what determines whether or not a farmhouse is required? Is this an objective test or a subjective test?

HMRC's approach in practice seems to be to evaluate whether the size of the land and the farming activities justify the existence of the farmhouse. This was their approach in *Golding*.[18] One argument often used by HMRC as a basis for rejecting the contention that the farmhouse is of a "character appropriate" is to point to the fact that after the farmer's death, the farmhouse was sold off separately from the land, i.e. proving that the farmhouse with the small acreage of land could not have been a viable commercial entity.

The correctness of HMRC's approach is surely in question if the purpose of APR is to prevent farms being sold to pay IHT.[19] Provided that the occupier of the property is the farmer, there cannot be a precise link between farming income and property values, bearing in mind in particular that property values often bear no relation whatsoever to the profitability of farming activities on the land. Further, it is not clear what evidence one would produce in practice to show viability as a commercial unit. In *Golding*, Mr Clive Beer (who gave evidence on behalf of the executors) produced evidence of a notional budget to show that the buildings and agricultural land could be used for intensive poultry farming, and that the farm could generate about £17,000. This was based on keeping 60,000 birds in moveable sheds. Under cross-examination, he conceded that his budget had made no allowance for any capital expenditure and so on. Ultimately, the tribunal considered that his evidence on this point was not satisfactory. But could any amount of evidence ever have been satisfactory? The many variables that might make a farmhouse and land a viable commercial operation are infinite, particularly as farmers often farm other land together with their own in-hand land to make ends meet. Further, the risks that different individuals are prepared to take will vary infinitely, depending also on what other assets and businesses they can draw from to fund their lifestyle. It cannot be right that the "character appropriate" test requires that evidence of the farming operations that might be carried out on the land have to be put to HMRC (and ultimately to the tribunal) in order to prove that a particular farmhouse is of a character appropriate to a particular piece of land. Apart from anything else, that line of enquiry would render obsolete the historical dimension that has many times been accepted to be a central part of the "character appropriate" test.

As a final point, the "character appropriate" test will be applied in the same way whether or not the property is sold after death. So *if* the relationship between the value of the land and the profitability of the farming activities is relevant, relief may be denied in precisely the circumstances when APR was designed to operate, i.e. when the farm is retained in the family with the aim of it continuing to be run as a farm.

Conclusion

There have always been significant doubts about the relevance of both profitability and the value of land, as compared with profitability of the farming activities, to the "character appropriate" test, particularly in the case of a working farm. Yet these are often the very factors often identified by HMRC as the basis for making a determination that a farmhouse is not of a "character appropriate" to the land. *Golding* is therefore an important decision for the taxpayer, particularly as the area of land farmed was relatively small.

By way of a footnote on the relevance of the size of the land, the following passage in *Rosser* should be borne in mind:[20]

> "The size of the property could have a critical bearing upon the question of whether the house is and or barn were of a character appropriate to the property. Forty-one acres of agricultural land is a very different proposition from two acres".

This seems to imply that a claim for APR on the farmhouse might have been successful if the "character appropriate" test was applied to a 41 acre holding, instead of a 2 acre holding. But in my view, it was a significant factor in that case that a substantial part of the land previously farmed with the farmhouse had been given up. Accordingly, although it is clear that size does matter, following from the decision in *Golding* – which concerned 16.29 acres of land and where the Tribunal were clearly impressed by the statistics showing the number of small farms in the country with acreages even smaller than that of Blue Gates Farm, HMRC may have to accept that a farmhouse can be of a "character appropriate" to a small acreage of land, particularly where the farmhouse has historically been associated with only a small acreage and that land was farmed up to the farmer's death.

It will be interesting to see what HMRC's response to the decision in *Golding* will be. In practice, it seems less likely that they will rely exclusively on the "character appropriate" test to deny APR. Instead, HMRC is likely to place increased reliance on the "working farmer" test[21] and to deny that a property is a "farmhouse" at all, i.e. for the purposes of IHTA 1984, s.115(2). In the author's view, applying the "working farmer" test is not always straightforward or appropriate. Challenges to HMRC's determinations made by reference to the "working farmer" test seem inevitable.

---

[1] The original version of this article first appeared in issue number 5, 2011, of Private Client Business, published by Sweet & Maxwell, part of Thomson Reuters (Professional) UK Limited.

[*] *Marika Lemos MA (Cantab), LLM Tax (Lond); email: mcl@taxbar.com. Co-Author of the 5th Edition of McCutcheon on Inheritance Tax; Principal Editor of Whiteman & Sherry on Capital Gains Tax; etc.*

[2] *Lloyds TSB v IRC* [2002] STC (SCD) 468.

[3] *Rosser v IRC* [2003] STC (SCD) 311, at 323.

[4] See *Antrobus I*, at paragraph [48].

[5] *Arnander (executors of McKenna, deceased) v HMRC* [2006] STC (SCD) 800

[6] See *McKenna* [2006] STC (SCD) 800, at [102].

[7] See HMRC's Inheritance Tax Manual at para. IHTM 24052.

[8] See G*olding*, at paragraph [19].

[9] At the time of writing, it is not yet known whether HMRC will appeal the decision in *Golding*.

[10] A preliminary issue at the hearing was whether proceedings could be adjourned for the taxpayer's representatives to prepare submissions to meet a point first raised only in HMRC's skeleton argument, i.e. that the house was not a "farmhouse" for the purposes of s.115(2) IHTA 1984. The tribunal decided that it would be inappropriate to adjourn the hearing, partly because it was clear from the correspondence between the parties that the only matter in issue was whether the house was of a "character appropriate". It having been agreed in correspondence that the house was a "farmhouse", the appeal was dealt with on that basis. It appears that the Tribunal would in any event have decided that the property was a farmhouse. The decision records the Tribunal's view as follows: "From the photographs provided by the experts, it seems to us that the state and condition of the farm is such that it would only be acceptable as a farm house. The kitchen is spartan at best; we have been told that apples were stored in one of the bedrooms; there was no electricity in any of the bedrooms upstairs so that they could only have been functional for sleeping and it appears storage of farm produce; the bathroom was downstairs, which would have been very convenient for Mr Golding, when coming in having worked on the farm. We are satisfied that the educated rural layman would also agree that the house was a farmhouse (at para [27]). There is therefore no departure in this decision from the principle that the greater the state of disrepair of the farmhouse, the more likely that it will qualify for APR. This is perhaps not surprising in cases where production from the farm has diminished significantly before death, but, in the author's view, this factor ought not to be determinative in every case.

[11] The expression "in-hand land" is used here as shorthand for all the "property" against which the character of the farmhouse is to be tested i.e. any land and buildings which are part of the deceased's estate, including tangible property, equitable rights, debts and other choses in action, etc. as set out in *Rosser*, at paragraph [50].

[12] *Golding*, at paragraph [28].

[13] *Lloyds TSB Private Banking Plc v Peter Twiddy* [2006] 1 EGLR 157

[14] *Antrobus II*, at paragraph [58].

[15] In *Rosser*, the farm originally consisted of 41 acres of land together with the house and a barn, 39 acres of which were subsequently given up and farmed by the children of the donors. It was held that the farmhouse had lost its character as such and become a retirement home.

[16] Look also at the decision in *Atkinson v Revenue and Customs Commissioners* [2010] UKFTT 108 (TC) for a clear example of the Tribunal sympathetic approach to aging farmers (reviewed by the author in "Tax tip – farming partnerships following Atkinson v Revenue and Customs Commissioners" [2010] P.C.B. 349). HMRC put in a late appeal in *Atkinson.* The appeal was heard on 25 July 2011. I understand that the taxpayer chose not to appear at the hearing. At the time of writing, no decision has yet been released.

[17] See in particular *Dymond's Capital Taxes* (London: Sweet & Maxwell), paras 24.824 *et seq*.

[18] See *Golding* at paragraphs [25] and [26].

[19] It should be noted that HMRC's submission in *Golding*, at paragraph [19] was that this was the purpose of APR.

[20] See *Rosser*, at paragraph [47].

[21] I.e. the test first enunciated in *Rosser*, and then expanded in the *McKenna* case.