TAXATION

Agricultural Productivity, Land Occupation and Use After Brexit

A CAAV Discussion Paper

Central Association of Agricultural Valuers

September 2017

About the CAAV

The Central Association of Agricultural Valuers (CAAV) represents, briefs and qualifies some 2,800 professionals who advise and act on the very varied matters affecting rural and agricultural businesses and property in all four countries of the United Kingdom. Instructed by a wide range of clients, including farmers, landowners, lenders, public authorities, conservation bodies, utility providers, government agencies and others, this work requires an understanding of practical issues.

The CAAV does not exist to lobby on behalf of any particular interest but rather, knowing its members will be called on to act or advise both Government and private interests under developing policies, aims to ensure that they are designed in as practical a way as possible, taking account of circumstances.

Following its work and publications on agricultural tenancies, taxation, agricultural policies, support schemes and other The CAAV is widely engaged in and contributes to discussions with governments and other bodies about Brexit and post-Brexit issues across the United Kingdom. It is a member of many bodies involved in these discussions including the Tenancy Reform Industry Group, the Agri-Brexit Coalition and the UK Livestock Brexit Group.

Central Association of Agricultural Valuers,
Harts Barn Farmhouse, Monmouth Road, Longhope, Gloucestershire. GL17 0QD

Contact: Jeremy Moody, Secretary and Adviser jeremy@caav.org.uk

Presidential Foreword

Brexit potentially brings a period of perhaps the most significant agricultural policy change for more than a generation, with its associated economic uncertainties and opportunities. Rural businesses throughout the UK are likely to face more challenge to deliver both food and environmental benefit. That will see an emphasis on productivity and the management of associated change for agricultural and rural businesses to compete and thrive.

We in the CAAV have long served all in agriculture across the United Kingdom, providing practical help and guidance. In many instances, this has required publications interpreting and explaining policies from others, disentangling their ambiguities and uncertainties to make them workable in the field, while understanding the policy objectives.

This paper is different. It is very much a discussion paper to prompt thinking about how to help meet the needs of this important time. While pointing to policies that seem most likely to make a real difference, it does not make formal proposals. Instead it brings issues forward for review, drawing on our technical knowledge and practical experience to open and encourage discussion of the potential role for taxation policy to support that key goal of agricultural and environmental productivity. We want to see what could make a real difference and help achieve the results we need.

The issues reviewed in this paper concern how taxation can support rather than hinder:

- effective entry into and progression within agriculture
- environmental improvement
- sensible means for those who wish to retire to release land beneficially
- an open door to practical investment, innovation and diversification
- the management of risk.

In part, we can do that with the benefit of analysis and experience in other countries, notably the recent thorough review in the Irish Republic of which the first practical fruits are now coming through. With Ireland's commitment to agricultural growth, that stresses the importance of flexibility in land occupation and the need for investment as routes to productivity in the hands of those who can best do it. We can learn usefully from it.

This paper is offered to start this discussion. I encourage you to read this paper and bring your views forward. We look forward to discussing them so we can all contribute at this critical time to the future prosperity of our rural industry.

James Dick
President, Central Association of Agricultural Valuers **September 2017**

Introduction to the CAAV Discussion Paper

Brexit, with the withdrawal from the CAP that comes with leaving the EU, gives the greatest opportunity we have had to determine agricultural policy in the round since entering the EEC in 1973 and, in practice, since 1947 and to see that our industry is fit for the future.

Brexit is expected to unfold a time of accelerated change bringing a more commercial and a more challenging environment. The developing policy discussion includes two overall strands: a concern for the future productivity of the sector, encouraging a focus on business, and the pursuit of environmental improvement. It seems likely that policy objectives, tools and the associated transitions will be largely bent to those ends.

With Brexit, we can regain the sense that agricultural policy is about much more than we have done within the CAP. Among the tools available are those offered by taxation and its interaction with business structures, land tenure, innovation, investment and environmental activity. The recent agri-taxation review and measures in the Republic of Ireland, considered in this paper, gives a useful comparative experience.

The CAAV, as the UK-wide specialist professional body representing, briefing and qualifying those advising on agricultural and rural property and business, sees this as an important time to bring key issues in these areas out for discussion in agriculture, UK governments and the wider public. Such a comprehensive opportunity to shape our own destiny may not come again.

With the European Union (Withdrawal) Bill before the House of Commons, an Agriculture Bill in prospect and the repatriation of agricultural policy from the end of March 2019, now is very much for those who are concerned to think about these issues, form judgments and debate them with policy makers so that positive decisions can be taken with full practical knowledge.

To that end, the CAAV offers this paper on the opportunities for tax policy to aid productivity to start the discussion. It cannot be complete, requiring the review, analysis and judgment that comes with wider discussion and debate. We very much welcome responses to help take this conversation forward.

Central Association of Agricultural Valuers,
Harts Barn Farmhouse, Monmouth Road, Longhope, Gloucestershire. GL17 0QD

Contact: Jeremy Moody, Secretary and Adviser jeremy@caav.org.uk

CONTENTS

INVITATION TO DISCUSSION

This paper, concerned with the occupation and use of land and so the business of agriculture and the management of land, offers a review of potential tax measures that could aid agricultural and environmental productivity by assisting:

- entry, progression and exit from farming
- innovation and its adoption through investment
- the management of risk and resilience

seeking "game changing" measures for the sector to face the future.

It does so as taxation policy is seen as an important influence on behaviour which can have positive or perverse effects on real businesses and the economy. The positive effects can where its structures, rates and incentives accommodate change and enable or encourage businesses to thrive. The perverse effects can be where they hinder growth, lead to tax-driven gamesmanship or are just too complex to be effective or certain.

In this, we can look with interest at the agri-taxation review of 2014 in the Republic of Ireland and the resulting measures, now with some evidence of their effects. As a common law, English speaking market economy with similar land law and other commonalities there is much that can have relevance.

With this opportunity for the discussion and the benefit of this paper, we offer some questions to start the process, looking for practical effective answers.

- How could the taxation system be changed to support improving productivity?
- Where does the taxation system now act against agricultural productivity?
- How might taxation best enable flexibility in land occupation with entry, progression and retirement?
  - in the owner-occupied sector?
  - in the tenanted sector?
  - opening more opportunities for lettings and other business arrangements?
- How much larger might the tenanted sector be as a result?
- How can the taxation system most effectively support innovation and investment?
- How to achieve equal treatment for businesses whether under Income Tax/Capital Gains Tax under Corporation Tax?
- How might taxation help with risk management and resilience?
- What changes might help businesses make and sustain environmental improvements?
- What measures would have the greatest practical effect?
- What might they replace?

As well as seeking views now, the CAAV is proposing to convene an event later in the autumn for all those interested to review these questions and others put forward.

SECTION 1 – SUMMARY AND OVERVIEW

1.1 Introduction

1.1.1 This paper considers taxation measures with the aim of enabling and supporting a continuing and sustained improvement in the productivity of agriculture that will also bear on the rural economy and the wider food sector. Taxation is an important factor as one component of a larger suite of policies to promote improving productivity in this sector of an economy that faces this as a larger issue.

The requirements for greater productivity are seen to be:

- skills
- investment
- confidence
- removing barriers to change and innovation
- removing barriers to markets.

1.1.2 With some review of recent similar endeavours in Ireland (close enough to the UK to be particularly relevant) and observations of some other experience abroad, this package focusses most on measures to support:

- access to land, particularly for those who are trained – the study for the Irish agri-taxation review showed a 12 per cent increase in output (taken at this point as a proxy for productivity (see 2.1.2) from such a move
- new investment in necessary fixed equipment, technology and business development to support the growth of productivity and innovation as well as substituting for labour.

1.1.3 For access to land, this paper is concerned with the occupation and use of land, not directly its ownership although recognising that only landowners can let

farmland. The ownership of rural land in the densely populated and affluent UK is seen to be driven by other factors than the business of farming. While owning farmland give security and can be valuable collateral for a business, a model of purely owner occupied agriculture would not offer the flexibility or entry needed for the challenges we face and would be a distortion of investment not expected of any other sector of commercial life. Thera are good reasons why the last 35 years have seen a steady separation of ownership from farming use.

1.1.4 While there is a range of measures that would be beneficial, many might only offer marginal or incremental easing, not decisive change. This review seeks to focus discussion on those that could effect a significant change in behaviour ("game changing") and open new doors for the sector, although noting other proposals.

1.1.5 Such a taxation review is though only seen as part of a package of legislative and other policy measures, including the reform of support in each UK territory, that, taken together, set a new course.

1.2 Access to Land for Trained Farmers

1.2.1 The reform of agricultural tenancy legislation for England and Wales in 1995 was a "game changing" moment, usefully supported for the private landowners and potentially retiring farmers who are the potential providers of land by the equalisation of the rates of Agricultural Property Relief from Inheritance Tax for different tenures. The aim would be to build on that with these three goals:

- to attract more land into the tenanted sector with its flexibility for farming use
- to move land into the hands of the trained
- to encourage longer lettings

creating the conditions for improving productivity. As will be seen they can come into conflict.

1.2.2 While there are still issues with capital taxation, no changes that have been discussed seem either sufficient to effect the change needed or to do so without perverse consequences.

1.2.3 In the Irish Republic, the recent enhancement of relief from Income Tax for rental income from agricultural land, with the cap graduated by the length of letting, appears to be delivering substantive change. What is currently known is reviewed below and is encouraging. It is noted that this relief had been available at smaller scales from 1985 but the 2015 changes seem to have been at a level that is now changing behaviour. It could be seen as analogous to the Rent-a-Room relief for Income Tax for householders letting lodgings. With allowances for some differences in circumstances (save in Northern Ireland where the position is very close to the Republic), it is proposed that close consideration be given **to rent relief from Income Tax for letting farmland, geared to length of letting.**

1.2.4 We suggest that, with the benefit of the review in this paper of the Irish experience such a relief might be along these lines:

- a relief from Income Tax, not Corporation Tax
- for lettings of agricultural land made in writing
- to tenants who are not connected to the owner
- that are let for at least 5 years
- increasing with the length of the tenancy, perhaps sharply at 10 or 15 years
- for new tenancies, excluding ordinary surrender and regrants of pre-existing tenancies, and successions to secure tenancies

with consideration as to if and how training might be recognised response to the Irish evidence of the benefit of land going to the trained.

1.2.5 Specific levels for the caps for the relief are not proposed though a model with possible levels is discussed. In judging this, the Irish evidence is that the new higher levels are delivering the intended change in the attitudes of current occupying landowners while the previous lower rates were ineffective.

1.2.6 Such a relief can be presented as a positive aid to retirement for farmers in conjunction with the newly introduced Residential Nil Rate Band Amount with its potential in many, but not all, situations as a more secure alternative to Agricultural Property Relief from Inheritance Tax.

1.2.7 Intra-Family Transfer – The form of that proposal does not tackle the important issue of encouraging greater succession within family businesses which merits further discussion and does appear susceptible to intervention by taxation whether by defining the circumstances in which a current owner can have the benefit of tax relief on rent to a following generation, provisions in capital taxation or otherwise.

1.3 Equal Tax Treatment for Unincorporated Businesses

1.3.1 One significant feature of the rural economy, and notably of agriculture, is that businesses are conventionally sole traders or partnerships, rather that companies. As such, the differences between the Corporation Tax regime for companies and the Income Tax/Capital Gains Tax regime for unincorporated businesses pose a substantial problem as they are not neutral between the sectors. We have seen business incentives focussed on incorporated businesses rather than the self-employed, so excluding many rural businesses. These are highlighted by the next sections on encouragement for innovation, diversification and investment. One example is that when capital allowances for both agricultural and industrial buildings were removed under the Finance Act 2008, it was explained that the loss of relief was balanced by the accompanying reduced rates of Corporation Tax. However, sole traders and partnerships simply lost that relief with nothing to balance it. That raised problems for a sector like agriculture with its need to reinvest in buildings. More of the issues are developed in this paper.

1.3.2 Many concerns relevant to this paper would be eased by greater neutrality between Corporation Tax and Income Tax in their approaches to business taxation. We see that some of the concerns in this area have attracted the interest of the Office of Tax Simplification. The simple point is that businesses should not be discriminated against because of their structure so that reliefs designed to encourage the innovation and business development we need should be equally available to the self-employed and companies.

1.4 Encouragement for Investment and Innovation

1.4.1 The measures proposed seek to create a benign environment for businesses to invest, develop, adapt and innovate successfully.

1.4.2 A revised approach to diversified but unified composite businesses would be of great assistance. One model is that offered by the recent Office of Tax Simplification report on simplifying Corporation Tax which seems readily capable of being applied to the Income Tax that is relevant to most farmers and estates.

1.4.3 Two developments to the structure of capital allowances are proposed:

- **Agricultural Buildings Allowances** should be reinstituted with a rate of 5 per cent as buildings are now more akin to machinery and more vulnerable to technical and regulatory obsolescence.
- **a specific capital allowance of £2.5m to be available on a floating basis over a five year period for automation and digital technologies.** The sector faces a major need to embrace automation using new technologies, including the developing opportunities offered by digital, optical and other research, substituting for labour and improving competitiveness. Such a flexible allowance would be available at any point in that period as the need to invest arises and so optimise the effectiveness of this relief as technology develops - for investment in such specified technologies.

Buildings could also be brought within the scope of the Annual Investment Allowance.

1.4.4 **Research and Development relief should be extended to Income Tax.** At present it is only available under Corporation Tax (another example of how tax policy overlooks unincorporated businesses), it is suggested that it be extended to Income Tax for sole traders and partnerships and so available to all classes of business, not just those in corporate form.

1.4.5 Allied to supporting much needed new building, **any new system of CIL/LIT contributions should exempt agricultural buildings,** so removing that counter-productive burden on business development.

1.5 Diversification and Innovation

In seeking to stimulate the necessary exploration of new business and initiatives, three measures are proposed:

- raising the **limitations on sideways loss relief** as new lines of business frequently do not make money when they start, representing a drain on their parent business.
- a review of **treatment of composite interdependent trades**
- giving some relief for the **treatment of the costs of abortive proposals**, as where a project fails to secure planning permission. Where a purchase or project does not come to fruition, there is no tax relief for the costs involved in pursuing it as there is no project for them to capitalised with and they cannot ordinarily be set against the main accounts. At a time when encouragement for innovation and broadening the base of the rural economy is important, it is suggested that an innovation relief or allowance be considered for such abortive costs, perhaps subject, if necessary, to:
    - a cap and/or
    - 50% recognition of relevant costs

  to ease the financial risk for individuals and businesses pursuing new options.

1.6 Risk Management and Resilience

Once outside the EU with the constraints of its State Aid rules, a UK version of the Australian Farm Management Deposit Scheme should be established so that farmers can put aside money tax free when they can and draw it down when they need it, taxed at that time.

1.7 Environmental Policy

1.7.1 Aspects of other proposals already reviewed can also have environmental and other benefits. One example would be buildings allowances where larger buildings may be needed on welfare grounds or improved arrangements for slurry handling can reduce pollution risk or greenhouse gas issues. The adoption of new technology will also assist these larger ends.

1.7.2 While recognising that, beyond these points, this may be a more difficult area for effective intervention by taxation measures, some measures taken in the USA are reviewed briefly, the Green Alliance's concept of Natural Capital Allowances is set out and the potential raised for a form of stock relief on soil improvement.

Summary of Proposals for Discussion:

- **Rent relief from Income Tax for letting farmland, geared to length of letting**
- **Agricultural Buildings Allowances reinstated with a rate of 5 per cent**
- **Introduction of a specific capital allowance of £2.5m to be available on a floating basis over a five year period for automation, digital and other new technologies**
- **Neutrality between Corporation Tax and Income Tax for businesses**
- **Review treatment of composite interdependent trades**
- **Research and Development relief extended to Income Tax**
- **Raise the limitations on sideways loss relief**
- **Give some relief for the treatment of the costs of abortive proposals**
- **An Australian type deposit scheme to manage money between years and so support resilience at farm level**
- **Review tax treatment of environmental expenditure**

SECTION 2 – THE GOAL OF PRODUCTIVITY

2.1 Provisional Identification of the Object of the Policy

2.1.1 Starting Point – The aim is for tax measures to enable and support a substantial and sustained improvement in the productivity of agriculture and in environmental productivity. Between them, they will bear on the rural economy and the wider food sector.

2.1.2 It is an important analytical point that productivity is not understood to be simply yield measured by gross output, but is rather the most efficient use of resources to produce the outputs that the market will buy (Total Factor Productivity). That said, studies tend to show that, within any given situation, the rational maximisation of yield tends to produce figures that are (with all the variations in working with natural systems) similar to the profit maximising yield – costs are not incurred wantonly. However, the changing economic circumstances that may come with Brexit as well as new technologies may more radically change the conscious and unconscious farming judgments in this, making total factor productivity more directly relevant at both national and business levels.

2.1.3 Although there have been modest gains in resource efficiency (illustrating the point that productivity is not just about output), the picture is largely one of general and sustained stagnation in productivity growth in the UK for over two decades. With the prospect of more open international markets, the UK's position as a high cost producer in both absolute and relative terms, perhaps especially in some of the meat-producing sectors, poses a major issue that could drive significant change. The object of policy should be to manage and master that change positively for the long term health of the sector and the rural economy.

2.1.4 While that definition of productivity is not limited to agricultural produce, discussion may also be

interested in non-market outputs, ranging from environmental goods to social and

- some non-agricultural outputs will have their own existing market places
- new approaches such as true Payments for Eco-systems Services may unlock or develop new markets for environmental services
- the example of the Republic of Ireland's *Origin Green* assurance scheme indicates some potential for branding of food and drink linked to sustainability and other values
- not all issues of possible concern to public policy are issues of productivity but may, in their own right, warrant other interventions which are outside this paper's remit. Nonetheless, economic vitality is a key underpinning to achieve these other objectives.

cultural concerns. Initial comments on this area are that:

2.1.5 Economic Dynamism - Concern about productivity also leads to attention to the concept of dynamism, usually looking at the capacity of an economy to change and so support future productivity and competitiveness and also respond to developments, opportunities and challenges, such as those from new technology and a post-Brexit world. Less dynamic economies can be more brittle, leaving them at greater adverse risk from economic change. As a proxy for adaptability, the notion of dynamism encompasses rates of creation of new businesses, improvements in human capital, and flexible labour markets. There is a general sense that it has been reducing in the wider economy and the concept seems useful for discussion of improving productivity in the farming sector and the rural economy. Typical issues raised in considering dynamism are:

- the proportion of businesses that started plus the proportion that closed
- a similar measure for jobs created and ceased
- the growth or reduction in the number of businesses
- employment in new businesses.

While data for agriculture and the structure of the sector may make such measures more difficult to use than elsewhere, these give an indication of the direction associated with creating the opportunities for improved productivity.

2.2 Some Centreline Assumptions

The Brexit process seems likely to produce for farming both:

- a more challenging environment and
- a more commercial environment.

2.2.1 These are seen as separate, albeit related, points. The first point is about market circumstances, whether or not enhanced by changes to tariffs and related controls, and the greater domestic scrutiny as agricultural policy is patriated. The second envisages a greater focus

within the industry and by government on expectations of farming as a business.

2.2.2 The larger pressures as the Brexit process unfolds seem best understood as not posing new issues but rather accelerating the pace of changes that have long been features of the rural economy (though a revised approach to science may see more application of bio-technology).

2.2.3 One way of crystallising that is to pose the question of a business as to whether it both is capable of and willing to be a commodity producer.

2.2.4 Continuing or accepting that role is taken to require a commitment to the continued reduction of unit costs, perhaps the more so with an assumed probability of continued reductions in real commodity prices over time.

2.2.5 The alternatives (other than withdrawal) can perhaps be grouped in two classes (which are not necessarily mutually exclusive for any single business):

First, finding ways to move production out of commodity markets, include:

- segmenting markets, so no longer producing standard undifferentiated enterprises, which could be seen as further reversing the trend of the post-war decades
- moving into niche markets with alternative products
- locking into higher value supply chains
- adding value to produce.

Second, using the business' resources of land, buildings, labour, machinery, skills, collateral and other assets to seek ways to earn a return, perhaps often as a multi-income business.

Both tend to involve new challenges, risk and expenditure. Judgments in considering potential development of these options should reflect a practical pursuit of future business strength, rather than a distraction for an already failing business that might use its resources better.

2.2.6 It is assumed that the outcome of these pressures is likely to see an acceleration of existing and long standing structural changes for farming businesses. That may be enhanced by any substantial erosion of area payments, or simple reductions in the net margin they offer for

land occupation, as these appear to have restrained adaptation.

2.2.7 If those pressures do result in some shift from commodity production, it could be that farming businesses that have expanded to achieve lower unit costs as commodity producers rethink their approach to scale in the context of a different strategy. This might particularly apply to higher value enterprises for which it may be difficult to place the same large volumes of product. Such a business review could again see changes in farm structures.

2.2.8 We are also beginning to see the wider potential of the digital revolution with the advent of:

- precision farming
- the potential for big data
- optical technology
- a new generation of automation.

These are all likely to require new skills and investment to meet what may increasingly be the norms of the competitive market place. While all these areas of development were under way before the Brexit process, it is possible that Brexit may, with a possibly more pragmatic approach to the use of science, pave the way for new uses of biotechnology.

2.2.9 Finally, farming is likely to see more expected of it in terms of land management and environmental delivery, notably issues around soil and water and climate change mitigation.

2.3 Presumed Requirements

2.3.1 It may be helpful to see the potential for productivity improvement in three areas:

- new ways of doing things - technological development enhancing what it is possible to do with associated investment
- getting better at doing things – in part, people being better skilled in their work
  re-organising how things are done – in part, structural change in the businesses involved.

2.3.2 Assuming that output can be produced in forms and at values that the market wishes to buy, the requirements for improving productivity are seen to be:

- skills
- investment
- confidence
- removing barriers to change and innovation
- removing barriers to markets.

2.3.3 Public policy and the volumes of money currently spent through the CAP and other means can be seen to offer the resources to assist a sector with a relatively large number of very small businesses, mostly unincorporated, to respond to these challenges to the benefit of the country and the economy.

2.3.4 In passing, it is noted that the study undertaken by Indecon International Economic Consultants for the Irish Government's 2014 Agri-Taxation

Review found a cost benefit ratio of 1.16:1 for the then Irish structure of agricultural taxation reliefs, after allowing not only for the direct costs but also administration and imputed costs (including the environmental effects of increased production). Indecon further noted that better targeting of reliefs could improve this ratio. Indeed, the resulting Review's prime recommendation was that tax reliefs be aligned with strategic objectives to realise the potential of the sector. In particular, they noted that, in a system that had developed incrementally over time, only a small percentage of resources offered by reliefs was devoted to longer leases of land and new entrants. It was of concern that historic reliefs could now have unintended adverse effects running counter to the objective of encouraging the productive use of agricultural land.

*[**Note** - That can be seen as akin to the Green Alliance's analysis of the balance between CAP payments in England that aid water management goals and those that run counter to them. The real point is a review of the purposes of intervention and the effectiveness of the tools used when judged against those objectives.]*

2.3.5 The Review adopted five key objectives from Indecon's report to it:

- facilitate land mobility and access to agricultural land
- facilitate access by new entrants and support young farmers (listed as one objective)
- improve farm efficiency and facilitate restructuring
- assist the agricultural sector to respond to income volatility and risk
- improve the environmental sustainability of Irish agriculture.

2.4 An Approach to Tax Policy?

2.4.1 Any review of tax policy necessarily confronts the not only the main structures of tax legislation but the complexity of present legislation, arising variously from:

- its historic accumulation
- often ad hoc origins
- responses to special and sometimes rhetorical points
- an overlay of anti-avoidance measures
- the complexity of the real world.

While we might be only too aware of this in UK terms, this paper's partial review of Irish fiscal measures for agriculture equally illustrates the point in the context of another country.

2.4.2 Aside from issues and costs of administration and compliance, that raises questions of effectiveness, as complexity leads to ignorance, confusion and myth. Some measures may also be trivial in their scope or consequences.

2.4.3 It is suggested that measures proposed:

- be judged by their relevance to objectives
- be those with the greatest capacity to deliver those objectives.

2.5 Means to Ends?

***Note** – The key focus on this part of this paper is how taxation may beneficially influence the occupation of farmland to promote productivity. It is not directly concerned with issues of land ownership but with the practical issues of occupation and use by farming businesses.*

Tenancy	Licence	Share Farm
Contract	Conacre	Partnership

2.5.1 Farming is not a simple standard homogenous sector. There are very wide ranges of both technical and financial performance, as well as in resources, objectives and other key points.

2.5.2 It is a sector of small family businesses, often with considerable capital assets but also often yielding relatively little from farming. By the standards of the wider economy, an unusually large share of these businesses is of long standing – surveys suggest that towards 30 per cent have continuity from before 1900 – with much greater continuity within families. While farming has seen times when the farming population changed (as with the substantial Scottish migration south in the 1930s) there has been relatively little movement or entry since the Second World War and corresponding concern about limited entry to the sector. This highlights the tension between the virtues of stability and the virtues of innovation.

2.5.3 The land markets in the United Kingdom see low levels of turnover whether by sale or rent. They are low by historical standards and recently lower still, with area payments rewarding land occupation (rather than activity, management or production) as part of that more recent change. More land may now be available through other forms of business contract, essentially the many variations of contract farming. In that, there is concern to have the assurance to make investments and the need to see entry, progression and innovation.

2.5.4 With the discussion of farm structures and length of tenancies, there does not seem to be an empirically demonstrable link between security of land occupation (once beyond the seasonal agreements) and farming productivity. It is, for example, not obvious that tenancies with security under the 1986 Act offer more productivity than land farmed on a 5 year farm business tenancy. Analysis of this will be confused by the multiple factors at work. Previous studies have suggested some, but not necessarily large, advantage to mixed tenure farmers but that could easily be because better farmers become mixed tenure ones, as growing tenants may buy some additional land as well as rent it, and owners may see rental opportunities to expand. It may also reflect a more progressive temperament.

2.5.5 These observations, of mixed tenure as a badge of progression not a cause of it, point to the potential for new tenancies, also the result of contemporary choices, to be more likely to be held by better farmers.

2.5.6 It is suggested that the key factor on which to focus is **who** is farming rather than the structures used. In that it appears that the critical issue turns on training and education more than age.

2.5.7 Work in the Irish Republic by Indecon for the 2014 Agri-Taxation Review found that:

- a trained farmer had on average a 12 per cent higher output than an untrained one *["Trained" was not defined further in the published papers but later legislation put it at degree level.]*
- farmers over 65 typically had output that was between 4 and 7 per cent lower than farmers under 65
- there was an additional €1.76m of agricultural output for every €1m of retirement relief in agriculture (which requires disposal of assets rather than necessarily retirement).

Those figures will be subject to the usual problems of such assessments. For example, it may be that a younger family member is really doing the management and work on an older relative's farm. Simple issues of physical capacity as much as more dynamic associations between age and farm size may be relevant to this. Nonetheless, they point in the reasonable direction that having land farmed by trained people, who may often be younger, is likely to see better management. The Review's conclusion was direct:

> "The potential for Irish agriculture will in Indecon's judgment only be unlocked if progressive farmers with ambition have access to agricultural land."

2.5.8 Current demographics point to a further issue. So far as the reported age of a farmer indicates the age of the effective person in the business (and at least for one-man businesses without major use of contractors it must usually be), increasing longevity now makes it more likely that a successor on death may already be in their sixties. This is perhaps more material than the often quoted average age which can mask more complex patterns of who may really take decisions, perhaps especially those relevant to productivity.

2.5.9 Purely as an illustrative exercise, with a gross UK output of around £20 billion before subsidies, even an uplift of 4 per cent (allowing for the many trained people in UK farming) would add £800 million. If this were very largely passed through to Total Income from Farming (TIFF) without additional costs, it would be a significant uplift on a figure that, excluding subsidies, has been of the order of £1 to 2 billion. On those very basic assumptions, that is potentially an increase in TIFF (ex-subsidy) of towards 50 per cent. There would, of course, be other dynamic effects as markets respond to changes in prices, opportunities, risks and support after Brexit – for example, any weakening in the financial margin from area payments might tend to see a

reduction in rents, perhaps especially for shorter term agreements.

2.5.10 While the Indecon study is reported in terms of production rather than productivity, it seems intuitively reasonable that that same transfer of farming to trained people would see at least no less an improvement in productivity and quite possibly a greater benefit.

2.5.11 Indecon concluded that

> "the ownership structure and age profile of the Irish agricultural sector is preventing it from realising its potential".

It proposed better targeting with a

> "focus on facilitating land access and enhancing the relative incentives for leasing. There is also a need to redirect tax measures to support active farmers …"

2.5.12 Who Might Now Let Land - and Let It For Longer? – A reviving let sector is necessarily more diverse in its landlords. It is simply not useful to presume that prospective landlords are typically substantial estates with no desire to farm. Estates, thought of as such, do not cover enough of the land area of England, Wales and Northern Ireland or even of farmable Scotland to be the main key to this. There are now not enough of them and their motives are various. Their letting decisions, core to the continuance of the let sector, are often largely made with an established commitment to letting or, alternatively, other arrangements. Many, though, may also have land that could, if it were attractive to them, be let or let for longer.

2.5.13 Smaller ownerships, including those of farmers wishing to retire, are equally part of this universe – or potentially part of it - and are more likely to be key to any expansion of the let sector. Many do now let on FBTs. Others are in personal or economic circumstances where it could be a rational answer for them and the Brexit process may encourage more to consider this. Those who are using FBTs are often letting for shorter terms to retain a sense of control of their land but then allowing the initial tenancy simply to run on under the 1995 Act's provisions allowing that. They are likely to be cautious about letting for longer agreed terms.

2.5.14 A fraction of those already letting could be prompted by changes in the regulatory environment to look at letting for longer terms. The 1995 legislative reform delivering near freedom of contract for England and Wales (already the position in Northern Ireland) means there is little that is "game changing" to be done by law; it is tax which remains for review.

2.5.15 A further group of potential landlords are investors, just as investors see commercial property as a home for investing private capital. They are more likely to be private individuals, as the limited nature of the farmland market and the relatively smaller size of units may limit the ability for larger funds to see opportunity at acceptable cost here rather than in other areas of the world. Where they see a place for rural landownership, whether because of long run views on the potential for food production, development trends or other matters,

tenancies with the flexibility offered by FBTs, or freedom of contract in Northern Ireland, can offer a low cost means of managing that asset without direct exposure to business risk. That is, however, a pragmatic choice to be compared with the other options for managing that land.

2.5.16 It can be argued that they provide a counter-balance in the market to larger existing farming businesses expanding by acquisition. With that role, they can keep more opportunities open for flexibility, entry, progression and change.

Summary Points:

- **The discussion of productivity might not be limited to food, it can also include non-market goods such as environmental benefit.**
- **Brexit is likely to create a more challenging and commercial environment**
- **To increase income many farmers may look to move production out of commodity markets or look to use the business resources to earn returns from non agricultural enterprises.**
- **The requirements for improving productivity are seen to be:**
  - **skills**
  - **investment**
  - **confidence**
  - **removing barriers to change and innovation**
  - **removing barriers to markets.**
- **Focus on who is to do the farming**
- **How can progressive innovative famers have more access to land?**
- **How to encourage private owners and retiring farmers to let land?**

SECTION 3 – EXISTING TAXATION PROPOSALS: TENANCIES AND LAND OCCUPATION

3.1 Introduction

3.1.1 This section summarises the three main packages put forward in recent years proposing measures for changes in taxation to aid the let sector:

- those made by TRIG's last substantive review in 2002/3, since when some of the relevant taxation legislation has substantially changed
- the proposals made by the DEFRA Future of Farming Group in 2013 intended to encourage progression and movement, with entry and exit for the industry overall
- the TFA's proposals designed to encourage more lettings over 10 years and more (this paper then offers initial modelling to help appraise the effects of the main suggested tax change).

3.1.2 As it is landowners who make the decisions about their land might be occupied, the questions here largely revolve around the taxation options for landowners that ensure at least fiscal neutrality between the options, or, as with the TFA's proposals, seek to nudge decisions in a particular direction.

3.1.3 That reality has led to a focus on issues around Agricultural Property Relief (APR) from Inheritance Tax (IHT), often seen as a major driver. The extension of full APR from owner occupied land to give equal treatment to newly let land in conjunction with the introduction of FBTs in 1995 was and is a success. However, that action effectively excludes the options for further extension of APR and so discussion in this context has, as with the Future of Farming proposals and the TFA's proposals, tended to look at ways in which it might be limited to promote potentially positive outcomes.

3.1.4 Perhaps as a consequence of that, there has been less focus on other IHT reliefs, the place of CGT and its reliefs or VAT.

3.1.5 As far as Income Tax, relevant to the great majority of farmers and potential landlords, has been considered to date, it has been to suggest that farm rental income should be treated as trading income (previously Schedule D income) rather than property income (previously Schedule A income). We are still living with the restrictions inherited from the historic schedular system with its differing treatments of incomes in different schedules. These differences have narrowed substantially, now largely concerning liability for national insurance and relevance for pension contributions. As reviewed in later sections, the practical debate in this area has moved on to the restrictions imposed by the distinctions for Income Tax between types of income as well as between trades for diversified businesses with overheads shared between the operations (with some contrast offered by Corporation Tax).

3.1.6 The rising burden of taxes on transactions in property has also been considered, perhaps primarily because it is the one tax that bears on the prospective tenant considering an offer rather than on the landowner choices. Whether Stamp Duty Land Tax (SDLT) for England, Wales and Northern Ireland, Land and Buildings Transactions Tax (LBTT) in Scotland or the prospective Land Transactions Tax (LTT) in Wales, the taxation of tenancies is driven by the rent and the length of letting. That imposes a greater proportionate burden on longer lettings but does not affect non-tenancy options such as business contracts, licences or conacre. Analysis suggests there is relatively little tax revenue at stake but, at least in a thin market, this is not yet seen as a significant factor in actual decisions by prospective occupiers.

3.2 What is the Place of Agricultural Property Relief (APR)?

3.2.1 With that background, it is useful to look afresh at APR as it is possible that APR has a public salience for its critics, its beneficiaries and their advisers that may overstate its actual importance. This argument turns on the practical interaction with Business Property Relief (BPR) which is available across the economy in respect of private ownership of unquoted business so far as they do not mainly consist of investments. This would become more apparent were it not the technical rule that APR is assessed before BPR. If, instead, BPR were taken first with its usually full relief on the market value of qualifying assets, it would be seen that APR's role is now essentially about farmhouses and situations in which let property predominates, rather than the generality of farmland and working farm buildings.

3.2.2 Significantly, APR applies to the "agricultural value" (not market value) of agricultural property which is agricultural land and pasture, farm buildings and farm dwellings that qualify under a range of tests drawn from statue and interpreted by a body of case law. Case law has also considered approaches to agricultural value so that, subject to circumstances, qualifying farmhouses might commonly be relieved on 70 per cent of its value.

3.2.3 Historically, the designers of taxes on death have recognised that the practicalities of agriculture have merited a relief. The basic argument has been that

where the tax is at any significant level it would force family businesses to sell part of the business to pay the tax, so damaging, if not destroying, the business. In part, that reflects agriculture's low yield on its asset values but also, at a deeper level and with a resonance in the argument that led to partial relief and then exemption from business rates, the role of land as agriculture's process plant as well as a capital asset. From its introduction in 1894, Estate Duty offered a relief using a multiple of rental value (effectively a precursor of the concept of agricultural value) with an initial multiplier of 24. Even when Capital Transfer Tax was introduced in 1975 (at a time of volatile and then rising farmland prices) it first adopted a qualified relief and the resulting issues led to Working Farmer Relief in 1977. That was replaced by Agricultural Property Relief in 1981 with its attempt to equalise of the incidence of tax, given the then prevailing substantial difference in values, on owner-occupied land (relieved on 50 per cent of value) and let land (30 per cent). Those rates of relief were increased to 100 per cent and 50 per cent in 1992, accidentally creating a more significant deterrent to letting until full equalisation alongside the FBT reform in 1995.

3.2.4 Private owners of businesses or of interests in businesses (including farms) can claim BPR on their full market value, with the standard rate of relief being 100 per cent since 1992. The business has to have been owned for two years and must not consist wholly or mainly of investments. Points about that have been tested in a series of cases, including ones concerning caravan parks, arrangements over farmland and furnished holiday lettings. As well as the land that (where it is farmland) might be considered for APR, it covers shares in businesses and, where directly owned, the livestock, machinery and other assets of the business.

3.2.5 **Tenanted Farmland** - In simple terms, where in-hand farming is operated together with hands-on diversified business it will all qualify for full relief on the market value of the interest through BPR. Small scale lettings, whether of land for specialist cropping or otherwise as well as cottages or sheds, in the same management could also qualify. However, where the letting activity outweighs the in-hand activity then the entire business fails to qualify for BPR – a precipice at the point where the balance tips from BPR being fully available to it being withdrawn completely. Without APR, that would create a particular problem in considering how to manage another farmer's use of the taxpayer's farmland. However, APR is seen to apply in both circumstances because of the fact of it being taken first.

3.2.6 In this context, APR's true role is to ensure that agriculture does not become a purely owner-occupied sector given flexibility by business contracts but also allows existing private owners to let to farming tenants, with relief on the agricultural value of their land. Further, as most other walks of commercial life rely on investors who let the premises to the businesses using them (saving them the capital cost of purchase), so APR makes this feasible for investors in farmland. They bring capital that would otherwise be drained from the operational businesses, whether directly by funding

land purchase or indirectly by reduced access to a thin land market. The complex market for rural land in the United Kingdom gives no reason to assume that land values would fall significantly without such people.

3.2.7 Thus, one of APR's distinctive roles is in relation to those whose interest, current or potential, in farmland is an investor looking to let and so make the occupation of that land available to others. Such people may not wish to structure themselves as businesses to qualify for BPR.

3.2.8 **Farmhouses** - That leaves the farmhouse which would usually be no more covered by BPR than any other house of a business owner, despite its still common role in farming as working premises, albeit perhaps not now as universally and fundamentally as in the days when farm staff lived in. This depends on the house being the place from which the day to day farming is conducted. Discussion of the Future of Farming proposal for APR to be available until the taxpayer reached 70 showed that, with the alternative of BPR for most other agricultural property, the point of pressure was the qualifying farmhouse. APR offers relief on the agricultural value of that house, an assessment depending on its circumstances but commonly leaving some value that is potentially taxable.

3.2.9 Practical issues here are:

- the extent over the last 35 or more years to which the values of residential property, perhaps especially detached traditional rural properties, have outpaced other farming values so allocating more value in the farm to the dwelling than was the case when houses were once often not seen even as separate assets
- the usual importance of the location of the farmhouse, frequently amid the working farm buildings or central for the perpetual needs of many livestock enterprises
- the difficulty, were the house lost, of finding replacement convenient housing to buy or rent or of securing permission to build it.

That then returns to one of core points made for APR (and now, by extension, BPR) that where paying the tax requires the disposal of part of the business, that may make the business unviable either just by reduced scale or the changed relationship with overheads. Current relationships between land and house values could mean that, without APR, protecting the family home would force a larger disposal of land to pay the equivalent tax.

3.2.10 This analysis indicates that, in practice, the official scale of APR is substantially overstated, although it is of particular importance for its two specific areas of farmhouses and predominantly let land.

3.3 The 2003 TRIG Report: Taxation

3.3.1 A chapter of the 2003 TRIG report considered taxation issues.

3.3.2 The three headline proposals were

1. Define **all land let under 1986 and 1995 Acts to qualify for agricultural property relief** so removing the risk to landlords from tenants diversifying.

This was discussed further and, understanding that the Treasury was seeking evidence that this was a problem, efforts were made to produce evidence from landowners and none was forthcoming. That could be because the issue does not arise in practice or because of a reluctance to draw the tax authorities' attention to personal circumstances.

While outside TRIG's direct remit, it is assumed that any such measure would also apply to the various types of Scottish agricultural tenancy.

However, as there is no specific agricultural tenancy legislation in Northern Ireland a different approach would have to be taken there to ensure equal treatment.

That approach, if taken in its own, would also exclude agricultural land within other forms of tenancy.

2. Introduce **a relief from CGT** deferring tax due on any **gains which are reinvested to enhance the economic value of a unit let** under either Act and used for business purposes. The deferral would broadly be for the life of the tenancy.

There has been no development on this which would require an exception of the classes of assets eligible for roll over relief to allow investment in land not used by the taxpayer's business.

There is then a further problem with the alternative regime for rollover relief available under the shadow of compulsory purchase (as with HS2) which can benefit landlords in that, while it allows reinvestment in let land, it does not assist reinvestment in constructing new buildings.

3. Extend **business asset taper relief (BATR) from CGT** to all land let for business purposes, not just land let to companies.

That change was made but subsequent major changes in CGT saw BATR abolished. This revision was not carried forward in Entrepreneurs' Relief.

3.3.3 SDLT was then a proposed tax replacing Stamp Duty. TRIG's report expressed concern about its expected impact on lettings with their potential to discourage tenants from taking longer, larger and better equipped lettings. It was proposed that all FBTs of more than 10 years term be deemed to be for ten years for SDLT purposes.

3.3.4 There have been no developments on that front.

3.3.5 TRIG subsequently endorsed the proposals by the CAAV and CLA in 2012, intended to be fiscally neutral, for a new approach whereby:

- all FBTs let for more than two years (that is, those FBTs that can continue statutorily) or from year to year would simply be assessed to SDLT at their outset as though they were for a fixed term of seven years (coinciding with the threshold for registration as well as the requirement for notification) with no further liability thereafter.
- the very limited number of new tenancies let under the Agricultural Holdings Act 1986, assumed all to have the legal form of a tenancy from year to year although statute gives longer term security, should be assessed on the same seven year basis at their outset with no liability thereafter.
- the requirement for tenants to notify the Stamp Office of tenancies after seven years would then be abandoned as it would no longer serve a purpose.

3.3.6 Those measures were not taken up by Government but one change did ease a compliance burden by moving the date for settling SDLT on a continuing tenancy to the 30 days after it finally ends rather than on an annual basis. SDLT is further reviewed at 4.6 below.

3.3.7 Other taxation measures proposed by the 2003 TRIG report included:

- a **review of the schedular system of Income Tax** as it applies to farm lettings. With subsequent changes to taxation legislation, this concerns the problems arising from the distinction between the taxation of property income and of trading income.
- a **review of VAT treatment where a farm with dwellings is let** primarily for agricultural purposes. This would be to allow recovery of VAT on landlord's works to dwellings on agricultural tenancies
- a common **two year qualifying period of ownership for owners and landlords for APR.** At present a landlord has to have owned land for seven years prior to death while an owner occupier qualifies after two years. That difference could discourage some owners from letting, and so they continue existing arrangements, good or bad, instead.

3.3.8 VAT and Rent Review Dates - The anomaly shown by *Mason v Boscawen* that a change in the VAT status of the let land or a change in VAT rates where it was opted to tax could re-trigger a rent review cycle was resolved, after TRIG concern, by the Finance Act 2009.

3.4 Future of Farming Report of 2013

3.4.1 The Future of Farming review was convened by DEFRA and reported in 2013

on entry to, progression in and exit from farming. Its report covered a wide range of topics from farming education to housing, and included some proposals on taxation as part of a chapter on legislation. Th relevant extract from the report is set out in full at Appendix 1 to this paper.

3.4.2 Its highlighted taxation recommendations were:

- that the taxation of agriculture should be neutral between business structures.
- to commend to the Government the joint CAAV and Country Land and Business Association (CLA) proposals on SDLT, endorsed by Tenancy Reform Industry Group (TRIG), of August 2012 to the then HMRC review, which were intended to be tax neutral.
- letting property on a farm business tenancy under the Agricultural Tenancies Act 1995 should not disqualify it from Entrepreneurs' Relief.
- after a necessary period of warning, APR should not be available to individuals occupying property qualifying for APR after a stated age (say, 70).

3.4.3 The last point attracted some debate, illustrating that proposals to achieve objectives for change can be contested. That also makes it helpful to summarise the reasoning:

"… the key theme of this report being the need to encourage entry, progression and economic dynamism in the industry, we considered areas where the tax system may discourage older farmers from handing over to the next generation or letting to new or progressing farmers. We are concerned that aspects of the operation of APR may encourage an occupying farmer to retain ownership of the farm until death. While that is always an individual's choice, collectively that can hinder the opportunities for the entry, progression and economic potential we need. We suggest one simple change to the operation of APR to address this so that it operates as a relief for early succession, promoting generational transfer or letting of the land. The legislation should remain otherwise unaltered.

"… [APR] would remain fully available on its present rules for transfers made at or below that age, whether lifetime or on death and for those of any age for land they have let out. This would have the added advantage of providing greater certainty to the farmer, rather than leaving a successor to face the consequences for the business and family of a possible failure of APR to apply at the unforeseen date of a later death."

3.4.4 The report was offering an answer to the perception that the best form of tax planning is to wait for death with the

consequences that can have for the vitality of the sector.

3.4.5 In exploring the Irish Agri-Taxation review proposals considered below, it is understood that the Irish Farmers Association was initially very concerned about the ways in which such a review in current economic circumstances might go. However, it was reassured by assurances that its goal was to support the thrust of the FoodHarvest 2020 strategy and the political will of the two ministers concerned to support the important agri-food sector. While that review resulted in few, if any, adverse proposals, there is a moral in the results of such an experience being part of an intelligible package supporting positive change.

3.5 TFA FBT10+ Tax Proposals

3.5.1 The Proposals - The TFA has made tax proposals part of its larger campaign for the average length of FBTs to rise to 10 years. As set out in its press release of 27th June these are:

> "(a) Restricting the generous, 100% Agricultural Property Relief from Inheritance Tax (currently available to all agricultural landlords, regardless of the length of time for which they let land) only to those landlords prepared to let farmland for 10 years or more (excluding rotationally let land on short terms for vegetable and other high value crops)…"

> "…(b) Clamping down on those land owners who, through schemes promoted by agents and accountants, are using share farming, contract farming, share partnerships and grazing licences as thin veneers of trading activity and as vehicles for aggressive tax avoidance where they take no risk in the business, have little, if any, entrepreneurial input and lack any management control
> (c) Offering landlords prepared to let farm land for 10 years or more the ability to declare their income as if it was trading income for taxation purposes
> (d) Reforming Stamp Duty Land Tax to end the discrimination against longer farm tenancies."

3.5.2 There has since been some discussion of a version of this proposal for APR under which graduated lesser rates might apply for terms below 10 years.

3.5.3 The point the TFA makes is that this would not be not a legal prohibition on lettings under 10 years but an encouragement to owners to do the "right thing", with an exception where there were lettings for seasonal cropping. That raises two lines of question:

- what is the "right thing"?
- how might landowners react?

3.5.4 The "Right Thing"? - The argument put is clearly that terms granted for more than ten years gives an assurance for management and investment and can enable bank lending. However, there are also arguments for the virtues of flexibility requiring a variety of terms for differing types of letting for differing purposes.

Such issues are already revealed by the range of terms agreed for current FBTs according to the level of fixed equipment, size and previous history of the holding. Encouraging a minimum of 10 years may serve to obstruct fledgling business wanting land to start and prove themselves with then opportunities of a flexible letting market. It could seem perverse to suggest that, for example, beef and sheep businesses then fall back on seasonal grass keep or conacre. The demands of adaptation with the possible evolution of farming in the post-Brexit world point to the importance of flexibility, including the ability to give land up. Does such a change ease entry, change and progression?

3.5.5 How Might Landowners React? - In the absence so far of modelling, it could be suggested that outcomes might tend to be:

- institutional and equivalent owners would, as outside the scope of APR, be unaffected directly though it might, indirectly, help frame a climate of opinion alongside their other practical concerns
- private owners who are already letting for terms of 10 years and more are assumed to be supported in that action and so not change. However, experience of such thresholds, perhaps most recently seen with the move in the minimum length of Scottish LDTs from 15 to 10 years, is that there may be a tendency for lease lengths to bunch at the minimum with potential shortening of at least some tenancies that might now be let for longer.
- private owners who are already letting for terms approaching 10 years might on balance take that extra step. Those who already have reasons for not letting that long would judge whether those reasons were outweighed; in some cases they may be but not in others.
- internal family arrangements might also find this a significant change and adopt a 10 year structure.
- other private owners who are already letting but for shorter terms will be harder to persuade and are more likely to look for alternatives to letting rather than taking the step to commit themselves for 10 years or more, though some may. The precedent would be the extent to which owners used lettings of less than two years (Gladstone-Bowers) before 1995 as the overwhelming way to offer land rather than let with life time security (more onerous than the TFA's 10 year minimum term for full APR).
- those who are not already letting but might have reasons to consider it as an option could generally find this an additional reason not to let, but rather to continue farming or find alternatives.

3.5.6 The TFA has also proposed accompanying legislative changes so that early resumption clauses and a Notice to Pay procedure would be newly available to FBTs of 10 years and more. That could be expected to reinforce the attractions of letting for 10 years for those already interested in that move. For those it does not suit, the flexibility of short agreements or alternatives might well remain more attractive on both the practical points.

3.5.7 Those are necessarily general expectations to which there would be individual exceptions but, taken overall, they point to:

- the probability of there being more lettings for terms at least 10 years, though possibly not many for longer than that, but
- the let sector shrinking in size.

The more that there is any climate of political uncertainty about land tenure law and tax, the more it would tend to lead to an adverse outcome, however well-meaning the intentions involved.

3.5.8 So far as the outcome can be assessed, it is then a matter for individual judgment as to the point at which the overall balance of those two probable trends would be seen as positive or negative.

3.5.9 **A First Modelling?** - Figures for England and Wales from the CAAV's Annual Land Occupation Survey 2016 are now used in an initial attempt to offer indicative orders of magnitude for the outcome of these effects.

3.5.10 In doing this, no reason is seen for such a change to lead to any noticeable move of land into the let sector. That mean the analysis is about moves within the current let sector and the potential loss of land from it. These effects could include:

- land let for 10 years and more being re-let for such terms, whether or not influenced by these or other changes
- land let for shorter term being le-let for terms of at least 10 years, to secure the benefit of this and other possible changes
- land let for short term being let for unchanged or perhaps shorter terms, whether because of case-specific reasons or the more general desire to preserver flexibility while still letting
- land currently let not being re-let, in order to protect flexibility, secure the alternative benefits of BPR and avoid perceived uncertainty about the regulation of the let sector and the taxation system.

In this, only private individuals are directly influenced by the way IHT works and that may vary over their live and by circumstances; other owners, such a charities, are unaffected.

3.5.11 Scotland is not considered at this point with the current trajectory for its let sector, its larger uncertainties and issues, though the inability to let there for terms of between 5 and 10 years may make the issue less relevant. Landowners there are already making larger choice over whether to let and, if so, for what length.

3.5.12 A 10 year threshold might be too long to have much traction in Northern Ireland in its current position here the aspiration for longer terms is expressed in term of 5 years.

3.5.13 **What Might Move to 10 Year Terms? -** The first indicative assessment is of the extent to which land might move to 10 years lettings:

- a breakdown of terms by type of ownership has not been given but County Councils and the small number of financial institutions, neither affected by APR, let for average terms of 7 years (Table 6.12).
- along with traditional institutions, private owners let for an average of about four and a quarter years (Table 6.12).

- private owners provide 82 per cent of bare land lettings, 72 per cent of holdings with land buildings and 74 per cent of fully equipped lettings with a dwelling (using figures from Table 6.5). Where letting is a lesser part of their activity, BPR may anyway give them the relief they want but that effect is ignored in this rough analysis.
- while that could suggest that the Survey's overall figures might be used as an approximation for the effect on private owners for whom Inheritance Tax will generally be relevant, the data for Tables 6.9 and 6.10 of the 2016 Survey have been reworked to give figures for just private landowners and these are used in the following points.
- 6.1 per cent of FBTs were already let for more than 10 years (7.8 per cent overall in Table 6.9). Such a change in APR could be expected to confirm those decision but give the landlord no new benefit, though it would be relevant to later decisions.
- 5.1 per cent were let for periods over 7 years and up to 10 years (4.8 per cent overall). This is, perhaps, the segment most likely to be persuaded to let for longer by the tax change where privately owned though some will have had reasons for not rising to a 10 year term. The proposed legislative changes might often also have weight here.
- below that, 4.9 per cent were let for periods above 5 years to 7 years (5.8 per cent overall). The proposed legislative changes might also have some weight here but these are owners whose present choices are further from 10 years, possibly for reasons that would not alter. As well as reasons specific to each case, this might commonly reflect the larger desire to retain flexibility over an important asset.
- 18.7 per cent let for terms of between 3 and 5 years, with 5 per cent of the land
- 14 per cent let for terms of between 2 and 3 years, with 10 per cent of the land
- 51 per cent let for 2 years or less accounting for 29 per cent of land let by private owners.

3.5.14 **Model 1** - Taking that in the round, perhaps 10 per cent of FBT lettings by private owners (so about 8 per cent of all FBT lettings) offer the most likely segment of current lettings to adopt a 10 year term with private owners susceptible to the influence of APR. These are those currently letting for terms of between 5 and 10 years. Looking at that segment of the market:

- as lettings for longer terms than the average tend to be larger holdings, some 19 per cent of the area let in 2016 was let for periods from above 5 years to 10 years (21 per cent overall in Table 6.10).
- if three quarters of that land were persuaded to move to 10 year lettings, perhaps a very strong conversion rate but one that then allows for some movement also from still shorter lettings, that could be 6 per cent of lettings and about 15 per cent of the area currently let in a year on FBTs. Higher conversion rates might not be readily plausible once allowance is made for the range of individual circumstances and some land being lost to other uses;

lower conversion rates are possible.

3.5.15 On the assumption that, as in 1995, the change would only apply to new lettings or was with sufficient forward notice, that movement could, over time, amount to perhaps 3 per cent of the agricultural area of England, essentially within the let sector and predominantly from existing lettings of between 5 and 10 years. On those assumptions, that shift might be expected to occur over some seven or so years from its introduction.

3.5.16 The influence of any change might be particularly strong on land that where an AHA ends, as the data show that not only is there is a strong conversion rate to FBTs (86 per cent in 2016 and no recent year less than 62 per cent) but the average length of terms for the following FBT is longer (10.26 years in 2016, with no recent year showing less than 6 years).

3.5.17 If the change was with immediate effect for all lettings, then there would be an incentive for a spate of activity with the surrender of current FBTs and the termination of tenancies continuing after their expiry with the regrant for holdings that might be switched to 10 year lettings. It is assumed that there would also then need to be a provision deeming lettings under the 1986 and 1991 Acts to be for more than 10 years (one might anyway be needed for successions even were this limited to new lettings).

3.5.18 **What Might be the Opposite Effect?** - Land might though also be lost from the let sector to other arrangements or offered on shortened terms to retain flexibility of control. This outcome is harder to judge and will in part depend on the larger climate and circumstances at the time. The following comments can be offered:

- the segment of the market most vulnerable to a move to shorter terms might be that let for terms between 2 and 7 years, some 37 per cent of lettings by private owners (also 37 per cent overall) and some 47 per cent of land let in 2016 (44 per cent overall; Tables 6.9 and 6.10)
- it might be the lettings for less than 5 years that would be most likely to find other answers – some 82 per cent of lettings by private owners for whom Inheritance Tax and APR is relevant (71 per cent overall) and 64 per cent of the area let by private owners on FBTs (60 per cent overall).
- nonetheless, for a fraction of these may be in situations where either IHT is not seen as immediately relevant or where, on advice, BPR anyway offers an answer. These would have no reason to change their policy until those judgments changed.
- it would take the diversion of under a quarter of those lettings below 5 years into other arrangements or in-hand farming to move as much land – 15 per cent of the area let on FBTs in 2016 - out of letting as may make the step up within the let sector to 10 year terms.

If that were the outcome, that withdrawal from letting would arguably be a more fundamental move for the structure of agriculture than a lengthening of some tenancies, albeit affecting equivalent areas of land though involving more lettings (18 per cent rather than 6 per cent).

3.5.19 With the shorter length of these tenancies and the ability to terminate tenancies continuing after expiry, this loss of land from the formal let sector seems likely to become apparent more quickly than the move to 10 year lettings.

3.5.20 Alternative Outcomes – Having offered a framework for analysis with a structure of argument as to who might be encouraged by such a change to let for more than 10 years, who might still choose to let for shorter terms and who might withdraw from letting, this can be used to develop alternative analyses.

3.5.21 In this, it is stressed that the assumption above that three quarter of the land currently let for between 5 and 10 years could move to term of 10 year and more is already a strong one.

3.5.22 **Model 2** - A stronger assumption still would be more than half of all lettings (say 60 per cent) between 2 and 7 years to convert to 10 years lettings and so at least 80 per cent of those over 7 years do the same. Those assumptions, assuming a strong response to policy changes, would result in:

- a move of 4 per cent of all owners with 6.4 per cent of land from lettings of over 7 years to lettings of 10 years and more
- a move of 22.2 per cent of owners with 28.2 per cent of land form letting of between 2 and 7 years to 10 years and more.

In combination that would see some 26 per cent of lettings and 35 per cent of land move to the longer term, a large shift.

3.5.23 However, that seems likely to be accompanied by a polarisation of choices with others deterred by this option which could be seen as either attractive or repellent. Perhaps half of the remainder and also those letting for shorter terms, whose desire for flexibility is only balanced by specific circumstances and patterns of seasonal letting, might withdraw from lettings. That would see some 33 per cent of owners and 25 per cent of land leave the let sector.

3.5.24 **Model 3** - More moderate assumptions, reflecting the desire by private owners for flexibility and their caution about public policy, could see a move to 10 years by:

- 40 per cent of those letting for more than 7 years, noting that they have already chosen not to let for that longer period.
- 20 per cent of those between 5 and 7 years
- 10 per cent of those between 2 and 5 years.

In combination, that might see 6 per cent of owners and 9 per cent of land move to 10 year lettings.

3.5.25 Counterbalancing that would be two moves:

- longer lettings, such as those for 7 years, moving to shorter terms
- a fraction of all lettings moving away from letting altogether.

That could particularly see a larger loss of that land currently let for between 5 and 10 years than under the previous model's assumptions.

3.5.26 Summary – The three models sketched here for discussion all show some land moving within the let sector to 10 year terms:

- Model 1 sees 6 per cent of lettings with 15 per cent of land do this
- Model 2 could see 6 per cent of letting and 35 per cent of land do this

- Model 3 see 6 per cent of owners and 9 per cent of land do this.

3.5.27 Each model though also sees movement to shorter terms and out of the let sector by other owners. This is easiest to assess with Model 2 which would see 33 per cent of owners and 25 per cent of land leave the let sector while longer lettings that do not move to 10 years might shorten significantly.

3.5.28 The larger issue for productivity is the balance between:

- the gains thought to arise from encouraging a fraction of lettings to move to longer terms
- the loss of flexibility and opportunities for entry and expansion by the loss of land from lettings and the shortening of other terms.

A further tension in that is that the gains in security seem likely to accrue mostly to existing farmers than to facilitate change.

3.5.29 Review - The analysis above suggests that the key to judging the probable outcome lies in judging the motives and reactions of those private individuals who currently let for terms of between 2 and 7 years, accounting for almost half the agricultural land let in 2016.

3.5.30 The proponents of the FBT 10+ package would argue that the place of APR in the minds of private owners and their advisers is such that it would overcome other concerns, reinforced by any other changes made to support longer lettings. It does not though seem to be suggested that such a restriction of APR would encourage anyone not currently letting to let.

3.5.31 There will always be some loss of land already let for 10 years as circumstances change or land goes for development and other uses. There is also, as illustrated by Scotland, the risk that a climate of policy uncertainty could deter such lettings from being repeated but, at this stage, that is discounted in this analysis. However, the point still stands that, if no new land is coming into the sector, it will shrink by failing to replace natural losses.

3.5.32 APR is the relief that supports the investment activity by private individuals that can aid entry and progression, rather than farmer diverting capital into expansion by acquisition. The FBT 10+ proposal would see unlet land have the same APR status as land let for 10 years but a better status than land let for terms such as 2, 3 or 5 years. It would also, subject to circumstances, have access to BPR. If the let sector is not refreshed by new land, the natural losses to sale, development, afforestation and other uses will inevitably see its size fall.

3.5.33 More generally, discussion suggests that, for many private owners, the retention of flexibility of control over their land is fundamental, even if it is a flexibility that may never be used. Larger ownerships, estates and institutions can more easily take a longer, larger view but smaller scale ownerships can be the more concerned about locking themselves into an inflexible position with the risk of exposure to policy changes. They accordingly tend to prefer a succession of shorter lettings or allowing a shorter letting to run on from year to year.

3.5.34 The outcome turns on judging the overall balance between those two motives: flexibility or access to one of the

available Inheritance Tax reliefs. As this proposal is not intended to be about increasing the size of the let sector but about altering its structure, the question can be expressed as asking what proportion of land or lettings lost to the sector would be seen to balance the gain said to be given by other lettings moving to longer terms?

3.5.35 The conversations to date with members suggests that the instincts of private owners would tend to be more driven by the desire to retain flexibility so that, at most, only a small fraction of that land would convert to 10 year lettings, so more like Model 3 and placing the emphasis on the probable overall risks to the let sector. That choice may vary with the age of the owner.

3.5.36 If the result is a significant loss of land, the examples of both the situation before 1995 and, more recently, in Scotland illustrate the cumulative effect where such losses are sustained year on year, leaving a smaller let sector on longer terms, generally from institutions and estates with a policy of letting, rather than other private owners. Economic change and new opportunities might then be more focussed outside the formal let sector.

3.5.37 In conclusion, such a change to APR, while potentially assisting some within the core of the let sector, does not seem to assist the answers needed for farming to respond to the challenges foreseen

3.5.38 **SDLT** - It might also be worth noting the SDLT that the incoming tenant would pay on the initial grant of a 10 year lease – assuming at this point no change. SDLT would be due if the rent capitalised over the term at the statutory rate of 3.5 per cent exceeded £150,000. For a 10 year term, SDLT would be due where the rent exceeded £18,100 per annum. For a cereals FBT with a rent of, say, £150 an acre it would be due on the initial grant of a lease of 121 acres. Higher rents would see SDLT due on lower acreages and vice versa. It would be due at a rent of 1 per cent of the excess of capitalised sum over £150,000.

3.5.39 These figures illustrate the position, using the same £150/acre for leases of 10 and 20 years:

Area (Acres)	Rent Due (£)	10 years SDLT due (£)	20 Years SDLT due (£)
121	18,150	9	1,079
200	30,000	994	2,763
500	75,000	4,737	9,159
1,000	150,000	10,974	19,818

3.5.40 It is unlikely that the 2 per cent rate of SDLT on the excess of capitalised values over £5 million would apply save perhaps were significantly longer terms granted. For a 10 year term at rent of £150/acre, it would only be triggered by a lease of 4,033 acres for which the SDLT due would be £49,130 but that for a 20 year lease would be £120,470.

Summary Points:

- **Agricultural Property Relief (APR) and Business Property Relief (BPR, open to all privately owned businesses) from Inheritance Tax interact closely, BPR focussing on in-hand farmland and other business assets**
- **The basic argument for both APR and BPR is to prevent family businesses having to sell part of the business to pay the tax, so damaging, if not destroying, the business.**
- **APR is important for genuine farmhouses and owners of tenanted land**
- **APR's cost is substantially overstated. BPR would relieve many farming assets but not help the tenanted sector.**
- **Retaining flexibility of control over their land is fundamental to private landlords, even if it may never be used.**
- **Restricting APR is likely to see land lost from tenancies with few owners moving to longer terms**
- **It is more important for the Brexit challenge to keep flexibility and encourage lettings than to focus on longer terms**

SECTION 4 – ENCOURAGEMENT TO LET LAND: LESSONS FOR THE UK FROM THE IRISH AGRI-TAXATION REVIEW

4.1 General

4.1.1 The weight of this paper now shifts to consider in some detail the analysis, recommendations, measures and outcomes of a focus in the Irish Republic since 2014 on the land occupation changes seen as needed to support its agricultural growth strategy. The aim for land occupation is to achieve tenancies of at least 5 years, and potentially 15, in place of near universal seasonal lets (conacre, also dominant in Northern Ireland) and to effect the transfer of the occupation of much land to trained younger farmers, being tackled separately for arms length agreements and internal family change.

4.1.2 Measures in Holland, France, Australia and New Zealand are also touched on, with notes then offered on their potential application in a UK context.

4.1.3 This paper draws heavily but not exclusively on the recent review work and measures in the Republic of Ireland on the role of taxation in improving productivity. Both the Republic and Northern Ireland have done extensive work on positive agricultural policies (Northern Ireland's Agri-Food Strategy; the Republic's Food Harvest 2020, FoodWise 2025) which could be regarded as industrial strategies, albeit limited by the constraints of the CAP and EU rules. Brexit allows those limits to be lifted for the UK.

4.1.4 The Republic very specifically undertook a major review of taxation and agriculture with a view to improving productivity. This comprised a substantial report by consultants, Indecon, to an Agri-Taxation Review Group formed by the Departments of Agriculture and Finance which reported in 2014 with many measures then adopted in the 2015 Budget (issued in October 2014), including enhanced Income Tax reliefs for letting farmland for terms of more than 5 years, and more in the 2016 Budget (of October 2015).

4.1.5 While the closeness of Irish circumstances to those in the UK makes this work and its outcomes of particular interest, it is worth noting some points of difference:

- the relatively small size of many Irish farms, with 42 per cent less than 20 ha (this may in part be for the same factors that distort the UK's statistics based on holding numbers)
- the absence (at least until very recently) of any significant tenanted sector, with land having been let on seasonal arrangements (conacre – in almost all cases effectively akin to grass keep). For more detail on conacre see the CAAV publication, *Tenancies, Conacre and Licences: Arrangements for Occupying Agricultural Land in Northern Ireland* (2015).
- thus, part of the character of the interest in "long term leasing" is to enable land to move from seasonal lets to lets of 5 to 15 years, as well as drawing new land into the sector.

4.1.6 With those points in mind, it is useful that the Republic of Ireland then went ahead with a range of fiscal measures, mainly from January 2015, whose effects can now begin to be judged.

4.1.7 While that package can be seen to include a miscellany of minor and sometimes complex measures that may be of little particular significance, it also contains more major measures worth more consideration as there is a sense that positive change is now underway after them.

4.2 Farm Land and Business Arrangements in Ireland

4.2.1 The Irish experience is useful as a common law country (with much basic law from before independence) with a generally comparable taxation system within the EU. Practical comparisons are easier than with the situations in continental countries.

4.2.2 The Republic also has a very limited land market with less than 12,500 ha of land (in 670 lots) actually sold in 2013 (Irish Farmer Journal, *Agricultural Land Price Report 2013*). As a typical figure, indeed now recovered to pre-recession levels, that sees less than 0.5% of the land area move by sale in a year; in simple terms, it would take over two centuries for the land market to turn over.

4.2.3 With a pattern of strong attachment to their land, retired farmers retain their land but, following the dismantling of the tenancy system over a hundred years ago, it has only been let on a seasonal basis so missing the tenancy structures of Great Britain. 42 per cent of Irish farmers lease in land from other owners but do so only on a seasonal basis that is increasingly felt to inhibit improved land management, making longer term leasing a key goal for Irish policy.

4.2.4 As well as now promoting tenancies, Ireland has sought to promote collaborative farming models:

- Milk Production Partnerships (MPPs), as a formal farm partnership framework under agricultural legislation, introduced in 2002. In 2014, there were 700 of these registered. CGT Retirement Relief has been adapted to suit this structure.
- wider registration of farm partnerships was being considered in 2014 to assist non-milk producers in partnerships participate in schemes and access to measures such as 50 per cent stock relief, currently limited to MPPs.
- other models, including share farming, are being promoted through grant aid schemes, advisory services and the Land Mobility programme.

4.3 Family Transfer Partnerships

4.3.1 Indecon recommended consideration of Phased Transfer Agreements to bring generational change forward with the use of leases and progressive transfer of assets over the period of the lease, allowing the older generation to have tax relief on the rent (not otherwise possible for connected parties). Family Transfer Partnerships to aid succession were brought forward in the 2016 Irish Budget (though subject to EU State Aid approval).

4.3.2 The adopted model sees family members enter a partnership with a profit sharing agreement and provision for the

farm to be transferred to the younger farmer at the end of the period (not more than 10 years). A tax credit of up to €5,000 pa for 5 years can be allocated to the partnership with the intention of encouraging it and mitigating some of the costs. The aim is gradual transfer of control and knowledge at an expected cost of €10m pa.

4.3.3 The Irish Department of Agriculture has now secured EU State Aid approval and so finally opened this from June 2017 as the Succession Farm Partnership initiative to encourage the increased transfer of farmland to younger farmers. The scheme requires the farmland to be transferred to the identified successor within 3 to 10 years of registering with the Department of Agriculture for the tax credit. That transfer must be of at least 80 per cent of the farm assets covered by the agreement. The tax credit available for five years or until the successor is 40, is split each year between the parties following the profit sharing ratio of the partnership between the Farmer and the Successor. As the Successor must have at least a 20 per cent share in the partnership, the outgoing farmer's tax credit cannot be more than €4,000 and so a saving of €800 to €1600 per annum where there is tax to pay. If it proves that the assets are not transferred the tax credit will be clawed back.

4.3.4 If forming a partnership to do this, that gives access to a Collaborative Farming Grant.

4.3.5 The basic rules to qualify for the tax credit are:

- a valid application to be placed on the register of succession farm partnerships maintained by the Department of Agriculture, Food and the Marine.
- at least one partner in the Succession Farm Partnership must be a natural person who has farmed at least 3 hectares in their own right for the two previous years - the "Farmer".
- the other partner(s) must be a young trained Farmer, also a natural person, taking at least 20 per cent of the partnership profits – the "Successor". That implies that the Successor's Income Tax credit would be at least €1,000 and so a tax saving of some €200 to €400 per annum where there is tax to pay. The income tax credit cannot be claimed in the calendar year where the Successor reaches 40 years of age.
- the My Farm My Plan Booklet must be completed for the partnership setting out a five year business plan.
- a legally binding agreement, distinct from the farm partnership agreement, must be signed by the "Farmer" and "Successor" who are partners in the same registered farm partnership. The succession agreement must specify the year of transfer and outline the assets to be transferred. The year of transfer must be within 3 to 10 years of registering with DAFM and at least 80 per cent of the farm assets outlined in the agreement must be transferred.

4.3.6 The required training for the successor is set out in Regulation 273/2017 made under s.667D of the Taxes Consolidation Act. That identifies a series of qualifications starting with the Irish

further education Level 6 (generally advanced certificates in range of specified relevant subjects and at HNC/foundation degree level), and specified first degrees, higher certificates and diplomas.

4.3.7 Where the farmland transferred is mortgaged, the successor is then to be liable for the mortgage. That may require all to review the current mortgage with understanding of exiting liabilities of both parties, any need for guarantees and perhaps see the lender look to have a new mortgage agreement.

4.3.8 That also highlights the need for clarity about title to the land and to resolve situations where the farm has multiple owners or, indeed, where there might be more than one Successor. Access to the tax credit ceases when the oldest successor reaches 40. Thus, where the succession is to be from parent to child, the parent might, dependent on the generation gap, typically be less than 70 when entering into such an agreement. Provision, typically by a will, should also be made where death dissolves the partnership during the life of the succession agreement.

4.3.9 It seems reasonable to question whether the tax credits now offered (essentially up to a maximum of €1,600 a year for up to 5 years to the previous farmer) would be sufficient stimulus to drive the early succession of owner occupied units that is wanted, given all the historic biases and inertia against such a move. As it has only just been introduced that cannot be known for some time with the early measure being the number of registered agreements.

4.3.10 There is also a relief in Ireland from Capital Gains Tax to assist a child building a home on the farm. The site must be transferred from parent to child and for the purpose of the child building a principle private residence on that land. It is then possible to transfer the new house into the names of child and spouse. (As a parallel, it may be noted that there is a development control equivalent in Wales in the form of TAN6 to assist planning permission for a new dwelling to aid generational change on the farm, though the impression is that it has been little used.)

4.3.11 With the main scheme only launched in June, it will be some time before the usefulness of these measures can be judged.

4.4 Income Tax Relief on Rent

4.4.1 Introduction for the UK

4.4.1.1 This is a new area for discussion in the UK (initially in Northern Ireland and now raised in TRIG) that appears to have been greatly enhanced recently with success by the Republic of Ireland, as the centre piece of a package of measures. The UK parallel would be the Rent-a Room relief, encouraging householders to offer lodgings and so making better use of housing stock (this is now to be refined to exclude “Airbnb” lettings and support longer lodgings). The more recent £1,000 general allowance for property income is available for farmland rents as much as any other rents (and so perhaps commonly relieves the rent from, say, 6 to 10 acres).

4.4.1.2 To date, the UK experience has been that owners of farmland are

sensitive to capital tax measures – hence the importance of fiscal neutrality for Inheritance Tax between land farmed in hand and land let and also the then value of securing recognition that land let for a business use should qualify for the former Business Assets Taper Relief from CGT.

4.4.1.3 With the UK's interest being in encouraging current and future decisions about letting:

- current rates mean that little more positive relief can be given under Inheritance Tax
- we await the full impact of the new Residence Nil Rate Band Amount for Inheritance tax as a potential alternative to APR on putative farm houses and so allowing land to be let. The present scheme will be in full force from April 2020 and perhaps of most significance for smaller units in lower house price areas.
- CGT now appears of lesser relevance to these decisions though it does not help that Entrepreneurs' Relief no longer recognises land let for business use and has a lower threshold for investment activity (20 per cent) than BPR's 50 per cent.

4.4.1.4 If the major source of new lettings offering improvements in productivity is potentially from retiring farmers (of any age), then Income Tax reliefs may indeed have a role. The Irish Agri-Taxation Review considered both reliefs on agricultural rents for Income Tax and exclusion of such rents from assessment for some state benefits (see below).

4.4.2 The Irish Background

4.4.2.1 With a view to encouraging longer leases than seasonal lets, the Republic of Ireland initially introduced a relief from Income Tax in 1985 on up to £2,000 of rent. That was progressively developed so that by 2014 it was available where farmland was let by a taxpayer over 40 (the lessor, not the tenant) for more than 5 years (but not to a connected party or a company) with relief increasing with the length of the lease. This structure exempted rental income from Income Tax:

- on 5 to 7 year leases on up to €12,000 pa
- on 7 to 10 year leases on up to €15,000 pa
- over 10 years on up to €20,000 pa

However, the uptake had been low by 2014 (a tax cost of some €5m) and it is anecdotally understood that lease lengths appeared driven by the thresholds.

4.4.2.2 The relief (applying under s.664 of the Taxes Consolidation Act 1997 as amended) is on the arm's length letting by written agreement of "farmland", defined to mean:

> "land in the State wholly or mainly occupied for the purposes of husbandry and includes a building (other than a building or part of a building used as a dwelling) situated on the land and used for the purposes of farming that land;".

4.4.3 The 2015 Measures

4.4.3.1 The 2014 Review saw the benefits of greater long term leasing as including:

- a route to retirement for older farmers, aiding generational renewal
- facilitating access to and for young farmers
- encouraging new entrants
- enhancing the certainty required to encourage tenants to invest and improve land with access to credit
- encourage progressive and competitive farmers to increase their farm holdings

4.4.3.2 Accordingly, Indecon recommended that the reliefs be doubled as a signal of the importance attached to long term leasing. In part, this illustrates the concern at so much land being leased only on a seasonal basis as well as a concern to move more land into the let sector.

4.4.3.3 Other recommendations, relevant to the design of any similar relief, included:

- with submissions by banks that loans typically run for 15 year terms and so best suited by at least a matching length of lease, a higher tier of relief for leases over 15 years be enacted
- not changing the minimum length of 5 years qualifying for relief.
- extend the relief to apply to rent from leases to companies (with anti-avoidance measures to preclude letting to family controlled companies)
- removing the minimum age of 40 for Income Tax relief as serving no purpose.

4.4.3.4 The structure finally proposed by the Review Group's report was to increase the reliefs by 50 per cent so that they would be

- on 5 to 7 year leases on up to €18,000 pa
- on 7 to 10 year leases on up to €22,500 pa
- on 10 to 15 years on up to €30,000 pa
- with a new category for leases over 15 years with relief of up to €40,000 pa on rent, intended to align with periods for farm credit.

Those recommendations were then implemented under the October 2014 Budget with effect for all new lettings form 1st January 2015. The rates of relief for previous lettings were left unchanged.

4.4.3.5 Indecon's other proposals were also recommended.

It is understood from conversations that the key factor in Indecon's analysis was the 12 per cent improvement on moving land into the hands of "trained people".

4.4.3.6 That combined with the politically supportive will of the then Finance and Agriculture ministers led to the uprating of the reliefs to the point where they appear to have traction in the market place.

4.4.3.7 Irish Income Tax rates are 20 per cent of the first €33,800 per person and thereafter at 40 per cent, and so with marginal rates like those in the UK, though the Irish higher rate has a lower threshold. The 2015 Budget increased the exemption from tax under the Irish Rent-a-Room scheme to €12,000 of income and which was increased further to €14,000 for 2017.

4.4.4 The Outcome

4.4.4.1 Irish Revenue data suggest that the preceding rates of relief had a growing take-up that then accelerated in 2015 with the new measures:

Year	Cost	Number	Average Relief
2009	€4.4m	2,960	€1,486
2010	€5.0m	3,230	€1,548
2011	€6.3m	3,590	€1,755
2012	€7.3m	3,980	€1,834
2013	€7.3m	4,370	€1,670
2014	€9.2m	5,130	€1,793
2015	€13.9m	6,830	€2,035

The 2015 data was issued in August 2017, necessarily delayed by the lags in receiving and processing Income Tax returns.

4.4.4.2 Initial Analysis - Those initial figures for 2015 with a 51 per cent increase in the value of the relief indicate a 33 per cent increase in the number of taxpayers claiming the relief, to twice the number claiming in 2011. The total number of people identified as farmers for Irish tax purposes is around 130,000 but as this includes many spouses and others involved in the business, it is hard to know its use as a means to judge these figures.

4.4.4.3 The average value of the relief rose by 13 per cent, much less than the increase in the ceilings on the reliefs, perhaps indicating that the changes for 2015 have succeeded in attracting more farmland owners to be landlords rather than simply giving more relief to the same people. While there is no particular reason to think that there has been more interest in lettings for the longer terms that would unlock higher levels of relief, the figures do not allow a view on whether the higher average payment results from:

- larger units now being attracted into the system
- land that was already being let with some acres qualifying for relief seeing more of those acres qualify within higher ceilings from 2015.

However, the considerable increase in claimants suggest that this appears to be rewarding new decisions as well as confirming old ones. On that basis, it seems reasonable to suppose that area newly drawn into letting has increased by half.

4.4.4.4 As an attempt, ahead of further information, to put some order of magnitude on these figures:

- if it is assumed that the relief is typically at the Irish basic tax of 20 per cent
- the value of rents relieved was €69.5 million
- moderating the average rents suggested by remarks below €160/acre to allow for the typical

spread of actual rents and potentially lower figures in the Republic's areas of Munster and Connaught/Ulster

- gives a very rough estimate of the area of farmland let on terms of at least 5 years and giving rise to the relief of 435,000 acres in 2015 up from a figure for 2014 on the same assumptions of 287,500 acres.

Those figures should not be treated as anything other than a speculative illustration, though the relationship between the figures for the two years is likely to be broadly accurate.

4.4.4.5 With a total agricultural area in the Republic of some 11.1 million acres (excluding common land), the area of land let on a term of at least 5 years and benefitting from the tax relief would by the end of 2015 be about 4 per cent of the available agricultural land area, possibly having been half of that in 2011. While that may look a small fraction, it is the creation of previously non-existent sector rested by traditional practice. No figure is to hand for the area of seasonal conacre agreements in the Republic but in Northern Ireland it is put at almost 30 per cent. Comments reported below indicate that, while some let land is coming from conacre, some is moving directly from in-hand farming where the owner is withdrawing from using the land in question but retaining ownership.

4.4.4.6 The average size of reported holdings in the last 2010 census was 81 acres. Multiplying that by the number of claimants produces a figure of 553,230 acres. That suggests either that, despite comments below, €160/acre overstates the average rent or perhaps, as may be at least as likely, it is typically smaller units that are being let. The rough estimate of 437,500 acres would yield an average let area of 64 acres pointing to restructuring either by established farmers taking more land or new entrants taking land.

4.4.4.7 Overall, it would appear that the 2015 Budget has had an immediate impact in increasing the number of landlords of tenancies for 5 years and more by a third, which is itself significant as such land management decisions commonly take some time to make and work through. That point could suggest further growth in 2016. Some of this effect will not only come from the level of relief or simple design of the scheme but also the sense of political approval for letting so that it is taken as a stable part of the taxation framework.

4.4.4.8 Available Commentary

While the larger Irish discussion and the overall package could be seen to encourage a change of mood promoting lettings, there is general agreement that the improved Income Tax reliefs have achieved a substantial change.

For example, there is anecdotal evidence of one farmer who had 3,000 acres of land from several landowners on conacre agreements, all of which have shifted to tenancies. In reviewing the commentary below, "long term" means at least 5 years

4.4.4.9 The *Annual Review and Outlook for Agriculture Fisheries and the Marine 2015-2016* gave an early report:

"There has been anecdotal evidence of an increase in long term leasing but there is no official data as there is a significant time lag for Revenue information in this regard. In order to gauge the effectiveness of the rent changes, the Department carried out its own survey in 2015. This indicated that a significant behavioural shift from renting on a conacre basis to longer term leasing has occurred.

- 27% of respondents commencing a new long term lease in 2015
- Almost two thirds of these indicating that it was the first time they had entered a long term lease."

NB – The immediate source of data here is the Irish Revenue, as cited above. It does not appear that Ireland has published an agricultural census since 2010.

4.4.4.10 The Irish Farmers Association's Chief Economist has advised that:

"Our own evidence is the number of farmer queries we have received seeking advice on long term leasing, which has increased significantly."

4.4.4.11 The Irish Professional Auctioneers and Valuers (IPAV) has commented in its Agriculture Review 2017:

"The young farmer of today takes a more commercial view of farming, with little or no emotion involved. Excel sheets, projections and yields are of more immediate concern than the ownership of lands. An interesting development has been the move towards the long-term leasing of land, allowing available capital to be invested into the operation. This is in tandem with the ever evolving agri-tech sector, which is delivering new and innovative tools, thus improving the overall efficiency of the typical farm.

"Today, leases by and large last for a term of 5-15 years, which provides security of tenure for farmers. It is also proving attractive to landowners as they can secure a tax-free income. Average prices achieved currently for long leases are in the €250 per acre range, with some achieving up to €300. Prices achieved are location-dependent, with quality of land being a key determinant."

4.4.4.12 In discussion with IPAV, it was suggested that a figure of €200/acre was more typical with BPS then split between landlord and tenant and the larger observation:

"This is a chance for your farmers to get into farming and for ones that are in to increase their acreage with no serious capital investment."

4.4.4.13 Comments in the Review from IPAV members included:

"… young farmers entering the sector take a much more commercial view of the business and are less emotive. Therefore ownership of land is not the priority." (Co Westmeath, Leinster)

"The supply of lands coming for sale is down as a result of landowners agreeing long leases

with farmers. Priced achieved are up to €320 per acre " (Co Cork, Munster)

"There has been a big fall-off in the amount of land coming to the market. Many landowners are opting for long-term leasing, thus availing of tax breaks." In his region, prices are holding or maybe slightly ahead of 2016 figures. Young farmers are opting for long-term leasing rather than buying, using capital to develop facilities and increase stock numbers." (Co. Limerick, Munster)

"The popularity of long-term leases is significant." (Co Galway, Connaught)

4.4.4.14 This has been further reported on in the Teagasc/SCSI *Land Market Review and Outlook 2017.* Rather than reporting on actual transactions, it reports on SCSI members' opinions of the market place in a way that allows some measure of sentiment and comparison. The Department's view was affirmed but now with some more detail:

"The majority (64%) of chartered surveyors reported that the tax relief for long term leasing of land introduced in Budget 2015 impacted (either moderately or significantly) on the volume of transactions. Respondents in Leinster (excl. Dublin) reported the highest level of impact (72%) of all regions, while over a quarter (26%) of respondents in Connaught/Ulster reported little or no impact."

"Most SCSI members continue to be of the view that the measures introduced in Budget 2015 have led to an increase in long term leasing. In Leinster [the eastern province], it appears that the increase in long term leasing activity is associated with a decline in the land rented under the conacre system (i.e. short lets of less than 12 months). In Leinster, 38% of survey respondents reported a decline in the area allocated to conacre, while 66% of survey respondents, in the same region, reported an increase in the demand for long term leases.

"The rise in long term leasing is also evident in the other two regions but is not concurrent with large declines in the conacre area. In Munster [southwest], 52% of survey respondents reported an increase in the demand for long term leasing while 58% of survey respondents in Connaught/Ulster reported the same trend. However, only 19% of respondents in Munster and just 16% of respondents in Connaught/Ulster reported the same pattern.

"The overall finding in relation to the land market suggests that rise in long term leasing is leading to a tightening in the land rental market in Leinster as land is transferred from conacre to long-term leasing. In Munster and Connaught/Ulster, this pattern is less apparent. In both of these

regions, there has been little change in the price for the majority of rented land and the rise in long term leasing does not appear, as of yet, to be driving a decline in the conacre area."

4.4.4.15 Reviewing those remarks that appears to suggest that:

- in Leinster, with a larger area of better land, longer leasing has both replaced some conacre and brought new land in the market. In particular, it could appear that the dairy sector is driving demand for the more suitable land in the east and south of Ireland.
- in Munster and Connaught/Ulster it has had less effect on conacre but has brought some new land into the let sector.

4.4.4.16 Even so, the conacre market appeared to remain robust:

> "Nationally 56% of chartered surveyors report no change in land let under conacre in 2016, a result which is almost identical to that reported in 2015. However, there was a marked decrease (8%) in the proportion of respondents reporting an increase in the in the area let on conacre over the same period."

4.4.4.17 Looking ahead, the report comments:

> "With regard to the land rental market, the data shows that 26% of survey respondents have expectations of an increase in the volume of agricultural farmland for leasing. 51% expect no change and 13% expect that the volume of agricultural farmland for leasing will decline in 2017."

4.4.4.18 Again, that varies between regions:

> "In relation to the land rental market, the expectations for 2017 vary between regions. Relative to respondents in the other two regions, the survey respondents in the Leinster region expressed greater optimism regarding the volume of land leasing agreements in 2017. For instance, 34% of survey respondents in Leinster expect an increase in the volume of leasing. This compares to only 19% of respondents in Munster and 26% in Connaught/Ulster."

4.4.4.19 The types of owners most active in leasing were:

- farmers who were no longer interested in or who have retired from farming
- landowners who had inherited but had no desire to farm.

4.4.4.20 It is possible that there are hints in the survey that following a marked increase in letting following the 2015 Budget's increases in relief on rents the pace of that growth may, perfectly naturally, be easing:

> "In terms of the volume of agricultural land leased in 2016, 45% of chartered surveyors nationally reported no change, while 24% reported an increase in

volumes, representing a marginal decrease on 2015 levels. There is an evident regional disparity, with 33% of chartered surveyors in Leinster reporting an increase in the volume of farm land leased compared to 10% in Connaught/Ulster."

"Nationally, 60% of chartered surveyors reported that the demand for long term leases (tenures in excess of 5 years) increased in 2016, a decline of 9% on 2015 levels. Similarly, there was a decrease in the proportion of respondents who reported that the average duration of lease agreements had increased with 39% reporting an increase compared with 55% in 2015."

That appears to describe a levelling in the growth of longer leasing, not a decline. Only time will show the outcome, while many other factors, including the effects of Brexit on the Republic and later changes in the CAP, will intervene. On its introduction, the Income Tax relief would attract the accumulated number of people most susceptible to it with only smaller additional numbers accruing in each subsequent year. The Basic Payment offers a countervailing pressure, perhaps especially as its payment values (generally reflecting patterns of subsidy distribution from before 2005) are being phased to standard rates over a longer 10 year period in the Republic. Any significant erosion of the net income it offers could add further encouragement to letting.

4.4.4.21 Subsequent informal conversation suggests that most of the take-up of the relief is currently for leases of 5 or 6 years with some lettings for 10. In itself, that is a considerable change from the previous experience of seasonal conacre lettings, especially with the caution that many small land owners have regarding their property. Three points may also arise in considering that:

1. caution may encourage landowners not to let for the longer terms, perhaps concerned that the relief might not last when they have committed themselves
2. access to the relief is limited by the area of land a taxpayer has available and its rental value. As rent does not rise with the length of the letting, once the available rent is fully relieved any further relief is not relevant and does not stimulate any longer term for the land being let. That though tends to suggest that the relief can encourage longer lettings of larger units.

3. there may, where relevant, be an interaction with higher value lettings for specialist rotational cropping, such as potatoes. In themselves, they would not qualify for the tax relief but that would be more than compensated by the higher rental. The landowner's choice could be to allow the tenant to sub-let (with an increased rent for the opportunity) or to use ordinary lets of at least 5 years between the specialist cropping lets. That may in places beneficially widen rotations but nonetheless tend to cap the length of lets.

4.4.5 Use of Such a Relief in the UK?

4.4.5.1 Of the possible tax measures currently under review, it is perhaps this Income Tax relief on rents that has the capacity to be a "game changer", in both being of interest to owners and signalling the larger intention with the least number of perverse outcomes.

4.4.5.2 A critical point is that it seems that it is only the substantial increase for 2015 in the rates of relief that has turned a previous relief into an effective stimulus. While that may have been supported by the larger discussion of the merits of longer term leasing and other possible but coincidental factors, it is the increase in the rates of relief appears determinative in achieving the perceived change in behaviour from long held customary practice.

4.4.5.3 It is recognised that there are three aspiration:

- to attract more land into the let sector
- to move land into the hands of the trained
- to encourage longer lettings.

4.4.5.4 While Northern Ireland is in the same position as the Republic and so with a similarly stark case for this change, it has to be recognised that, in the rest of the United Kingdom, a relief of this sort would give a benefit to those landlords who would anyway let land for qualifying periods (a question of the "dead weight" of the policy). However, it could make a substantial difference to many smaller landowners who tend to let for shorter terms or do not let at all. The nature of the land market is that only a limited number of those who are committed to letting would be in a position where an Income Tax relief of this sort would make the substantive difference to them – some will be companies, some charities, some will be at a scale of operation for which the relief would be of marginal concern.

4.4.5.5 Such a relief would sit alongside the new Residential Nil Rate Band Amount for Inheritance Tax offering an alternative to APR on a possible farmhouse. In combination, they could make a positive package for retirement in some situations.

4.4.5.6 In terms of design, a model might be:

- **a relief from Income Tax**, not Corporation Tax
- **available for lettings of agricultural land**. The definition here needs to be able to cover the position in all four territories so cannot be based on specific tenancy statutes; the definition of agricultural property for Inheritance Tax might be most apt. It is assumed that in the UK this might include farm dwellings and farm buildings but exclude property in non-agricultural uses. It would include the agricultural property element of a business letting.
- but **only for those new lettings agreed in writing after the new policy takes effect**, not previous lettings (the aim again being to influence future decisions)
- **to tenants who are not connected to the owner**, as this is the most obvious area for artificial outcomes (family transition might require an alternative tool to promote succession)
- **for terms of 5 years and more** - above the median and the mean lengths of FBT for England and Wales as well as being consistent with Northern Irish aspirations and the extent to which they too are influenced by the Republic's rules.
- **with the rate of relief increasing with the length of the tenancy**, perhaps sharply at one or both of 10 or 15 years. With the interaction for England and Wales at 7 years with SDLT compliance and registration, it might be considered whether a separate rate at 7 years would help or hinder – on the approach taken here it could simply complicate matters while adding to the risk of distorted choices at 7 years.

4.4.5.7 Other technical issues for review include:

- **the position for a surrender and regrant of a pre-existing tenancy** needs to be considered. While the new tenancy could only qualify if it met the other conditions proposed (including length of term), it would by definition be to the same tenant. Would that achieve anything policy terms where 1986 and 1991 Act tenancies were concerned? In the same vein, should it only be available for other pre-existing tenancies where the new term is longer than the previous outstanding term and otherwise qualifies?
- should it apply to **new tenancies from year to year that are secure under the 1986 and 1991 Acts**? Doing so would be a stimulus to encourage successions and maintain neutrality between forms of letting. If it is to apply to successions under the 1986 Act (where done as a new tenancy),

provision should be made for Scottish successions (effectively handled by assignment of a continuing tenancy)

4.4.5.8 It is striking that, despite the conviction that a marked benefit arises from seeing land move into the hands of the trained, neither Indecon nor the Review Group nor the Irish budget make education a test for the relief. There may simply be practical point of the administrative and compliance issues over the taxpayer landlord vouching for any level of education achieved by the tenant. It may also be politically difficult to assert a high enough level to matter as that will clearly exclude some who will be seen as deserving, by temperament or experience. However, were this thought feasible, the level chosen would give a clear signal of intent. If, for example, it were at degree level, that would be marking a required status. That would not stop landlords giving tenancies to others though it could also see tenancies going to degree holders with others then involved in the farming under them. It is probably not possible to define the qualifying degree in terms of subject so it would, in practice, be a sieve as to the educational level achieved, with the landlord's choice of arm's length tenant being the real selection point.

4.4.5.9 This paper does not propose specific levels for the caps, but to deliver the intended change in attitudes of current occupying landowners, the benchmarks set by the old (ineffective) Irish regime and new ones seem relevant, to be judged in the context of the wider challenges to the sector of the Brexit process and other policy measures. Using a rate of 86p/€, this table gives before and after rates of relief. The 2015 rates are then expressed in the number of arable acres they might represent if let at £150/acre (though that might change if the net benefit of area payments were reduced):

Length (years)	Pre 2015	2015	Arable Acres
5 to 7	£10,320	£15,480	103
7 to 10	£12,900	£19,350	129
Over 10	£17,200		
10 to 15		£25,800	172

4.4.5.10 It is too early to have good evidence as to whether it has been the uplift of rates overall, the development of the relief for the longer lettings or simply the general signal that the measure has had the reported positive effect in Ireland. In considering this, one issue might be natural caution of owners fearing that letting longer exposes them to changes in the tax regime.

4.4.5.11 The final column in that table illustrates the point above that once a landowner's available area has been let, further relief is not a stimulus. However, for larger units the higher rates of relief could prompt lettings for the longer periods and that would give access to the extra relief.

4.4.5.12 While not making a proposal as to the relief, the review above could, for the purposes of discussion, point to:

- an initial allowance for lettings of at least 5 years, matching the relief

available under the Rent-a-Room rules for Income Tax, now £7,500.
- a more serious allowance for lettings of at least, say, 10 years. The Irish experience suggests a relief of £25.000 would have sufficient impact to encourage private owners, including potentially retiring farmers, to let.

If the relief did not follow the Rent-a-Room in dividing the relief where the income is shared, then that second figure might instead be, say, £15,000. No need is seen to follow Ireland with its four levels of relief.

4.4.5.13 **A Retirement Package** - Especially if presented in conjunction with the alternative to APR on the farmer's dwelling offered by new Residential Nil Rate Band Amount for Inheritance Tax for a home passed down the family, such a relief could have a powerful stimulus as a retirement package, opening up new land for the tenanted sector.

4.4.5.14 This would see a potentially retiring farmer being able to consider:

- letting his land out to secure an income from the tenant while that land, as agricultural land still being used for agriculture, could qualify for APR. That income might be greater and more certain than from continuing to farm personally.
- the Residential Nil Rate Band Amount offering an alternative relief from Inheritance Tax on the house if it is passed down the family and the other tests are met. The famer need no longer strive to meet (and perhaps fail) the tests for APR on the house as a farmhouse, turning on the last to year of life.

4.4.5.13 **Cost** – While it may not be possible to model accurately the potential cost of the scheme, it is noted that the Rent-a-Room relief costs some £120 million. Scaling up the costs of the Irish relief but allowing for the situations that would not qualify for the relief under the model offered here could suggest a similar order of magnitude.

4.4.5.16 **Financial Benefit** – On the evidence from Ireland, this appears the most powerful stimulus reviewed in this paper to encourage the movement of land occupation to unlock the increase in productivity and agricultural income considered at 2.5.9 above, say £800 million.

4.4.5.17 That relationship seems to be scalable so that the more the relief is taken up, the more it would unlock that change. The less it is taken up, the less it would cost. There would be some owners who would be rewarded on re-letting land that has been let for over 5 years but the figure reviewed in the modelling at 3.5 above point to that number being limited as many longer lets will be by institutions, companies, public bodies and charities. The structure of farmland ownership suggests that such a relief would be naturally targeted on those who could make the greatest positive difference to the let sector. The largest effect would be on small private landowners and farmers, offering an encouragement to let and let longer. Some private owners who already let might increase the length of their

leases to qualify for the relief, when weighing it against their desire for flexibility.

4.4.5.18 Intra Family Transfer – As in Ireland, it is suggested that that this relief only be available where the landlord and tenant are not connected parties. That clearly leaves open the issue of any possible stimulus to encourage the passage of the use of land down the generations within families where future generations wish to farm. That is substantively a question about owned land; the issue for tenancies with succession does perhaps still lie more with the law than tax.

4.4.5.19 Possible options include:

- some version of the Irish Family Transfer Partnership whereby an agreement that meets certain conditions sees the land let down the family and so opens access to the tax relief on the rent
- adapting capital tax provisions as perhaps by revisiting the approach taken by Future of Farming or considering whether there might be circumstances in which Holdover Relief could adopt a current base value.

Other options may develop in discussion. Again, the combination of some such approach with the new Residential Nil Rate Band Amount for Inheritance Tax may prove attractive in some situations, perhaps particularly including those where there is no farming heir.

4.4.6 The Deadweight Issue?

4.4.6.1 The issues discussed in this paper revolve around measures that will change or enable changes in behaviour. There will always be some people who would behave in the desired way anyway, rewarding them leads to the "deadweight" cost of the policy. Where, for example, tax policy is changed its encouragement to some who make the change will also be an improvement for others who were going to do that anyway. It can be argued that, with the spectrum of circumstances, the change nonetheless confirms and supports their future choices. More starkly, there may be no need to reward past choices already made without reference to the new policy – this might usually be a waste of resources, altering nothing. That concern to avoid deadweight, relief given without effect, was, for example, addressed by the 1995 extension of full APR to let land when it was only for subsequent lettings. Relief was not given in respect of past lettings.

4.4.6.2 Recognising that, as in the Republic there will be no deadweight issue in Northern Ireland (indeed, even a case for this to be a province-based relief if not accepted for the UK) and that it will take more than tax relief to recover the position for any significant volume of new lettings in Scotland, there are lettings in England and Wales for more than 5 years that being created are occurring now and so would benefit from the suggested relief.

4.4.6.3 Re-analysing data in the CAAV Survey for 2016 for England and Wales shows that out of 46,532 acres of land on new FBTs it records, using the Irish categories:

Years	Area
5 to 6.99	14,675 acres
7 to 9.99	1,584 acres
10 to 14.99	4,402 acres
15 years and more	8,322 acres

That will not be comprehensive but will give an order of magnitude.

4.4.6.4 A proportion of those will be let by County Councils and other institutions for which Income Tax will not be a concern or will have larger estates management reasons that any way drive this. Others will be on estates with a scale of possible lettings where the ceilings on the relief would anyway limit its benefit. In summary, the deadweight issue is not seen as being of particular importance when compared to the potential stimulus to smaller private owners and potentially retiring farmers (aided by the new Inheritance Tax relief) to bring land forward for letting on a longer term basis.

4.4.7 The *Jaeger* Issue?

One apparent curiosity about the Irish relief is that it is limited to rent on farmland in Ireland. The CJEU held in the *Jaeger* case (concerning the German version of APR) that such nationally-based limitations were contrary to the free movement of capital under the Four Freedoms of the Single Market. That led to the UK extending APR and other provisions such as those for furnished holiday lets to property throughout the European Economic Area (EEA). Unless reliefs for Income Tax are outside this or the Irish Republic has secured some clearance, this relief could be more secure once outside the Single Market.

4.5 Other Treatments of Rent

4.5.1 Indecon also suggested two other ways of assisting those with rental income.

4.5.2 Disregard of Rent for State Assessments - Indecon further proposed that where land was let longer term by a farmer under 65, the income should be exempt when assessing eligibility for medical cards, nursing home entitlements and other state payments. This does not seem to have been taken forward.

4.5.3 Qualifying Rent as a Deductible Cost - In a related measure, Indecon recommended that rent and other lease costs only be allowed as a tax deduction from income where there was a written lease in place, implemented through self-assessment. This does not seem to have been followed through.

4.6 Land Transactions Taxes

4.6.1 In the UK, SDLT (now LBTT in Scotland and prospectively LTT in Wales) is chargeable to the tenant on all tenancies where the capitalised value of the rent is over £150,000 (a figure unchanged since 2004). In practice, the great majority of farmland leases are granted for terms below that threshold; however, the greater the rent and the longer the term the more a tenant is exposed to SDLT.

4.6.2 There has been discussion in Wales of exempting leases under the 1986 and 1995 Acts from the forthcoming LTT.

4.6.3 In **Ireland**, an exemption from stamp duty is available where land is transferred to someone under 35 and with a required level of agricultural education.

4.6.4 Indecon recommended that the Stamp Duty (at 1 per cent of the rent) on leases of under 35 years be abolished for agricultural leases. That charge is not due on seasonal lets or on residential leases of less than €30,000.

4.6.5 The Irish Review Group simply recommended a relief from Stamp Duty on all leases of agricultural land for over 5 years, again noting that no tax charge is due on conacre, as it is not a form of tenancy. The 2015 Budget exempted all agricultural leases of between 5 and 35 years.

4.6.6 In **France**, young farmers in receipt of a Young Farmers Grant have a reduced rate of 0.7% on purchases of up to €99,000 within rural regeneration zones. This seems unlikely to be material.

4.6.7 **Reform in the UK?** - As noted in Chapter 3, both TRIG in 2012 and the Future of Farming Group in 2013 urged reform of or relief from SDLT on at least some agricultural lettings. The HMRC review referred to in the Future of Farming recommendation resulted in a change to the administration of SDLT for continuing tenancies, so that the final assessment of tax was to be made and paid on the termination of the lease, rather than an assessment potentially each year While that change eases compliance issues, it does not alter the point that the longer the lease is let for (or proves to run for), the more the tenant is due to pay.

4.6.8 However, it does not seem that this is, to date, a significant factor in the choices between parties of the farming arrangements being used or the length of letting. That does not mean that it might not become a factor if a more lively market emerged.

4.6.9 Equally, modelling done for TRIG using the data from the CAAV's Agricultural Land Occupation Survey for 2011 suggested that there was very little tax revenue at stake to balance against the deterrent effect it can have on prospective tenants. As granted, the new tenancies in that year might have been liable for £0.5-1 million of tax across the whole UK. While that figure would rise where tenancies continued beyond their agreed term, that would not change the order of magnitude.

4.6.10 The 2012 paper by the CAAV and CLA, endorsed by TRIG and put to HMRC's review of non-standard leases proposed:

- the removal of SDLT on leases for less than 2 years or less
- all other leases to be assessed at grant as though they were for 7 years, irrespective of length or whether they continue after expiry.

This was thought to be fiscally neutral.

4.6.11 The adverse effect on behaviour from the negligible amount of tax at stake could equally be thought to justify the

simplicity of exempting leases of agricultural land.

4.7 Capital Gains Tax

4.7.1 It can appear that Ireland does not have a fully developed form of rollover relief but specific defined arrangements are made for some farming circumstances. There is a substantial form of retirement relief and now a limited form of Entrepreneurs' Relief.

4.7.2 Retirement Relief from CGT - This was phased out in the UK. However, on the abolition of Business Assets Taper Relief, the introduction of Entrepreneurs' Relief, a complex family of reliefs available on the cessation or disposal of all or part of a business, offers a broader replacement in the United Kingdom.

4.7.3 In **Ireland**, Indecon found €1.76m in additional agricultural output for every €1m of retirement relief, effectively a benefit of land moving from the retiring farmers selling it to those making the commitment of purchasing it. It is available where someone over 55 disposes by sale or gift of the whole or part of qualifying assets (but does not actually have to retire).

4.7.4 In a farming context, Retirement Relief is available in Ireland:

- where the disposal is to a child of the taxpayer, the farmer had to have owned the land for 10 years. The 2014 budget then allowed a five year letting period within the previous 15 years to count, if the 10 year rule had already been met (so testing this over at least a 15 year period). Indecon recommended that this should simply be a test of the preceding ten years provided the lease had been for at least five years.
- where the disposal is to anyone else, the land had been leased for a period of between 5 and 15 years ending with the date of the disposal provided that it had previously been farmed by the disposer for 10 years. The Review Group proposed that that letting period be extended to be between 5 and 25 years to allow for family situations where heirs had been too young.

4.7.5 The 2015 Irish Budget made two changes:

- land that has been leased out for up to 25 years (previously 15) can qualify
- land that has been leased outside the family on conacre will qualify if is leased out for periods of least 5 years for up to 25 years.

4.7.6 The 2017 Budget then created a reduced CGT rate of 10% to apply to the disposal in whole or in part of a business up to an overall limit of €1 million in qualifying chargeable gains – effectively on the model of the UK's Entrepreneurs' Relief though with a lower limit.

4.7.7 CGT Restructuring Relief – Ireland offered what was effectively rollover relief for sales and purchases in restructuring fragmented units within a 24 month period to achieve a more efficient farming unit. There had been little take up – just 6 of the required restructuring certificates were issued in 2013. Indecon recommended that this relief be enlarged to allow:

- whole farm replacement
- reinvestment of land sales in farm infrastructure.

The larger issue appears to be the 33 per cent rate of CGT and the apparent lack of general rollover relief. This issue appears overcome in the UK by the scope of rollover relief for business assets. The 2015 Budget approved whole farm restructuring relief.

4.7.8 Netherlands – With CGT due at Income Tax rates, some gains from farm sales are exempt but only so long as the land remains used for agriculture by its new owners.

4.7.9 Reform in the UK? – Rollover Relief already answers many of these practical and important points for farming and other businesses more directly and with less complexity, though not completely without difficulties in this context.

4.7.10 There is comment that rollover relief into farm land distorts land values, perhaps especially where a farmer has sold land for development and seeks to buy replacement land. It has been mooted that re-investment be limited to an "agricultural value" but that would still allow external re-investment into agriculture unless farmland were ring-fenced as an asset which seems an unattractive answer.

4.7.11 An alternative would be to extend the range of assets qualifying for rollover relief to land that is let or bought with the intention of being let. That would remove a point of fiscal discrimination against let land which does not exist for the form of rollover relief available where land is taken under the shadow of compulsory purchase.

4.7.12 A related point is the desirability of accepting landlord's spending on capital equipment on let land as qualifying re-investment for rollover relief. At present, that is not possible under either the main form of rollover relief not that under the shadow of compulsory purchase, even where buildings are lost.

4.7.13 There is a perhaps under-remarked issue around the UK's Entrepreneurs' Relief discriminating against letting farmland as the relief is excluded where 20 per cent of the business activity is "investment". While of most significance where land is going for development, it is also relevant where the ordinary sale of a farm is in mind, whether by this or the next generation, potentially deterring some from letting as a retirement option. It is noted that the Irish allow let farmland to qualify for Retirement Relief while the UK' previous Business Assets Taper Relief was extended to cover land let for business use.

4.8 Inheritance Tax

4.8.1 **Ireland** uses a donee-based Capital Acquisitions Tax on gifts received rather than the UK's donor-based Inheritance Tax (the renamed Capital Transfer Tax). The value of agricultural property is reduced to 10 per cent of its market value for assessment to this tax where the donee is a farmer at the valuation date. Being a farmer appears to mean that 80 per cent of the beneficiary's assets must be in farming; there is also a business relief. The relief is clawed back where the

land is disposed of or compulsorily purchased within 6 years and the proceeds are not reinvested in farmland within a year (6 years for compulsory purchase).

4.8.2 Indecon's work found a €1.88m improvement in output for every €1m in this tax relief. It seems plausible that there is on average a slightly higher return in improved output from replacing a farmer near death than one choosing to retire.

4.8.3 The definition of an inheriting farmer is based on asset valuation rather than active husbandry. That point concerned Indecon, seeing this as an incentive for the non-use or less productive use of land, given the remit for improving the sector. It quoted one consultee's submission:

> "there is little incentive to transfer land to a successor who will actively engage in farming the land".

It could though be suggested that if leasing is being encouraged, it is the use of the land rather than the nature of the owner that is more material, especially with the incentive not to sell within six years.

4.8.4 Indecon proposed the relief be limited to farming acquirers with farming qualifications (or are full time working in farming for the following six years) and those who lease the land out on a long term. That was then adopted by the final report in which the Review Group affirmed that agricultural relief from the tax should be retained:

> "to ensure the ongoing viability of farming businesses that pass from one generation to another. While a farming business may be asset rich, in many cases the income from the farm could not sustain major tax charges, hence the existence of Agricultural Relief."

It agreed with Indecon that the relief be limited to those who are deemed "qualified" or full time farmers or those who lease land out on a long term basis. The 2015 Budget made this change.

4.8.5 Netherlands – There is no specific relief for farmland in Holland but rather general reliefs based on closeness of family relationship. There is then a relief where a family business is transferred as a going concern and the heir then runs it for five years – that gives full relief on just over €1m and 83 per cent relief on values above that.

4.8.6 UK Review – While those models could suggest some form of conditional relief from Inheritance Tax requiring the heirs to farm for a period, the UK does not have a pattern of farmland capable of viable production lapsing out of agriculture, although land may be moving to or taken for development or environmental uses. In any event, the models for this would not offer any stimulus that moves land into the hands of better farmers, unless the option of leasing out is also recognised for this.

4.8.7 Issues of the use of farmland before death appear be more important to the goal of productivity. To an extent, those are tested by the requirement for APR that the land had been in agricultural

use in the years prior to death but those situations where the relief is most likely to be lost on this score are perhaps those where there may be least awareness of the issue.

4.9 Interaction with State Pension

4.9.1 Ireland's Macra na Feirme (equivalent to the Young Farmers) has observed that Ireland has more farmers over 80 than under 35. In reporting that Irish farming's age structure (25 per cent in 2010 over 65) was not dissimilar to other EU member states (30 per cent; UK 28 per cent), the Irish Department for Agriculture Fisheries and the Marine Annual Outlook for 2013/14 noted:

> "Less than 10% of all farmers in Germany, Finland, Austria and Poland are over 65 and this is due to some hard line polices which force a farmer to choose between the State Pension and the Single Farm Payment once they reach 65."

No further details were given but in France this seems to require a farmer to retire from at least part of his land before being entitled to a state pension. It has not yet been possible to secure any further confirmation or details of this.

4.9.2 In France, the Czech Republic and Luxembourg the proportion of farmers over 65 lies between 10 and 15 per cent; while in Denmark and the Netherlands it is between 15 and 20 per cent.

4.9.3 Indecon proposed a review of how social welfare provisions may inhibit land mobility and leave land under-used.

4.9.4 It may be interesting that the countries understood to be doing this appear to include some EU member states, such as Germany, that appear to have reconciled an area payment with improving productivity.

4.9.5 If the facts are as reported, this is apparently effective (at least in terms of who is reported as the head of business). However, it could appear to be difficult to deliver in the context of the structure and assumptions of the UK state pension, which is seen as compatible with continuing to work and implicitly the fruit of contributions. Is there any other circumstance in which the UK state pension is denied to someone of a qualifying age?

4.10 Young Farmer Establishment

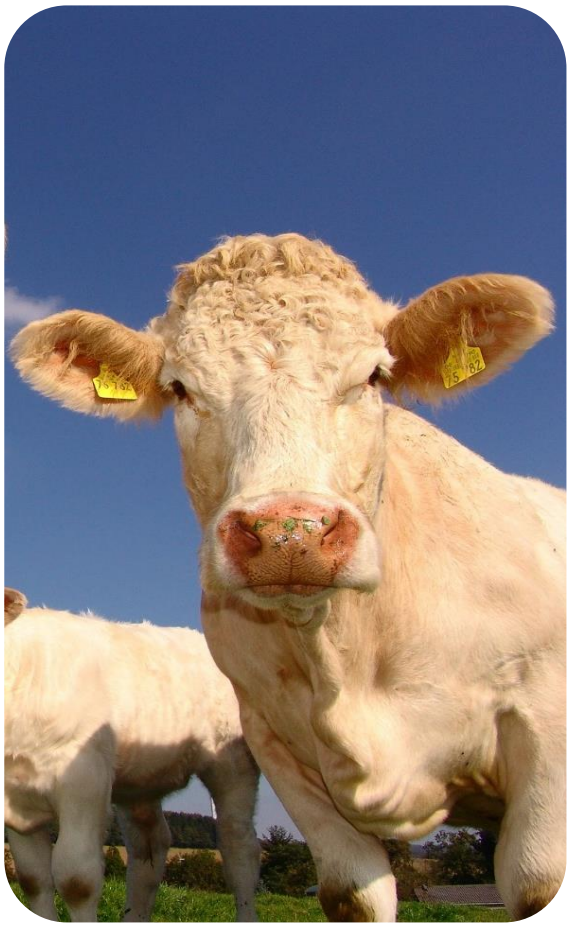
France offers a scheme for farmers between 21 and 38 with agricultural qualifications giving 100 per cent relief on Income Tax in the first year and a 50 per cent reduction in the following four years where the farmer is in a particular grant scheme.

4.11 Land Tax?

Indecon suggested there is a case for taxing unused land (on a similar basis to the Derelict Site Levy there on urban land under the Derelict Sites Act) but left implementation for further consideration. It could be harder than assumed to identify relevant farmland and deal with the environmental aspects of this argument. It is thought that no action has been taken on this notion.

Summary Points:

- **The closeness of Irish circumstances to those in the UK makes their measures and outcomes of particular interest**
- **The Irish 2014 agri-taxation review saw that tax policy could drive many benefits, including entry, progression, investment and retirement.**
- **The evidence is now accumulating that Ireland's sharply improved Income Tax reliefs on rent are delivering a substantial and positive change.**
- **The Irish farmers most active in leasing are:**
  - **farmers no longer interested in or who have retired from farming**
  - **landowners who have inherited but have no desire to farm.**
- **In the UK, that positive stimulus of a tax relief on rental income for smaller private owners and potentially retiring farmers can encourage retirement and the change of farming occupation, especially in conjunction with the Residential Nil Rate Band Amount for Inheritance Tax**
- **This paper offers a model for that relief**
- **Consider exempting or modifying SDLT on agricultural tenancies**
- **Extending the range of assets qualifying for rollover relief would remove a point of fiscal discrimination against let land**



SECTION 5 – THE TAXATION OF COMPOSITE BUSINESSES

NB *This topic is also touched on at 3.1.5 above and Section 6.7 below on Issues with Diversification.*

5.1 Many business operating farms and estates are individually owned and encompassing an increasing range of business enterprises. This has arisen from the economic pressures for diversification and the historically diverse nature of some estates as well as the chances of economic opportunity or necessity – and has been encouraged by public policy.

5.2 They are assessed to Income Tax where the legacy of the schedular system (especially where it distinguishes income from trade from income from property) and the rules regarding the separate assessment of different trades pose problems for what are operated for all practical purposes as unified composite businesses with shared overheads, such as labour, that can hard to allocate.

5.3 In July the Office of Tax Simplification reported to Parliament with proposals for the simplification of Corporation Tax for companies, including measures in this respect so that tax assessment could follow accounts and commercial reality. It would be helpful for this approach to be equally applied to Income Tax.

5.4 The root of the issues lies in the distinction for Income Tax between differing trades of the same taxpayer. Each trade is to be assessed separately in developing the tax return and assessment, although often within the same VAT registration.

5.5 Farming is anyway separately defined as a trade in its own right as the commercial occupation of land for the purposes of husbandry and has its own tax provisions such as averaging and the herd basis, requiring care in how this might be considered.

5.6 With those cautions, merit is still seen in recognising composite trades for those trades other than farming which are not so distinguished by separate rules.

5.7 In its early years, a new trade, such as a line of non-agricultural diversification on a farm, may commonly make losses. The recent limitations on Sideways Loss Relief affect multi-stranded businesses by limiting the ability for losses in, say, a new business activity to be offset against profits in another trade of the same taxpayer. That results in tax on profitable businesses but no allowance at that time for losses in other businesses, so raising the effective tax rate on the taxpayer. Those losses are, however, available to be carried forward against future years, as and when there are profits in the specific trade that generated them. Nonetheless, this can appear an artificial and counter-productive distinction where the various arms of a single farm or estate business are interdependent. In turn, that complicates or deters business flexibility and development.

5.8 Current knowledge of the Government's plans for the Making Tax Digital programme suggest that it will add further to the burdens on unincorporated rural businesses. A business farming income, holiday lettings, solar panels and property letting could have to make 15 returns a year for an operation that is inherently integrated.

5.9 Possible options for reviewing this area might be:

- relaxing the **limitations on sideways loss relief**
- taking a more positive view of **composite trades** so that they can be seen to come together into single trade for assessment

5.10 The continuing distinction derived from the former schedular system between income from trade and from property is a recurrent problem in this area. When considering the letting of land, that is automatically a separate exercise for tax purposes and so an issue where an owner is considering the letting of land.

5.11 Referring back to its report following its Competitiveness Review, the recent Office of Tax Simplification report on simplifying Corporation Tax recommended:

> "• bringing the definitions of trading and property deductions and management expenses together to remove the complication of having two sets of very similar rules
>
> > In time, this first step should lead to considering extending relief to all business expenditure of an income nature, to more closely align tax with the accounts and commercial reality."
>
> "• for companies with different sources of income, bringing these together into one business profit or loss for tax purposes, with losses fully pooled

This can be termed 'schedular reform' and would build on bringing the expenses rules together. It means abolishing the schedular system for income – so avoiding the need for analyses for tax purposes that do not reflect commercial reality. This would not mean eliminating the divide between trading income and capital gains: capital gains (and losses) would continue to be dealt with separately from income gains."

5.12 These proposals seem just as apt for Income Tax, as was recognised by the OTS' Competitiveness Review.

Summary Points:

- **The fiscal discrimination in favour of businesses taxed under Corporation Tax rather than Income Tax is a problem for agriculture and the rural economy. The two tax regimes should be more equal.**
- **Review in this area could include**
  - **allowing composite trades to be considered a single trade for assessment**
  - **less restriction on sideways loss relief between trades.**

SECTION 6 – ENCOURAGEMENT FOR INVESTMENT AND INNOVATION

6.1 Encouragement for Investment and Innovation

6.1.1 At one level, this can be seen as the same problem faced by the rest of the economy, with concern about apparently inadequate private investment and skills. However, it can be observed that, even leaving aside the capital value of land, investment in farming is more akin to manufacturing than the service sector in its proportionately greater call for fixed investment, machinery and the working capital. With agriculture's typical annual production cycle, key decisions can often only have effect with the consequent lags.

6.1.2 Support could come through grants or tax measures. While this paper naturally considers tax measures, arguments for that include its greater openness to and flexibility for private investment-led innovation rather than operating within the limits of any defined grant scheme with its priorities and conditions. There appears a good argument that farmers and landlords are more likely to take effective economic decisions about investment with tax reliefs than with grants subject to conditions and scheme design. Tax reliefs can thus encourage private investment that suits the business, even if only recognised for tax over a period of years, rather than the up-front cost of a grant.

6.1.3 In the context of the let sector, it may, in practice, be that more investment will come from the occupying tenants, some will come from private landlords who should be treated equally in tax terms where undertaking this.

6.2 Capital Allowances

6.2.1 The UK currently allows a £200,000 Annual Investment Allowance supplemented by writing down allowances for equipment.

6.2.2 The larger issue in the UK is the lack of any allowances on the buildings that are important to many farm businesses. That sees substantial expenditure for the business unrelieved against tax with the effect that businesses needing to invest in buildings face a higher rate of tax than those that do not.

6.2.3 For example, if two otherwise identical businesses with the same accounting profit before depreciation of £100,000 each have £20,000 in depreciation, but one for buildings and the other for IT, the former will be taxed on £100,000 and the latter on £80,000, even though they have the same accounting profit. In principle, the business that has invested in buildings will pay a quarter more in tax solely because of the nature of the investment it requires.

6.2.4 Enhanced Capital Allowances (ECAs) offer 100 per cent relief on specified items identified as energy efficient and environmentally beneficial plant and machinery. The lists are themselves restrictive and it is understood that the operation of the scheme imposes a number of awkward restrictions, taken to derive from EU state aid rules. Rainwater harvesting has been reported as an area found problematic. There has been a history of difficulty around lighting.

6.2.5 Ireland - In Ireland, capital allowances are the most expensive of the agricultural reliefs at €192m (out of a total of €340m of agricultural reliefs) but not all these allowances may be for agricultural items. For comparison, the equivalent of APR costs €77m.

6.2.6 Buildings and works are written off over 7 years (so faster than the UK's previous provision), at 15 per cent a year and 10 per cent in the seventh year. Plant and machinery are written off over 8 years.

6.2.7 Econometric work in Ireland by Indecon for the 2014 Agri-Taxation Review showed a positive relationship between investment in capital and stock with increased output – some €1.9m increase in gross output for every €1m of capital allowances claimed. It also concluded that capital investment had a positive impact on labour productivity with potentially lasting impacts, albeit that might differ by farming type (a point not developed in the report) – a plausible conclusion as a common point of business investment is to substitute for labour.

6.2.8 More detailed work showed that for every 10 per cent increase in capital inputs, annual agricultural output was likely to rise between 1.6 and 4.2 per cent.

6.2.9 Indecon recommended:

- accelerated capital allowances for young farmers in the first five years of business and where earning less than €50,000 pa. They would apply to buildings and equipment offering at least 50 per cent in Year 1 and then 12.5 per cent for the following four years, possibly with a cap of €500,000 of investment in any single year.
- temporarily accelerated allowances for dairy farm tracks and associated infrastructure. The argument was that the removal of quotas made access between grazing land and the parlour a key limitation on output.

6.2.10 The 2017 Budget introduced accelerated capital allowances for sole traders and non-corporates in respect of energy efficiency equipment.

6.2.11 Netherlands – Businesses are generally free to choose their approach to depreciation (writing down, straight line, decreasing percentage, output related).

6.2.12 The Dutch government has introduced a specific system of depreciation (VAMIL) for investment in environmentally favoured equipment, allowing the taxpayer to choose the timing of depreciation, whether accelerating or deferring it. Qualifying equipment includes investment in equipment specifically related to agriculture and farming.

6.2.13 Holland also offers a special system of depreciation for start-up businesses.

6.2.14 France – Agricultural materials, equipment and buildings are depreciated in the same way as for other businesses though accelerated depreciation is available for some specific agricultural items. There are other allowances for energy efficiency and renewables.

6.2.15 Thoughts for the UK – Two areas of reform are proposed for discussion:

- first, regarding **buildings** for which it is urged that:
  - Agricultural Buildings Allowances (ABAs) be reinstated. As buildings are now more akin to machinery and more vulnerable to technical and regulatory obsolescence, the rate be at 5 per cent (so written off over 20 years while the Irish allow buildings to be written off for tax over 7 years).

    This would both recognise the economic importance of this investment and prompt private spending on the building works which would then only be recognised over time in tax accounts.
  - buildings could be brought within the scope of the Annual Investment Allowance.
- second, **investment in innovation.** The sector faces a major need to embrace automation using digital, optical and other developing technologies, substituting for labour and improving competitiveness. a specific capital allowance of £2.5m be available on a floating basis over a five year period – and so available at any point in that period as the need to invest arises. That would optimise the effectiveness of this relief and allow for the current swift development of the specified technologies.

6.3 Research and Development Relief

6.3.1 In one of the ways in which the unincorporated businesses that dominate the rural sector are disadvantaged by tax law, Research and Development Relief is only available under Corporation Tax offering a relief for larger companies (now the Research and Development Expenditure Credit scheme) and the possibility of a tax credit for some smaller ones. The rate of relief is 230 per cent so that for every £100 of qualifying expenditure, £230 is allowed against taxable profit. It is suggested that it be extended to Income Tax for sole traders and partnerships and so available to all classes of business, not just those in corporate form.

6.3.2 The regime intends to support projects that seek to achieve an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technical uncertainty that relates to the trade of the taxpayer, conforming to guidelines by BEIS.

6.3.3 With the increasing need for knowledge exchange and subsequent use of that knowledge as part of the larger process, examples of where this could be useful include developments in soil management, formulations for adding value, improving animal health and welfare techniques. In turn, the recognition of this possibility might alter the standing of such work in taking the sector forward.

6.3.4 Under EU State Aid rules, the small and medium enterprises (SMEs) version of the relief is not available where the business receives grants or subsidies are received though they can use the large companies' version. Once outside the EU, a review of this boundary could be helpful.

6.3.5 It is recognised that, in the nature of this review, there may be an element of overlap with the relief proposed below for the development costs of abortive projects.

6.4 Enterprise Investment Schemes

As noted elsewhere, the EU's State Aid rules pose particular challenges for some schemes, so that Australia and New Zealand are able to run some schemes that could not be delivered in the EU even though presumably within WTO rules. It is understood that some of the Venture Capital and Enterprise Investment schemes exclude agriculture because of this. While farming has not traditionally welcomed third party equity capital (as distinct from bank loans), a review of these schemes should be undertaken to see what could be done after Brexit, perhaps particularly in the context of investment in new technology.

6.5 Community Infrastructure Levy (CIL) and Local Infrastructure Tariff (LIT)

6.5.1 A related point on agricultural buildings touches on the recommendations in the Community Infrastructure Levy (CIL) Review Team's report to the Government, *A New Approach to Developer Contributions*, proposing the introduction of a Local Infrastructure Tariff (LIT) as a mechanism

to capture some of the increased value of land after planning permission is granted.

6.5.2 New agricultural buildings are not constructed for sale, are often relatively large in area but are of low value and low impact, so any CIL or LIT charge which is more than negligible has a disproportionate effect which can deter investment. The report's equivocal recommendation 5.1.14 is that

> "agricultural buildings should be covered by the LIT but that local authorities should be encouraged to include this type of structure in its low or zero-rated bands".

New agricultural buildings are erected for the purposes of agriculture on the holding, for use as part of the farming business. Most are developed within an existing farming business, either to allow the business to grow or to replace obsolete structures with more efficient modern buildings for, as examples, reasons of animal welfare or food safety.

6.5.3 That is a fundamentally different approach from most commercial buildings or housing developments which are built by investors for selling or letting. A new agricultural building does not generally result in an increase in capital value of the unit, being more in the nature of business equipment. Any CIL or LIT charge is an additional cost on development which has to be funded by farmers with no corresponding value from sale or letting out.

6.5.4 In those areas where a CIL charge is levied on new farm buildings, the requirement to pay a substantial CIL charge has actually stopped farm development from taking place, so preventing improved productivity on farms.

6.5.5 With these circumstances, CIL and any new system of LIT contributions should exempt agricultural buildings.

6.6 Stock Relief?

6.6.1 Other than the Herd Basis, the UK does not offer stock relief. However, Ireland has a farming-only scheme that allows a deduction of a fraction of the uplift in stocks from trading profits.

6.6.2 Indecon found that increases in stock had a positive effect on both output and productivity.

6.6.3 Other countries also offer forms of stock relief but it is not clear that this is an issue in the UK.

6.7 Issues with Diversification

6.7.1 There are additional issues for farms seeking to diversify their economic base by developing other lines of business.

6.7.2 A key point here is that all enterprise and innovation is about risk. Not every project succeeds and some can take time to do so. Not only is the tax system not necessarily supportive of that but challenges to the sector with its potential need to adapt rapidly to prospective change may benefit from assistance.

6.7.3 As set out in Chapter 5, the root of the issues lies in the distinction made for Income Tax between differing trades of the same taxpayer. Each trade is to be assessed separately in developing the tax return and assessment. Farming is

anyway separately defined as a trade in its own right as the commercial occupation of land for the purposes of husbandry (with its own tax provisions such as averaging and the herd basis). However, activities on diversified farms are often interdependent with the use of shared resources such as labour.

6.7.4 As diversification alongside farming thus entails developing new trades which in their early years may naturally make losses, this creates issues. Those are compounded by the recent limitations on Sideways Loss Relief which limit the ability for losses in, say, a new business activity to be offset against profits in another trade of the same taxpayer. That results in tax on profitable businesses but no allowance at that time for losses in other businesses, so raising the effective tax rate on the taxpayer. Those losses are available to be carried forward against future years as and when there are profits in the specific trade that generated them.

6.7.5 Possible options for reviewing this area include, as discussed at Section 5 above:

- relaxing the **limitations on sideways loss relief**
- taking a more positive view of **composite trades** in circumstances such as farming so that they can be seen to come together into single trade for assessment

6.7.6 The continuing distinction between income from trade and from property is a recurrent problem in this area.

6.7.7 A related concern is how such trades are to be reported under Making Tax Digital for which the quarterly reporting of the several trades within an integrated business could be burdensome, especially with the issues of apportionment of items within the business to different trades. While aware of a prospective HMRC paper on Making Tax Digital and complex businesses, it is understood that this is only to consider larger businesses with a turnover of £10m or more and so would not be relevant to the great majority of businesses considered here.

6.7.8 Another area for consideration is the **treatment of the costs of abortive proposals**, as where a project fails to secure planning permission. Where a purchase or project does not come to fruition there is no tax relief for the costs involved in pursuing it. An example in the context of seeking planning permission was considered in *ECC Quarries Ltd v Watkis* [1975] STC 578. If the application had succeeded the costs in that would have been capital costs and so, as capital costs, were not allowable when it failed. Where the relevant costs (typically legal, professional and application fees) are initially included in the profit and loss accounts while the outcome of the project is unknown (and so against potential capitalisation), the adjustments needed to find the taxable profit will include:

- adding back (or disallowing) depreciation
- adding back any non-allowable costs such as these
- deducting capital allowances.

6.7.9 As an illustration:

Profit per accounts		125,000
Add back:		
Non-allowable fees, planning etc	6,500	6,500
Adjusted Profit		131,500

6.7.10 At a time when encouragement for innovation and broadening the base of the rural economy seems important, it is suggested that an innovation relief or allowance be considered for such abortive costs, perhaps subject, if necessary, to:

- a cap and/or
- a 50% recognition of relevant costs

to ease the financial risk for individuals and businesses pursuing new options.

6.7.11 The recent Office of Tax Simplification report on simplifying Corporation Tax recognised this issue and proposed (with CAAV highlighting):

"• using the accounting definition of capital expenditure (essentially creating an asset) for tax purposes

This would mean that valid business expenses taken to the profit and loss account would be deductible for tax purposes, saving significant amounts of time on identifying small tax adjustments (for example, capital elements of legal and professional fees). **Importantly this would encourage enterprise by giving wider relief for abortive costs incurred by companies in attempting new ventures.**"

Summary Points:

- **Tax reliefs may give more effective support for much innovation and investment than grants**
- **An investment allowance of £2.5m over five years for innovation in new technologies**
- **An allowance should be considered for abortive costs in innovation**
- **Investment by tenants and private landlords should be treated equally for tax purposes.**
- **The agricultural buildings allowance should be reintroduced and buildings should be brought within the Annual Investment Allowance.**
- **CIL and any new LIT should exempt agricultural buildings**

SECTION 7 – MANAGEMENT OF RISK

7.1 Income Averaging

7.1.1 Many countries offer a means for farmers (and sometimes businesses more generally) to average incomes over a period of years to limit the impact of large swings in assessable income on tax liability. The UK has long offered farmers (as well as writers and artists) two years and now, as a response to concerns over volatility, offers five years, albeit in a way that can be complex to operate.

7.1.2 Ireland offered income averaging over three years (except where the farmer or spouse has income from another trade or profession). In reviewing it, Indecon commented:

> "From a social perspective and as a way of underpinning the viability of farming, measures which reduce income volatility have value, but the direct impact on output may be less than some other agri-tax measures."

A related view was expressed by the House of Lords in a report in the last Parliament that poor economics was worse than volatile economics.

7.1.3 However, Indecon did propose:

- considering a move to allow five year averaging
- broadening income averaging for on-farm diversification for young farmers.

7.1.4 The 2015 Budget approved averaging over five years and where there is on-farm diversification. The 2017 Budget approved a one year opt out from five year averaging for particularly bad years.

7.2 Deposit Schemes

7.2.1 Australia (whose approach is to offer relief, not support, and so encourage self reliance) has offered a Farm Management Deposit Scheme since 1999

with tax incentives for farmers to set income aside so that it can be drawn down when needed. It is capped at AU$400,000. Deposits in a savings account reduce the tax burden in that year with tax only paid on withdrawal. It is not available for farmers with more than AU$100,000 of off farm income. Such a scheme would be in breach of EU State Aid rules but evidently not WTO rules.

7.2.2 New Zealand operates an income equalisation scheme with payments into and out of an income equalisation account where deposits are held for between a year and five years. The main scheme is open for farming, fishing and forestry. A particular scheme is available to farmers who sell livestock but do not replace it in an adverse event. Another recognises the timing problem of forestry thinnings. Such a scheme would be in breach of EU State Aid rules but evidently not WTO rules.

7.2.3 France – The *Deduction pour Aleas* offers a bank deposit scheme means for a risk reserve. This seems to allow a deduction from assessable income for risk with half that deduction placed in a specified savings account and tax deductible. The deduction can only be used for defined risk related expenditure:

- acquiring fodder to feed stock in the six months before or after the recognition of an agricultural disaster in the area or neighbouring areas
- the payment of premiums and contributions for insurance against damaged goods or loss of business
- payment of expenses resulting from fire or damage to crops or loss of insured livestock up to the deductible limit
- payment of expenses resulting from an uninsured climatic, natural or health hazard recognised by a qualified administrative authority
- economic risk where the difference in value added between the three previous years and the current year is more than 10 per cent.

If the money is not used in seven years it is put back into the accounts where it may be taxed and subject to late payment interest.

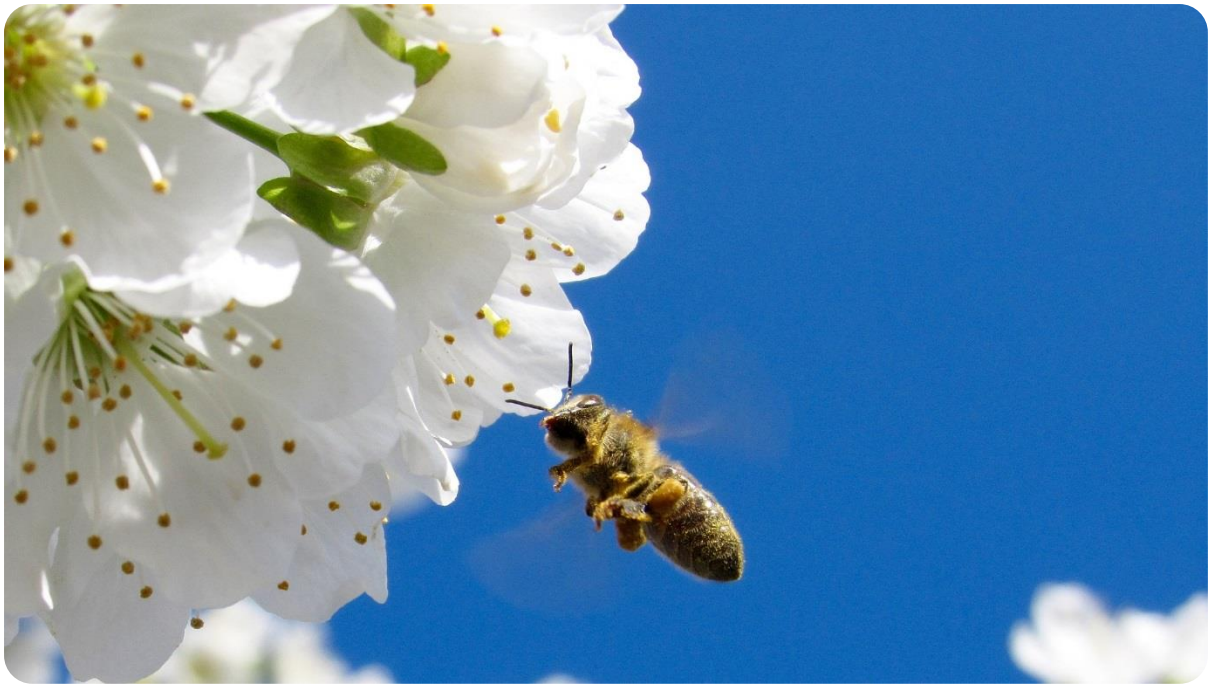
7.2.4 The complexity of this scheme appears at least in part to answer possible challenges under EU State Aid rules.

7.2.5 Thoughts for the UK – The Australian scheme should be considered as a straightforward means for farming business to manage risk over time, using the freedom given by being outside EU State Aid rules.

Summary Points:

- **Many comparable countries use both income averaging and deposit schemes as support mechanisms.**
- **The Australian deposit scheme should be considered in more detail as a model that could benefit UK agriculture.**

SECTION 8 – TAXATION AND ENVIRONMENTAL PRODUCTIVITY



8.1 General

The point has been made that public intervention may not only be merited as support for farming as a business but also for its role in land management and so on environmental matters. While it is possible that taxation is not the most apt tool for this purpose, it is nonetheless necessary to consider it. In this context, this paper offers a brief review of some US provisions, notes a taxation proposal recently made by the Green Alliance and then considers whether there may be a role for a form of stock relief for environmental improvements.

8.2 Some Measures in the USA

8.2.1 The United States Tax Code s.175 has, since 1954, made specific provisions for taxpayers in the business of farming with costs related to soil and water conservation, the prevention of erosion or (since 2008) the recovery of endangered species to make a one-off election for them to be deducted against income rather than capitalised with the land (which cannot then be depreciated). This appears to have the effect of 100 per cent capital allowance within the limit of 25 per cent of gross income. Eligible works include:

- the treatment or movement of earth, such as levelling, conditioning, grading, terracing, contour furrowing or restoration of soil fertility and the establishment of Coastal Bermuda Grass to prevent erosion.
- the construction of water courses, ditches, dams, ponds
- the planting of windbreaks.

Since 1986 the works must be consistent with an approved conservation plan. Expenditure on draining or filling wetlands is not allowable under this.

8.2.2 The allowance may not exceed 25 per cent of the taxpayer's gross farming

income in the year. Any excess over that can be carried forward or back for use in other years. If the deduction creates a loss, that loss can be carried forward or back.

8.2.3 There are then provisions for taxing some or all of the deductions made if the land, where owned for less than 10 years, is disposed of, save by gift or transfer on death. The money is fully taxable if the land is disposed of within five years of acquisition, with the taxable element phased down to nil at ten years. This mechanism is not geared to the timing of the conservation works.

8.2.4 The Revenue Act 1978 permits certain approved cost sharing payments under several federal and state programmes (as for clean water or conservation) to be excluded from gross income where they are for capital improvements. Where the property is sold within 20 years of the improvement being made, part or all of the payment can then be taxed as ordinary income.

8.2.5 The taxpayer can elect under s.180 of the US Tax Code for spending on fertiliser, lime and soil amendments and conditioners to be deducted from income, rather than capitalised over the period for which soil fertility is affected. Before this, any application expected to have an effect lasting more than a year was considered capital.

8.2.6 This could have a particular application not only with the growing interest in achieving improvements in soil structure in the UK but also with the emphasis on improving pH status and other nutrients shown in the Gilliland Agri-Food Strategy Land Use Experts Report on Sustainable Land Management Strategy in Northern Ireland with similar issues indicated for much grassland in Great Britain.

8.2.7 The US Heartland, Habitat, Harvest, and Horticulture Act of 2008 (the 2008 Farm Act) contained a package of tax changes including:

- the exclusion of conservation reserve payments made after 2007 from self-employment tax if received by an individual receiving Social Security retirement or disability payments.
- the extension of the favorable tax treatment of capital gains on property donated for approved conservation purposes, to encourage such donations.
- a new deduction (noted above) for expenses in aiding the revival of endangered species incurred after 2008.

8.3 Ireland

The 2016 Budget introduced an exemption from CGT for compensation payments made after 1st October 2016 to owners of and rights holders over bogs under the Raised Bog Restoration Scheme. This includes payments for the voluntary purchase of land or a management agreement. This provision also applies to such payments under the Cessation of Turf Cutting Scheme.

8.4 Natural Capital Allowances?

8.4.1 In 2017, the Green Alliance published Natural Investment: Future Proofing Food Production in the UK (an extract is at Appendix 2). Among its

proposals was the suggestion of Natural Capital Allowances (NCAs) as an incentive for investment by the private sector in environmental restoration:

> "The asset value of much of the UK's agricultural land is in long term decline, measured in terms of its productive potential and indicators such as soil carbon and ecosystem health. Increased private investment in land management is necessary to maintain the productivity of land over the long term, for the benefit of both private businesses and the public interest more broadly."

8.4.2 The NCA would enable businesses to claim tax relief from Income Tax or Corporation Tax, based on expenditure that enhances environmental efficiency by delivering measurable improvements to environmental systems on farmland.

8.4.3 In practice, it appears that a key point in this is its potential use by other businesses in the supply chain rather than farmers and landowners on their own.

8.4.4 This approach would have three distinctive characteristics.

8.4.5 Landowners and farmers would receive tax relief on the capital cost of, for example:

- purchases of technology that improve the environmental management of land, such as minimum tillage equipment. These are already covered by current allowances but the NCA could have the effect of:
    - increasing the Annual Investment Allowance, currently capped at £200,000 per year,
    - extending Enhanced Capital Allowances to qualifying technologies.

  In either case, qualifying technologies could be identified on a central list, as is currently the case for energy and water saving technologies;
- land use change, which could include changes in management, drainage modifications, installing fencing or seeding and planting. Again, some of those items would be deductible revenue costs but others might not be.

8.4.6 Other businesses in the supply chain would receive tax relief on certain capital costs related to support for asset owners, potentially including:

- technology and knowledge transfer to support farmers in the adoption of environmentally efficient agricultural practices
- co-investment (for example loans or grants) with suppliers to support technology purchases or land use change.

8.4.7 This approach would be based on the principle that businesses may receive tax relief for investments into an asset that they do not own but which is essential for their ongoing trade.

8.4.8 That, of course, raises the point about any interaction between measures sought by others in the supply chain and the landowner's or tenant's position for tax and other matters, as, for example, if land devoted to environmental measures no longer qualified for reliefs from capital taxation. Might it raise the possibility of double relief on some measures and so

perhaps as to which relief should take precedence?

8.5 Environmental Improvements: Soil and Water

8.5.1 With the growing policy concerns and public interest in issues over soil status and water management, it seems right to question whether there is a role in the taxation system for this. The present structure and language of natural capital accounting still seems more relevant to environmental economics than to the accounts of small businesses. It may yet be that the potential uses of cross compliance and the more positive commitments of agri-environment schemes are the more effective tools.

8.5.2 The developing exploration of value for soil status by the CAAV could though lead to a proposal that the taxation system could play its part in this as one means of internalising the issues for businesses, especially while such issues are not expressed in the market place.

8.5.3 It might be that there could be a means to recognise the initial improvement in stocks of, say, soil organic matter.

8.5.4 At the margin, a recognition of works to improve water management as business costs would remove some concerns that they are not incurred for the purposes of business.

8.5.5 Consideration of the soil and water conservation expenses provisions of s.175 of the US Tax Code discussed above may assist the development of thinking.

Summary Points:

- **How can the taxation system help with the growing policy concerns and public interest in issues over soil status and water management?**
- **Could long-term spending on soil status and water management deducted from income, rather than capitalised over the period for which soil fertility is affected?**
- **Are there ways of recognising the "capital" nature of environmental works?**

SECTION 9 – A POSITIVE ROLE FOR TAX: OPPORTUNITIES AND CHOICES

9.1 Most discussion of tax policy to achieve desired ends tends to prompt talk of further reliefs. Securing those reliefs will depend on accepting that they are seen as necessary or good in themselves or that they achieve ends justifying their cost. So far as any package appears to lower the incidence of tax, it requires review of whether:

- it will unlock more taxable income
- the loss is justified on public policy grounds
- the loss should be made up elsewhere by compensating measures.

9.2 Much of this discussion paper concerns taxation's role as part of supply side policy and so how it could be re-designed to open the way to flexibility and innovation, unlocking more economic activity and taxable income. The goal of improved productivity drives that focus.

9.3 It could be suggested that agriculture, short of physical investment in recent years, on the cusp of a major technological revolution and with many keen and skilled potential entrants, is at a point where such supply side moves could yield real dividends.

9.4 In that, the analysis for Ireland is striking, that moving land into the hands of the trained can deliver a significant improvement in productivity. Achieving only a fraction of the identified gain would have a substantial impact on the Total Income From Farming (TIFF), especially if it is considered without subsidies.

9.5 The figure suggested here (see 2.5.9) for that gain resulting from perhaps modest assumptions is substantial when compared to the very rough initial view of the potential cost of Income Tax relief on rental income from farmland (see 4.4.513): a gain of £600-800m and a tax "cost" of based on £120m. The Irish evidence suggests that a soundly designed scheme (see the model offered in at 4.4.5.6) has real potential to effect supply side change. The sense of Brexit as a time of economic choice may add potency to that.

9.6 Nonetheless, recognising that the outcome of that and other measures cannot be certain, the discussion of improved policies must also pose such questions as:

- what reliefs might be removed or reduced in compensation?
- what reliefs offer less benefit than some reviewed here or run counter to the new policy goals?

9.7 Equally, it could be argued that anticipated costs could be seen as redirection of funds from the present Basic Payment, and so in competition with other policy uses for that money, with a choice between current support and future profitability.

9.8 Both policy decisions and economics are about choice. Brexit gives us the moment and the opportunity to look at better choices to improve the sector that provides much of our food, our environment and our landscape.

APPENDIX 1

FUTURE OF FARMING REPORT 2013 – SECTION ON TAXATION

Taxation

5.45 Many of those who have provided evidence to us have highlighted the role of taxation in driving behaviour that affects progression in the sector. If new land is to be let it will often be let by private land owners for whom taxation is often a key factor. We have set out some tax arrangements that relate to the letting of land and sale of businesses. We recommend that Government consider these proposals, but recognise that more investigation would be needed into the cost and benefits, for the exchequer and industry, and the affordability and simplicity of the proposals.

5.46 Those who own agricultural property with its relatively low returns but with substantial investments in buildings, plant and machinery are naturally sensitive to the stimuli provided by the taxation regime, notably but not exclusively capital taxes. These points have often been recognised by tax legislation with examples such as averaging for Income Tax and Agricultural Property Relief (APR) from Inheritance Tax.

5.47 The farming sector is dominated by family businesses, with the majority operating as partnerships and sole traders for whom incorporation would often pose tax problems. However, the pressure of recent tax legislation has been apparently to favour companies over other business structures. For example, recent reductions in Corporation Tax rates that benefit farming companies, a minority, were said to be funded by the withdrawal of Agricultural and Industrial Buildings Allowances. This disadvantages the majority of farm businesses who are partnerships and sole traders. **We believe that the taxation of agriculture should be neutral between business structures.** It seems wrong for tax law to favour corporate structures, which new entrants tend to avoid for understandable reasons (e.g. administrative burden), and as a result for it to discriminate against the more common structures in the farming sector.

5.48 There are two specific areas where modest tax reform could encourage more farm tenancies, an important area for new entrants.

5.49 Stamp Duty Land Tax (SDLT) was introduced in 2003 to target issues in very different and much higher value sectors of the economy. The present structure of SDLT creates both a disincentive to longer term lettings and a compliance burden for agricultural tenancies which may be running on from year to year after the expiry of the initial fixed term. Noting the Central Association of Agricultural Valuers (CAAV) estimate that the SDLT due on all the new agricultural tenancies granted in the UK in 2011 would have been less than £500,000, **we commend to the Government the joint CAAV and Country Land and Business Association (CLA) proposals on SDLT, endorsed by Tenancy Reform Industry Group (TRIG), of August 2012 to the HMRC review, which were intended to be tax neutral**.

5.50 Entrepreneurs‟ Relief is a very important relief from Capital Gains Tax (CGT) on the disposal or cessation of a business, particularly valuable since the abolition of indexation

allowance for individual taxpayers. However, the relief is not available on let land. That means that a farmer wishing at some point to sell has a very strong reason not to let his land in the meantime. **We recommend that letting property on a farm business tenancy under the Agricultural Tenancies Act 1995 should not disqualify it from Entrepreneurs' Relief.**

5.51 These two points, among others, create particular problems for our goal of ensuring a flexible and progressive industry. Having had little time to review these, we recommend that a working group be asked to report in greater detail on the two areas described above.

5.52 A further area that farmers have access to, are two key reliefs from Inheritance Tax (IHT):

- Business Property Relief (BPR), is available to any private business owner on the market value of the business
- Agricultural Property Relief (APR) on the agricultural value of qualifying agricultural land, buildings and houses. Unlike BPR, it recognises the distinctive place of the working farmhouse and makes no discrimination against letting land.

We recognise the complex nature of the reliefs and interactions between them.

5.53 History shows the practical need for an agricultural relief from IHT, so that working farms with their fixed equipment do not have to be broken up to pay the tax, distorting their structure and damaging their economic potential. Another long term theme is the concern that it should not discourage owners (often aging ones) from letting. Such a relief has always existed in some form ever since Estate Duty was introduced in 1894, save for a brief period after the introduction of Capital Transfer Tax in 1975 when it rapidly became necessary to introduce Working Farmer Relief, subsequently reformed to be APR.

5.54 With the key theme of this report being the need to encourage entry, progression and economic dynamism in the industry, we considered areas where the tax system may discourage older farmers from handing over to the next generation or letting to new or progressing farmers. We are concerned that aspects of the operation of APR may encourage an occupying farmer to retain ownership of the farm until death. While that is always an individual‟s choice, collectively that can hinder the opportunities for the entry, progression and economic potential we need. We suggest one simple change to the operation of APR to address this so that it operates as a relief for early succession, promoting generational transfer or letting of the land. The legislation should remain otherwise unaltered.

5.55 **We propose that, after a necessary period of warning, APR should not be available to individuals occupying property qualifying for APR after a stated age (say, 70)**. It would remain fully available on its present rules for transfers made at or below that age, whether lifetime or on death and for those of any age for land they have let out. This would have the added advantage of providing greater certainty to the farmer, rather than leaving a successor to face the consequences for the business and family of a possible failure of APR to apply at the unforeseen date of a later death.

5.56 If an occupying farmer wished to remain in business on his own or in partnership, he could, like any other owner of a private business, qualify for BPR, but not on the farmhouse.

With our interest in who is using the land rather than who owns it, the position for those who own farmland but let it out would remain unaltered, still potentially qualifying for APR as a landlord and offering opportunities for others to farm.

5.57 The nature of the issue being tackled makes it is very important that such a change be handled carefully and with good notice. With many owners already elderly, such a change should not be introduced overnight. Family, property and business matters often take time to resolve. We therefore suggest that the legal change be made to take effect some five or seven years its announcement, giving adequate notice and so encouraging early planning and action by those affected.

APPENDIX 2

EXTRACTS FROM THE GREEN ALLIANCE REPORT: NATURAL INVESTMENT: FUTURE PROOFING FOOD PRODUCTION IN THE UK (2017)

The government has asserted that it expects the private sector to play a substantial role in funding the long term maintenance of the UK's natural assets. But a range of factors currently inhibit this, including:

Short term competitive disadvantage
Restoration of the natural environment would disrupt current practices and transform how some natural assets are managed, requiring individual enterprises to accept short term competitive disadvantage to secure long term gains.

Low perception of risk
In the absence of immediate environmental shocks, and with a low risk of regulatory intervention, many companies will see no commercial case for action to improve the condition of the natural systems on which they depend.

Knowledge gaps
There are knowledge gaps relating to the status of natural assets such as soil, hindering effective decision making about how they should best be managed. Even where data exists it is not always in a form useful to businesses.

To overcome these barriers, in recent years the government has encouraged business action using a range of non-regulatory approaches, which we explore below. These include:

1. Reporting, valuation and accounting
2. Assurance schemes
3. Industry-led voluntary initiatives

Reporting, valuation and accounting
To date, valuation and accounting approaches have been most widely applied in the area of greenhouse gases. Since 2013, UK listed companies have been required to state their direct greenhouse gas emissions as part of their annual reporting.

There is considerable interest among both government and business in applying these approaches to natural asset impacts. Substantial progress has been made in developing corporate natural capital accounting tools, as well as the Natural Capital Protocol, which enables any company in any sector to incorporate natural capital risks into their decision making.

Nevertheless, the government's bullishness that natural capital accounting can deliver large scale private investment in maintaining the natural environment seems unjustified. One of the lessons from carbon pricing (see page 18) is that, unless the price allocated by businesses to their environmental impacts reflects the full costs incurred by society, there

will be no case for them to invest collectively in environmental protection at the level society needs. Furthermore, the feedback from businesses involved in the development and application of natural capital accounting is that its value lies in improving business management and strategy, which could be lost if it were approached primarily as a balance sheet exercise.

Setting the right value for natural capital: lessons from carbon pricing

Natural capital accounting enables companies to understand the value they derive from natural assets and systems and, hence, the value at risk from degraded natural systems. Many companies now allocate a shadow price (an internal accounting mechanism) as a decision making tool to help manage their environmental impacts. This is most commonly applied
to carbon. The price can be set in several ways:

- **Social cost**, ie the cost to society of the total damage from now into the indefinite future of emitting an extra unit of greenhouse gases now. This was estimated at £70 per tonne by the Stern Review to keep climate change below two degrees centigrade. More recent estimates are considerably higher.
- **Market price**, ie the cost of a tonne of CO2 in carbon markets, currently around £5 per tonne.
- **Abatement cost**, ie the marginal cost of avoiding greenhouse gas emissions. Analysis by McKinsey identified the range of costs to reduce CO2 from minus €150 per tonne through to €40 per tonne.

  While many abatement actions will be cost effective for business, many will be too expensive to support a business case based on market price alone, although other factors may justify individual companies investing in actions above this level. Under these circumstances, government intervention is necessary to raise the market price to a level closer to the social cost.

Assurance schemes

Assurance schemes are proliferating to reflect the growing demand for better environmental standards in production, alongside the development of supply chain guidance at scales from global to national. Some commodities, for example coffee, have a high proportion of assured
product on the market and others, such as wheat, have very little. However, assurance schemes vary to a significant extent in criteria and standards, and tend to weaken when applied to mainstream commodities. Many struggle to improve the underlying sustainability of agricultural production from land significantly. As such, they are more likely to contribute to a reduction in environmental losses, than to provide the sole means to ratchet up value chain performance to the degree necessary to achieve significant improvements in the environmental health of farmed land.

Industry led voluntary initiatives

Self regulation has become increasingly favoured by the UK government as an alternative to regulation in delivering policy goals. A number of initiatives have been introduced for food

and agriculture in recent years, including the Campaign for the Farmed Environment, the Courtauld Commitment and the Greenhouse Gas Action Plan.

A recent review of voluntary agreements concluded that their effectiveness depends on strong regulatory drivers, clear targets, monitoring and reporting. Most voluntary agreements were found to be ineffective as a result of the lack of one or more of these factors.35 This is reflected in the performance of the Greenhouse Gas Action Plan, the means through which the government is aiming to meet its target for reducing non-CO2 emissions from agriculture. This voluntary industry led platform aims to promote cost effective good practice to farmers in areas such as livestock feed and soil management. But overall emissions from agriculture have actually increased during the period in which the scheme has been in operation, and the government's statutory climate change advisers have called for a stronger framework to address the scheme's failures.

Summary

There is a strong economic case for the food sector as a whole to take action on environmental restoration. However, the barriers to action by individual farmers and value chain businesses are currently too high. Existing non-regulatory schemes supported by the government have delivered some benefits but fall short of protecting and improving the environment at a meaningful scale. Stronger government intervention is necessary to mobilise effective collective action by food sector businesses.

5. Harnessing the Power of Business

The natural environment will be restored more effectively, and at a greater scale, if the government works with businesses to set shared goals and remove barriers to private investment. Making this approach integral to the implementation of the government's 25 year plans for the environment and farming will lead to a higher likelihood of success than a continuation of existing policy approaches. And, in spite of the mixed results of many approaches, there are examples of the government and industry working together where market forces have not worked in the public interest.

Two areas in particular merit further investigation: the use of collaboration to secure shared natural assets, and stimulating private investment in environmental restoration via incentives.

Collaboration to secure shared natural assets

Structured collaboration to address complex challenges is becoming an increasingly important corporate strategy in some sectors. It is most strongly evident in the pharmaceutical and biotechnology sectors, where the scale and costs of medical research are increasingly motivating major pharmaceutical companies to collaborate on issues which benefit everyone,
for example by sharing data on properties of molecules at the research stage to make the process of drug discovery more efficient.

But there has not been much collaboration focused principally on environmental issues. Examples that do exist include the Sustainable Apparel Coalition, an initiative involving over

30 US clothing brands to develop an index and design tools to increase the sustainability of their products. There is also the Supply Chain Sustainability School for the construction and facilities management sector; and Refrigerants Naturally, an alliance between competitors Coca-Cola, PepsiCo, Red Bull and Unilever, and also Greenpeace and UNEP, to develop sustainable refrigerants. In the food sector, there is the Sustainable Agriculture Initiative, a global platform promoting the uptake of sustainable agricultural practices among its members.

While competition is as important in the food and drink sector as in any other, there is a clear common benefit to be gained from collaborating to overcome cost and complexity issues and increase environmental efficiency. This could include the co-development of metrics, problem solving techniques and the adoption of environmental targets, in pursuit of shared goals.

How the government can broker precompetitive collaboration: the example of the pharmaceutical industry

Government regulation, brokering or funding has been necessary to promote action on issues of public significance. It has been used to accelerate the pharmaceutical industry's progress in bringing forward new products, for example in anti-microbial resistance (AMR). This is resistance by bacteria to drugs such as antibiotics and is a significant and growing public health threat.

Globally, 700,000 people die per year from AMR infections. This is forecast to increase to ten million a year by 2050, at a cost of US$100 trillion to the global economy. Development of new vaccines and antibiotics, an essential step in tackling the AMR problem, is seen as commercially unattractive by the pharmaceutical industry.

In July 2014, the prime minister established the Review on Antimicrobial Resistance to identify the societal implications of AMR and propose concrete actions to tackle it. Led by the economist Jim O'Neill, it delivered its final report in May 2016. One of the principles underpinning the review's final recommendations was that the pharmaceutical industry should be a substantial funder of the work necessary to develop new medicines.

In January 2016, in advance of the review's final recommendations, and in collaboration with the review team, the pharmaceutical industry issued a joint declaration committing to action in three areas: reducing the development of drug resistance; increasing investment in R&D to meet public health needs; and improving access to high quality antibiotics. As of April 2016 this declaration had been signed by 98 companies and 11 industry associations in 21 countries.

The UK government has also committed £50 million to a new Global Innovation Fund to fill gaps in traditional funding schemes for R&D focused on diseases affected by AMR.

Stimulating private investment

Currently, environmental restoration is funded principally by the government through payments to land managers. But, in other policy areas, government funding is contingent

upon co-investment by the beneficiaries. For example, to benefit from feed-in tariffs for renewable energy generation, businesses or households must cover the capital cost of installing the technology.

Using a different model, businesses can claim an enhanced level of tax relief on asset purchases that have particular environmental benefits. Companies can claim enhanced capital allowances (see page 23), which permit the purchase cost of approved energy and water saving technologies to be offset against taxable profits.

Enhanced Capital Allowances
Enhanced Capital Allowances (ECA) are available for certain approved energy and water saving technologies, which allow businesses to set 100 per cent of the cost of technology purchases against taxable profits in a single tax year. This means a company can write off the cost of new plant or machinery against its taxable profits in the financial year the purchase
was made. An ECA is claimed through income or the corporation tax return. Loss making companies are also able to benefit from this type of ECA. Lifetime CO_2 savings from assets bought in the first year of the scheme are estimated at 9.5 kilotons.

There should be scope to make greater use of alternative types of public funding mechanisms, to encourage a greater level of private investment in the natural environment, alongside the existing direct payments model.

Summary
Despite making progress, in particular around benchmarking and raising minimum standards, existing value chain initiatives have not changed behaviour or released investment at the scale needed for environmental restoration. The government could increase the scope and impact of the food sector's efforts to protect the environmental assets upon which it depends by exploring opportunities in two areas: facilitating collaboration to secure shared natural assets, and creating new incentives for private investment in environmental restoration.

6 Our recommendations

Recommendation one: Facilitate collaboration in the food sector
Precompetitive collaboration focuses on developing the tools and knowledge which benefit all participants, rather than on the development of products, although companies may use the outcomes to develop competing products and services at later stages.

The complexity of food value chains, and the diversity and number of businesses that operate within them, make collective action to deliver environmental improvement extremely challenging. There is a clear rationale for government to intervene to facilitate structured collaboration within the sector.

The scope of precompetitive collaboration

We argued in our report *Natural Partners* that, where there is a business case for protecting the environment, policy should evolve to enable private interests to play a role. But, where the public is the primary beneficiary, the traditional policy tools of regulation and incentives should be used.

The case exists for the food sector to restore the natural systems associated with agricultural productivity to good condition, for example soils, water cycles, genetic diversity and pollinators. This would provide a suitable focus for a government-brokered collaboration. It would support food sector businesses to overcome the complexities of managing challenges in which they have a collective interest, and provide both private and public benefits.

A Sustainable Food Pact

To stimulate precompetitive collaboration the government should consider brokering a shared responsibility agreement for food sector businesses. This would be an agreement to increase the environmental health of the UK's natural environment by restoring the ecosystems which underpin agriculture.

Specifically, businesses would commit to a number of actions: to work together towards an overarching goal to improve the natural assets that support agricultural production; to develop measurable environmental targets and delivery plans; and to participate in an implementation
programme, either on an individual company basis or through enhanced collaboration, over the duration of the agreement.

Using existing approaches to define environmental goals

The complexity of natural systems means it is difficult to set the simple targets businesses need. Restricting the scope of the Sustainable Food Pact to restoring environmental systems which underpin agricultural production would go some way towards reducing this complexity, but would still require the adoption of specific measurable goals. This could be based on existing approaches, such as:

- **Natural capital accounting:** the Office for National Statistics has developed an experimental set of ecosystem accounts for UK farmland, but they cover only a small number of services delivered by the land. It is anticipated that a fuller set of accounts will be developed for 2020, to be integrated into the existing national environmental accounts.
- **An aggregate indicator:** this comprises soil, water, biodiversity and carbon measures, along the lines of the Environmental Health Indicators developed by the Scottish Wildlife Trust.
- **Value-based metrics:** an example of this is the discontinued environmental account for agriculture developed for the Department for Environment, Food and Rural Affairs.

Existing policy targets: for example, the fifth carbon budget target for reduction in greenhouse gas emissions from agriculture, the COP21 commitment to increase soil carbon

content by 0.4 per cent per year, or the Aichi target to manage 17 per cent of land as high ecological quality protected areas.

To be effective, the pact would need to reflect lessons from previous initiatives in fields such as pharmaceuticals. Experience in these areas has shown that structured and impartial facilitation, clearly defined objectives and stable, long term funding are the preconditions for success. It would also need to have teeth; voluntary initiatives in the farming sector have frequently underperformed without a regulatory driver, adequate monitoring and clear objectives. Precompetitive collaborations of this kind have been good at identifying what needs to change and how; but they have been patchy at best when it comes to delivery.

Avoiding these pitfalls would require a strong role for government. It should set expectations for what the collaboration should deliver, ensure appropriate levels of participation and outline consequences for nondelivery, including regulation.

In return, participants would benefit from the guarantee of a long term partnership with government to manage important challenges. They would also have the commitment of public sector time and resources, and freedom to define priorities and plans based on objective expert advice.

Specific support could be provided by the Natural Capital Committee (NCC), for example to determine the priority actions that would lead to cost effective environmental gains. The NCC could also advise on the role of government, for example how this area would interact with other policies such as post-CAP agricultural subsidies and water resource planning.

Recommendation two: Introduce Natural Capital Allowances

The government should introduce a new mechanism providing incentives for investment by the private sector in environmental restoration. Fiscal incentives are already used to facilitate private investments that deliver both public and private benefits. The existing capital allowances system, which supports business purchases of technology and other assets, could be extended to cover environmental restoration. There is a strong rationale for using capital allowances in this way. Land is a physical asset essential to the ongoing trade of farmers and land managers and, therefore, also to the value chain above them in the UK food sector. The asset value of much of the UK's agricultural land is in long term decline, measured in terms of its productive potential and indicators such as soil carbon and ecosystem health. Increased private investment in land management is necessary to maintain the productivity of land over the long term, for the benefit of both private businesses and the public interest more broadly.

We propose the creation of a new Natural Capital Allowance scheme, enabling businesses to claim tax relief from income or corporation tax, based on expenditure that enhances environmental efficiency by delivering measurable improvements to environmental systems on farmland.

This approach would have three distinctive characteristics:

Value chain participation
Extending capital allowances beyond asset owners, to include the businesses they sell to, will increase by an order of magnitude the resources available to support environmental restoration.

Defined investment priorities
These would be set by the sectoral collaboration to identify the most effective route to environmental restoration.

Quantified assessment of value for money
This would be based on sectoral reporting of what has been invested and the environmental gains it has delivered. As a link to verifiable outcomes it would address a common criticism of tax relief schemes.

How it would work
Natural Capital Allowances would need to support investment by both asset owners and value chain enterprises.

Asset owners
Land owners and managers would receive tax relief on the capital cost of, for example:

- purchases of technology that improve the environmental management of land, such as minimum tillage equipment; this could be done by increasing the Annual Investment Allowance, currently capped at £200,000 per year, or by extending Enhanced Capital Allowances to qualifying technologies; in both instances, qualifying technologies could be identified on a central list, as is currently the case for energy and water saving technologies;
- land use change, which could include changes in management, drainage modifications, installing fencing or seeding and planting.

Value chains
Businesses would receive tax relief on certain capital costs related to support for asset owners, potentially including:

- technology and knowledge transfer to support farmers in the adoption of environmentally efficient agricultural practices;
- co-investment (for example loans or grants) with suppliers to support technology purchases or land use change.

This approach would be based on the principle that businesses may receive tax relief for investments into an asset that they do not own but which is essential for their ongoing trade. The existing capital allowances regime offers a parallel with respect to dredging: companies may claim capital allowances for expenditure on dredging waterways, provided the dredging
is for the benefit of vessels using a dock or other premises occupied by the person making the investment.

How Natural Capital Allowances would support investment

What it might cost
For illustrative purposes, we have examined how Natural Capital Allowances might apply to the £240 million investment into soil restoration outlined in chapter three. Of this money, just over £100 million would be spent as a capital cost, covering fencing and other infrastructure, planting and seed costs. The remainder would be spent on labour and other costs.

Assuming that this money would otherwise be subject to income tax of 40 per cent, the cost to government of making the whole of this capital cost eligible for capital allowances would be just over £40 million. This is likely to be an upper estimate, as it assumes that the full cost would be deducted from profits, ie that all parties making investments are profitable, which many agricultural enterprises are not. It may also double count tax relief already being claimed.

This is a simplified approach aimed at revealing approximate values. It suggests that a relatively modest contribution from the government, particularly in the context of a tax system that offers reliefs worth £100 billion annually to achieve specific policy goals, could potentially leverage five times more private investment.

Value chain business
Natural Capital Allowance supports investment in technology and knowledge transfer and co-investment with asset owners into land

Asset owners
Natural Capital Allowance supports investment in technology purchase and land management changes

Outcomes
Environmentally efficient food production, resilient soils and ecosystems

Benefits of collaboration
Increasing the private sector's participation in, and funding for, restoring the UK's natural environment will offer considerable benefits for both the public and the UK's food sector.

Brexit has opened up opportunities for the UK government to facilitate this process. By introducing the right policies and incentives in the short term, the government could help shift UK food and farming towards genuinely sustainable production, bolstering long term agricultural productivity and providing a genuine point of difference for UK food businesses outside the EU.