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# Agricultural Write News

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Agricultural Law Update

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# Rent reviews

It is now far easier for parties to agree how rent in agricultural tenancies is to be assessed on review. With increasing volatility in commodity and production costs, now has never been a better time to revise the rent review procedures in your agricultural leases. The purpose of this article is to explain the current position regarding rent reviews in agricultural leases and the pro's and con's of the new procedure.

## Introduction

In the current turbulent market both agricultural tenants and landowners should be considering whether the rent review provisions in their agricultural leases might be used to extract additional value from their land, or from a tenant's perspective, used to reduce the rent.

Land owners and agricultural tenants should also be considering whether now is the time to abandon the cumbersome and time consuming statutory formula for setting rent levels (in favour of something more in tune with current farming trends). Land owners may wish to move to a 'turnover based' approach to rent assessment (to take into account more intensive, higher yielding farming practices, and factors such as the increases in cereal prices seen in the autumn of last year) whilst tenants may wish to have increased production and energy costs considered on rent review.

## Flexible rent review?

Recent changes to the law governing rent review in agricultural tenancies have been introduced to promote greater flexibility for the parties to a Farm Business Tenancy (FBT) to agree how rent is to be assessed on review. It was felt that the previous system of rent review was too prescriptive and cumbersome (and out of touch with modern farming practices).

**The new rules apply to all new FBT's. FBT's created before 19th October 2006 will need to be amended by both parties in writing to incorporate the new procedure for the new flexible rules to apply. Rent review in pre 1995 leases is still governed by the old statutory arbitration rules, although the parties are of course free to enter into a new FBT (to which the new rules will apply).**

## Background

### Rent review under the Agricultural Holdings Act 1986

There are two parallel schemes of legislation that apply to rent reviews for agricultural land: the Agricultural Holdings Act 1986 (**the "1986 Act"**) and the Agricultural Tenancies Act 1995 (**the "1995 Act"**).

An agricultural tenancy entered into on or before 31 August 1995 is governed by the 1986 Act. The 1986 Act specifies that the parties must follow a highly cumbersome and prescriptive formula to agree any new rent on review. This process involves either party serving a notice on the other requesting that the rent be referred to arbitration (this cannot be done more than once in every three years). The arbitrator must then follow a prescribed formula to decide the level of rent on review. The arbitrator must create a

“hypothetical tenancy” (which is based on an assumption that the land is being let by a prudent landlord and farmed by a prudent tenant in a competent way). If the tenant is producing less from the land than he might be if he were, in the eyes of the arbitrator, acting competently, this is ignored when the actual rent is reviewed. The arbitrator may decide to increase or reduce the rent, or may direct that it remain the same. Once a notice is served to refer the matter to the arbitrator, it may not be unilaterally withdrawn.

## Post September 1995 - the new regime

### Rent review procedure

The 1995 Act was intended to simplify agricultural leases and introduce more flexibility into the farming tenancy sector. The provisions of the 1995 Act dealing with rent review were however still widely viewed as too prescriptive and inflexible. To address this problem, amending legislation was introduced in 2006 to simplify the rent review process and introduce greater flexibility into agricultural tenancies, by allowing parties to FBT's to contract out of the statutory arbitration process altogether and decide themselves how and when rent is to be reviewed.

### Freedom to choose?

Landowners and tenants can now choose any of the following options:

- to stick with the statutory formula for deciding rent;
- to agree not to review the rent at all;
- to review the rent at specific times by a specific amount or by a specific formula (for example a tenant may wish to link future rent to turnover, or to the price of a particular commodity) - to create a stronger link between actual costs incurred, and profitability and rent. The only limitation on the parties freedom to decide on the rent being a rule that any agreement or formula cannot result in an **upwards-only** rent review or the exercise of any judgement or discretion by anyone in deciding rent level; or
- to refer rent on review to an independent expert (whose decision is final).

*Landowners and tenants now therefore have considerable flexibility to decide how to review rent. The only requirement is that the agreement be in writing, that it fall into one of categories listed above and rent can go down on review as well as up.*

### The prescribed formula

In the event that parties to a FBT do not agree how rent will be reviewed (or if any agreement does not fall within the criteria set out above), then the 'statutory formula' applies.

Under the statutory formula, rent cannot be reviewed more than once in every three years. It is reviewed on an open market basis on the assumption of a grant of a lease by a willing landlord to a willing tenant (taking into account the terms of the tenancy). It should be noted however, that, unlike mainstream commercial rent reviews, an open market review in an FBT may result in a reduction as well an increase in the rent.

The process begins with either party serving on the other a prescribed form of notice requiring rent to be referred to arbitration. The parties can either agree on an arbitrator or make an application to the President of the Royal Institution of Chartered Surveyors.

### Time to review rent?

*Now may therefore be a prudent time to think about the rent provisions in your leases to see if, in the current turbulent times, this often overlooked area needs revisiting to more accurately reflect modern day farming.*

# Wills & Probate - Agricultural considerations

It is important to have a Will which deals appropriately with your assets and maximises the tax planning opportunities available after your death.

Everyone should consider what will happen to their assets after their death. For those who own, rent or work on land used for an agricultural purpose it is especially important to think about the ways in which agricultural property can be passed on and the special Inheritance Tax exemptions available on agricultural property.

## Will Planning & Trusts

Some Inheritance Tax exemptions, set out in this article, are only applicable to certain assets. When planning your Will and the division of your estate you should consider the best way to maximise the use of these exemptions.

Land, cash or other assets can either be given direct to beneficiaries or can be left in trust for them to receive the benefit. Trusts can be very flexible and, when used effectively, can save tax.

For example, you may wish to leave part of your land to your children and your cash or other assets to your spouse. If the right conditions are met, agricultural land is not subject to tax. Agricultural Property Relief is available on the land and the rest of your assets will be exempt from tax if transferred to a spouse.

Alternatively, you may want your spouse to receive the income or benefit from agricultural land during their lifetime, but do not want to give it to them outright. In this scenario, the land could be placed into a discretionary trust with your spouse and children as potential beneficiaries. This can enable your spouse to receive sufficient monies to live on whilst maximising tax relief.

## Succession rights for tenants

Where an agricultural tenancy meets the following conditions a right of succession to the tenancy will exist:

- The tenancy was granted before 12 July 1984.
- The tenancy was granted before 1 September 1995 and contains an agreement that Part IV of the Agricultural Holdings Act 1986 shall apply.
- The tenancy was granted after 1 September 1995, complies with circumstances set out in the Agricultural Tenancies Act 1995 and contains an agreement that Part IV shall apply.

The right to succeed to the tenancy can be exercised on the death or retirement of the tenant. The succession right can be used on a maximum of two occasions. In cases where the tenant has died, the person wishing to take on the tenancy (the applicant) must fall within the following criteria;

- They must be a close relative of the deceased - spouse, sibling, child, or someone who was treated as a child of the family (i.e. a stepchild)
- The applicant must not already occupy a commercial unit of agricultural land (commercial unit refers to land capable of producing a net annual income not less than the aggregate of the average annual earning of two full-time male agricultural workers aged 20 or over).
- For at least five of the seven years before the date of the tenant's death, agricultural work on the holding must have been the applicant's 'principal source of livelihood'. Cases have shown that 'principal' means more than 50% and can include benefits in kind.

If the applicant meets the above criteria, the Land Tribunal will consider the application and assess the applicant's training, age, physical health, financial standing and the landlord's view.

If there is more than one eligible applicant, the Tribunal will consider any wishes the tenant has made in his Will. If the individual named in the Will meets the eligibility criteria they can succeed to the tenancy.

**If you occupy land under a tenancy with this option it is important that your wishes are reflected in your Will.**

## Agricultural Property Relief (APR)

**APR is available for property including agricultural land or pasture, farm buildings, cottages and farmhouses. The breeding, rearing and grazing of horses on a stud farm are specifically included for APR.**

The property must have been occupied by an individual for 2 years before the date of death (or the date of the gift, if given away during lifetime) or owned by him for 7 years before the date of death and occupied for agricultural purposes by someone else. If the individual had the right to 'vacant possession' (i.e. the property is not rented to someone else) or has a right to vacant possession within the next 12 months,

the property will receive 100% APR. This means a possible Inheritance Tax saving of 40% of the value of the land.

If the property is tenanted, the landlord is entitled to 50% APR, but this can be increased to 100% APR in some circumstances.

## Farmhouses and APR

The application of APR to farmhouses had been the subject of several cases in recent years. The basic principle is that a farmhouse must be of a character appropriate to the property. These cases have highlighted the difficulties in establishing whether houses are too large or too luxurious in relation to the farmland associated with them.

Each farmhouse will be assessed on a case by case basis to establish whether the relief should apply to the building or buildings, in some cases a partial exemption will be allowed. In addition to the ownership conditions set out above, the following conditions must apply before the farmhouse can benefit from 100% APR.

- The farmhouse is a dwelling for the farmer from which the farm is managed.
- The farmer should be the person who farms the land on a day-to-day basis and not merely the person who is in overall control of the agricultural business conducted on the land, i.e. the home of an active farmer, not someone who just makes management decisions.
- The Courts especially look to the purpose of the occupation of the premises. If either the premises are extravagantly large for the purpose or have been constructed upon an elaborate and expensive scale, the farmhouse might be out of keeping when viewed in conjunction with the area of the farm being farmed.

Each case is decided on its own facts, including the size of the farmhouse, buildings other than the farmhouse and the area of farmed land.

APR is only given on the "agricultural value" of the property. This assessment values the property as if it was subject to a covenant which prevented it from being used as anything other than agricultural property. The effect of this notional covenant is that the agricultural value will usually be less than the open market value of the property (on which Inheritance Tax is assessed). There are few cases to guide us as developments in the law are relatively new but one leading case points to a discount of 30%, i.e. only 70% of a farmhouse's value may get the 100% relief. A 30% discount will not apply in every case.

The open market value may be higher because the property has development potential or is in a desirable location.

Please note that, where APR does not apply, Business Property Relief (BPR) may do so if other conditions are satisfied. Land and buildings owned by the taxpayer used in the business may get up to 50% BPR for inheritance tax.

## Business Property Relief (BPR)

Business property must have been owned for a period of 2 years before the date of death (or gift) to attract BPR. In some cases property may be eligible for both APR and BPR. In these circumstances, APR is applied to the 'agricultural value' first, and BPR applies to any excess 'non-agricultural value'.

**100% BPR is available for business interests and at 50% for Land, buildings machinery or plant.**

## Inheritance tax - Spouse allowance

The Inheritance tax allowance (known as the Nil Rate Band or NRB), per person, for deaths occurring in the 2008/09 tax year is £312,000. The available allowance may be reduced if annual gifts over £3,000 were made during the 7 years before the date of death.

Since October 2007 where a second spouse dies, their estate can claim that person's own NRB and the percentage of the NRB which was not used on the death of the first spouse. Potentially, the second spouse can have an 'enhanced' NRB of £624,000.

## Using exemptions effectively

The exemptions outlined above can be used effectively to reduce the Inheritance Tax payable on your death. It is important to have a Will which deals appropriately with your assets and maximises the tax planning opportunities available to your family after your death.

## Summary

- An appropriate Will is needed to ensure that your family are suitably provided for and to take advantage of the tax exemptions available on death.
- A tenancy can (in some circumstances) be left to a successor.
- In addition to personal Inheritance Tax allowances, Agricultural Property Relief and Business Property Relief may apply, reducing the tax liability.
- Surviving Spouses can increase their Inheritance Tax allowance by up to 100%.

## Key Contacts

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Chris joined the firm in 2004 having trained in the City of London. He is an experienced property lawyer and deals with a variety of work (both agricultural and non-agricultural). Chris has particular experience of development work, site acquisitions and disposals and landlord and tenant work.

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A solicitor in the Private Client department, Chris read law at the University of Liverpool and after completing his training, joined the firm in 2007. Chris specialises in Wills, Trusts and Probate and has experience in advising on the application of tax relief to agricultural and business property.

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