TAX AND LETTING OF AGRICULTURAL LAND: SCOTLAND

LAYMAN'S OVERVIEW

Purpose

1. To review the impacts UK land and assets taxation has on the letting of farmland in Scotland, in response to recommendation 9 of the Tenant Farming Forum, with a view to considering what action might be taken to help new entrants gain access to land.

Summary outcome

2. From a desk based research project and speaking to a range of advisors, it would appear in broad terms that present UK taxation provisions are not the inhibitor to the letting of farmland as previously thought. Excepting some estates, whose business interests place them at the edge between agricultural and other land/ business use, with care and appropriate advice, the letting of land under an agricultural tenancy should not present material disincentives over farming in-hand for tax purposes.

3. While tax may not be the inhibitor to letting as generally thought, nevertheless, for most landowners, use and control of agricultural land is probably more important in making decisions over letting, than necessarily its agricultural value or tax relief position. Any proposals for tax relief incentives would have to be balanced against tax increases elsewhere.

Background

4. Agricultural land and property already benefits significantly from taxation through exemptions, both in the form of relief from inheritance tax and from non-domestic rates. Nevertheless, there is a strong belief inflexible tax rules can impact negatively on rural areas

5. Tenant Farming Forum (TFF) recommended (May 08) that SG should commission a review of the taxation of land in relation to the letting of farmland. In their further letter of 12 February 2009, the Forum proposed review of:

- 5.1 treatment of diversified tenant farm enterprises for purposes of Inheritance Tax relief;
- 5.2 potential tax relief concessions specifically for letting to new entrants;
- 5.3 options for retiring farmers wishing to lease land but preserve their tax relief eg let the landlord preserve his taxation status.

6. The Tenancy Reform Industry Group (TRIG) (in respect of England and Wales), in its 2003 report on: tenancy reform and the case for removal of fiscal disincentives, included within its recommendations:

- 6.1 Land let under an agricultural lease (to) be added to the definition of agricultural property for APR purposes to the extent it is used for business purposes under consent from the landlord;
- 6.2 Landlords should be able to defer payment of Capital Gains Tax (CGT) on gains where used to improve the economic value of let agricultural land.
- 6.3 Stamp Duty Land Tax (SDLT) calculation should not exceed the value of a 10 year lease;
- 6.4 APR eligibility should be standardised at 2 years.

Trig has made extensive submissions on tax. It has had some successes eg in relation to extending CGT business taper relief - since ended in 2008. Although supported by DEFRA, no further progress on such reliefs has been made or can now be expected.

FINDINGS

7. This was principally a desk based research project, which additionally involved informal discussions with tax professionals. For those situations primarily involving individuals and partnerships the following sets out in simplistic terms how taxation might impact on the letting of agricultural land. Broadly similar issues apply to companies.:

Inheritance Tax (IHT):

8. IHT is payable on assets owned, including a landed estate, on death and on some lifetime transfers. Relief from IHT is available through Agricultural Property Relief and Business Property Relief – see below. The IHT tests can be complex and costs to an individual high if tax falls due. However, most farmers and landlords benefit from APR.

Agricultural Property Relief (APR)

9. APR is an important IHT concession for landowners. APR reflects increased Government support, from 1995 onwards, for agricultural let leases in relation to Inheritance Tax. It is fundamental to land being made available for letting. It does not, as such, promote the letting of land but it is not detrimental to letting.

10. APR applies to agricultural land and buildings (at least buildings in character for the purpose) and to woodland occupied with agricultural land or pasture. It is given on the agricultural value of the land. However, it is better to think about the purpose and use of the land, what is occupied and what it is used for, in understanding APR's benefit to let land. Land that has been let on leases dating from before 1995 qualifies for 50% relief. Leases dating from after 1995 qualify for 100% relief.

11. APR qualification for let agricultural land kicks in after 7 years. If farmed in-hand the land and buildings are eligible for APR after 2 years Thus short lets would appear to be a disincentive. However, eligibility is about occupation and purpose of use, prior to any let; so this should not be an issue where the owner has owned and occupied the land for agricultural use for some time (including such occupation by another).

12. IHT relief can be managed by "gifting" in stages. The timing of occupancy and use of the land can affect the HMRC judgement of eligible APR rate that applies for IHT calculation.

<u>Diversification of agricultural land</u>

13. Concerns are often raised over tenants' powers to diversify in Scotland, as introduced by the 2003 Act and applicable to 1991 Act tenancies and Limited Duration tenancies (LDTs). Diversification by a tenant away from agricultural use could potentially affect an owner's APR eligibility. However, overall effect on classification of the land has been marginal.

14. An agricultural lease predisposes the land it covers to agricultural use. Diversification would normally affect only a few buildings, or one or two fields – making little impact on the overall purpose of occupation of the land. Diversified use would have to materially reduce the agricultural use of the land under the lease to have an effect on APR eligibility.

15. Buildings used for non-agricultural / diversified use can be shifted to a non-agricultural lease – but that should not change the landlord's overall APR eligibility. APR particularly, and to some extend BPR importance, may well be more about perceptions and control of the land, rather than taxation cost impacts.

Business Property Relief (BPR) (under IHT)

16. BPR for 'in-hand' farmers may also be available, in addition to APR, for mitigating IHT. BPR applies to businesses that do not consist wholly or mainly of dealing in land, shares or securities, or the making or holding of investments. 'Investments' includes letting farms and other properties. The relief also applies to partnership interests. The rate of relief is 100% except that a rate of 50% applies to farmland held outside the partnership. It will only be relevant if a landlord is operating as a business and trading directly.

17. Although let land is not itself a qualifying business property for BPR, if a landed estate business comprises mainly 'in-hand' farming, BPR may apply to the whole (ie including the let land) as relief is all or nothing.

Capital Gains Tax (CGT)

18. When a trading asset is sold and the proceeds are reinvested by the owner in new trading assets, potentially the whole gain can be set against the new asset, thus deferring the tax. This is called rollover relief.

19. Holdover relief can also assist when gifting trading or APR assets. This relief is not available for let property other than let agricultural land qualifying for APR.

20. Capital Gains Tax relief will have a particular impact on letting of land where there is rising value or potential development.

Entrepreneurs' Relief (ER)

21. From 6 April 2008, a new Entrepreneurs' Relief (ER) was introduced. At the same time, land related value indexation and taper reliefs were removed. The key element of ER, applicable to land owners, affects gains arising on the sale of the whole or part of a trading business on or after 6 April 2008.

22. ER provides an effective rate of tax of 10% on 'qualifying business sales' for the first £1 million of lifetime asset gains. Let land is not considered a trading asset and is not normally eligible for ER. If sold, it will be charged at the higher 18% CGT rate rather than the 10% ER rate. Will be more an issue if an owner is thinking of selling or possibly gifting capital assets, – and thus less likely to tie up the land in a let.

Income Tax (ICT)

23. Direct, or 'in-hand' farming is trading for income tax purposes whilst rents are un-earned income. Trading income can be used to fund pension payments and can benefit from trading loss relief (with some restrictions).

24. Most owner-occupiers are likely to be already involved in letting out land (a field or two) and will be aware of rules. Again, of greater interest to smaller one man trading businesses and those on edges of relief categories, than large diverse estates.

Stamp Duty Land Tax (SDLT)

25. SDLT is payable by incoming tenants on the full value of the lease when taken out. The rental value for SDLT liability is a multiple of the length of the lease. This calculation can be expensive for prospective tenants. The grant of a new /replacement lease or formal change of the terms of a lease triggers SDLT liability. Also, in respect of leases granted after 1 Dec 2003 which were taxable, any lease extension (tacit relocation) will itself be taxable under SDLT. Thresholds can apply. A cost more for the tenant than the landowner.

Value added Tax (VAT)

26. Letting of land is an exempt supply for VAT whereas most (but not all) farming is zero rated. Leasing land can result in landlords not being able to recover input tax.

A landlord can waive the exemption from VAT on rent except in relation to domestic dwellings. However, if the exemption has been waived then a sale is also VATable. Uncertainty as to whether a change in VAT rate is classed as a rent review for agricultural land law may be inhibiting letting.

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The assistance of Forum organisations in aiding access to documents and professional advice is acknowledged and very much welcomed.

GLOSSARY

APR	Agricultural Property Relief	See para 9
BPR	Business Property Relief	See para 16
CGT	Capital Gains Tax	See para 18
ER	Entrepreneurs' Relief	See para 21
ICT	Income Tax	See para 23
IHT	Inheritance Tax	See para 8
SDLT	Stamp Duty Land Tax	See para 25
VAT	Value Added Tax	See para 26