



Farm Partnerships - Practice Notes

A series of eight practice notes for Practical Law written by

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Practice Note 4. - How land can be owned and occupied in a partnership situation

The series comprises:

1. Basic Principles
2. Who owns the business and assets?
3. Dissolution and winding up - retirement and death
4. How land can be owned and occupied in a partnership situation
5. Running the Partnership
6. Borrowings in Farm Partnerships
7. Tax
8. Limited Partnerships and LLPs

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Farm partnerships: how land can be owned and occupied in a partnership situation

- **Resource type:** Practice note
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Farm partnerships: how land can be owned and occupied in a partnership situation is part of a collection of eight practice notes on farm partnerships.

This note looks at how land is owned and occupied in a partnership situation, where land is held outside the partnership or where land is part of partnership property and held on land capital accounts.

This note also looks at how to recover land from a partnership and some of the the practical issues dealing with the actual occupation of the land.

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Scope of this note

This note looks at how land is owned and occupied in a partnership situation, such as where land is held outside the partnership or where land is part of partnership property and held on land capital accounts. This note also looks at how to recover land from a partnership and some of the practical issues dealing with the actual occupation of the land.

This note is part of a collection of eight practice notes on farm partnerships.

For further information on farm partnerships, see Practice notes:

- *Farm partnerships: basic principles* (www.practicallaw.com/5-614-4486) .
- *Farm partnerships: who owns the business and assets?* (www.practicallaw.com/8-614-4507) .
- *Farm partnerships: dissolution and winding up: retirement and death* (www.practicallaw.com/0-614-4525) .
- *Farm partnerships: running the partnership* (www.practicallaw.com/6-614-4527) .
- *Farm partnerships: borrowings in farm partnerships* (www.practicallaw.com/8-614-4531) .
- *Farm partnerships: tax* (www.practicallaw.com/6-614-4532) .
- *Farm partnerships: limited partnerships and LLPs* (www.practicallaw.com/4-614-4533) .

How land can be owned and occupied in a partnership situation

Under English law, several interests in land can exist. Land (and the buildings attached to it) can be held freehold; they can be occupied under a lease or tenancy (in which case the lessee or tenant would be said to hold a leasehold interest); or they can be occupied under a licence.

In practice, there is no material difference between a lease and a tenancy. The main difference between these and a licence (such as a grazing agreement) is that, under a licence, there is no right to exclusive occupation. Also, a raft of law applies to agricultural leases and tenancies which does not apply to licences.

Freehold and leasehold interests in land can be farmed by a partnership in the following ways:

- As separate property by one or more of the partners, who allow the partnership to farm it (that is, it is held outside the partnership).
- By the partnership as part of the general capital.
- By the partnership, with the capital value allocated to land capital accounts.

English law also makes a distinction between the legal ownership and the beneficial ownership of land. The legal owners are those named on the deeds or at the Land Registry. They hold the freehold or leasehold interest on a trust for land for the beneficial owners.

This means that where land is held as partnership property, it is not necessary for the partners to be the legal owners. All that is necessary is that the legal owners hold it on trust for the partnership.

Land: holding it outside the partnership

Licence or tenancy

Where a partner allows his land to be used by a partnership free of rent, he effectively grants to the partnership a licence to occupy. Where rent is paid without a formal tenancy being in place, tenancy rights can be created.

Where a partner allows his land to be used by a partnership but wishes to receive a rent, he can grant a farm business tenancy (FBT).

Introducing an FBT involves wider considerations. It may have to be for full market rent in order to avoid a transfer of value for inheritance tax (IHT) purposes. However, it should allow the landowning partner to receive APR at the highest rate (currently 100%, subject to meeting the other conditions). There may also be a stamp duty land tax (SDLT) cost depending on the rent and the term.

An FBT changes the relationship from pure partnership to landlord and tenant. It can be useful where a non-partner has an interest in the land.

Situation on death

Where a deceased partner allowed a partnership to occupy his farmland (which was his separate property) any licence to occupy would, on the face of it, terminate on death.

It is sensible to include a provision in the partnership agreement expressly providing for vacant possession within 12 months following a death in these circumstances, to underline a claim for APR at the highest rate (currently 100%) under *section 116(2)(a)* of the Inheritance Act 1984.

Where it is commercially undesirable for a partner to have the right to obtain vacant possession of land within 12 months, consideration can be given to obtaining APR at the highest rate by the use of an FBT.

Land as partnership property: land capital accounts

What is a land capital account?

Land capital accounts are now far more common than before. They are often tax-driven, particularly in terms of increasing IHT reliefs and widening the assets for which relief can be obtained. Such steps should be considered in terms of the practical complications that arise, and tax complications including capital gains tax and SDLT.

The fundamental point is that the legal nature of the asset changes, from the point of view of the party introducing it. Beforehand, the party holds an interest in land. After it has been introduced as partnership property, the party concerned no longer owns it directly, but instead owns an interest in the capital of the partnership which corresponds to it (legally, a chose in action).

How to introduce land as partnership property

In order to transfer land to the partnership (so that it is held as partnership property) it is not strictly necessary to transfer the legal title (see *How land can be owned and occupied in a partnership situation*). The persons on the title can declare that they hold it on trust for the partnership.

The transfer of an interest in land must be evidenced in writing. To be on the safe side this should be expressed as a deed. This means that all the signatories are bound, whether or not they receive any consideration.

If a single person holds the title to land introduced as partnership property, he or she will need to appoint a co-trustee in order to deal with the land in the future.

How to structure partnerships with land capital accounts

The partnership agreement needs to spell out clearly which land is held as partnership property and whether it is held as part of the general capital or on separate land capital accounts. It then needs to specify who is entitled to the land capital accounts, and also the capital profits and losses attributable to the land concerned.

It is good practice to identify the properties carefully in a schedule to the partnership agreement and, where possible, to identify the land clearly by reference to HM Land Registry numbers and a description, or otherwise using plans and ordinance survey numbers. The schedule should be kept up to date by supplemental agreements or memoranda.

The accounts need to reflect the treatment set out in the partnership agreement, dividing the partners' capital accounts between general capital and land capital (see *Practice note, Farm partnerships: basic principles: Sample balance sheet* (www.practicallaw.com/5-614-4486) for an example).

Experience suggests that it is this area that often requires a lot of preliminary work from clients and their advisers when putting these arrangements into place, or updating old partnership documents. It is important to record the position accurately.

Effect on the partners' wills, and the position on death or retirement

If land has been introduced as partnership property, a **specific gift** (www.practicallaw.com/3-383-4737) of that land in a will is likely to become ineffective (it will **adeem** (www.practicallaw.com/6-506-7836)); this is because the individual no longer holds an interest in land but an interest in the capital of a partnership. Wills need to be checked, and individuals need to be reminded that their wills need to reflect what is in the partnership agreement. (For more information on ademption, see *Legal update, Ask the team: What happens when a will contains a gift of a house that has been sold before the testator's death by his attorney?* (www.practicallaw.com/0-504-8884) .)

Generally, a partner cannot, by will, require a beneficiary to be admitted to the partnership. This is because partnership involves unlimited liability, and the partners have to have the utmost trust and confidence in each other. It is therefore unusual to allow a new partner to be capable of being imposed on the continuing partners.

In family farming partnerships, a provision is sometimes added to allow a deceased partner to nominate a successor to be admitted, and for his interests to pass across. However, this needs to be carefully considered and is, nowadays, unusual.

Recovering land from a partnership

Where land capital accounts are used, there is the question of whether the partners holding an interest in the land capital should be able to withdraw it on notice, or in the event of a death or retirement. These rights will not exist unless they are written into the partnership documents. These questions therefore need to be addressed, and the intended position reflected in the partnership documents.

A partner holding a land capital interest may well want to be able to recover the land itself (rather than just its value) on death or retirement, or on the solvent winding up of the partnership. In the event of an insolvent winding up, the partner may want to have the ability to buy the land back.

If a partner is given the ability to extract land on death or retirement, this may well impact on the remaining business. It may be necessary to include provisions allowing the remaining partners to renegotiate the terms of the partnership or to have it wound up. In practice, a reasonable period of notice should be provided.

It is quite common to see partners given the ability to withdraw a certain amount of land (up to an agreed limit). This may apply where land may have development prospects.

Part-interest held as partnership property

Can undivided shares in a property be introduced onto the balance sheet as partnership property? For example, if a property is owned equally by three members of a family, and two of them are partners in a partnership and one is a non-partner, can the two partners introduce their 2/3 interest in a property onto the partnership balance sheet?

As a matter of property law and partnership law, it should be possible for an undivided interest in property (that is an interest held as tenants in common) to be held as partnership property.

However, it is difficult to do this in practice. If the third family member (with a 1/3rd interest in a property) was not a partner, how would he be compensated for the use of the asset? It can be done through a co-ownership payment, but raises questions as to obligations for maintenance, insurance and so on. It also exposes the third family member to an argument that he is, in law, a partner (and therefore exposed to partnership liabilities).

In practice, the third family member would need to seek separate legal advice in order to enter into this sort of arrangement, so that they understand the consequences of the land being a partnership asset. Further complications arise if the land is subject to charge.

It is probably easier for the third member to be introduced perhaps as a limited partner (limiting his liability to the capital value of his interest introduced) and for him to receive a prior share of profits from the partnership.

An alternative is to keep the land out of the partnership altogether and to grant an FBT over it. The partners can waive their rent if they wish to do so, whilst the non-partners receive their share of the rent (although the tax consequences of any transfer of value would need to be considered).

Occupation of land: practical issues

As a partnership agreement is used increasingly to regulate the ownership and occupation of land, it is important to deal with the issues that arise as between the partners holding interests in the land, and the partnership as occupier; in practice, reflecting the obligations that would normally apply as between a landlord and a tenant.

Different considerations apply to land that is held outside the balance sheet, that which is partnership property but part of the general capital, and that which is partnership property but held on land capital accounts.

Separate property

Where land is held outside the partnership but contributed by one or two partners, they will normally remain the legal owners and therefore, the land cannot be sold or charged without their consent. However, they will want to be sure that the partnership:

- Is responsible for maintenance and repairs, insurance and outgoings.
- Will not make any alterations or improvements without their consent.
- Farms in accordance with the requirements of good husbandry.
- Pays any rates (for example, on converted buildings) and other outgoings.
- Meets cross-compliance obligations.

Land held in land capital accounts

Where land is held on land capital accounts, the same considerations apply. In addition, the land capital account owners will want to make sure that the partnership cannot sell, let or charge the property without their permission.

Land held as general capital

Where land is held as part of the general capital, there is less need to regulate the position as all the partners have an interest in it and it is held and controlled in the same way as the general assets of the business.

Resource information

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Products: Agriculture

This resource is maintained, meaning that we monitor developments on a regular basis and update it as soon as possible.

Resource history

Changes made to this resource

We will record here any changes to this resource as a result of developments in the law or practice.

Related content

Topics

Farm partnerships and farming agreements (<http://uk.practicallaw.com/topic9-607-6428>)

Practice notes

Farm partnerships: basic principles (<http://uk.practicallaw.com/topic5-614-4486>)

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