Lancashire, Manchester & N Merseyside

A review of some impediments to farmers entering environmental land management agreement commitments.

Produced for the Lancashire Wildlife Trust
by Jeremy Moody

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Biography of Jeremy Moody

Jeremy Moody has been an adviser on agricultural and rural property and policy issues since 1979, both as an independent consultant and retained as Secretary and Adviser to the Central Association of Agricultural Valuers. He deals with governments in Whitehall, Edinburgh, Cardiff and Belfast – and previously Brussels - and other bodies as well as with many practical issues and questions posed by valuers, farmers, owners and others. He is the Visiting Professor of Rural Land Management and Policy at the RAU, vice chairman of the European Valuation Standards Board and was awarded an honorary doctorate from Harper Adams University.

Having been engaged with the rounds of CAP reform for more than three decades and then the Brexit process, he is engaged with DEFRA and other governments on the new agricultural and environmental policies across the UK. He is a member of groups including the Arable Chain Advisory Group, the Livestock Chain Advisory Group and the Agri-Supply Coalition.

The policy work includes how major changes and improved farming productivity might be managed with farm structures, land occupation and use, and farming retirement and housing. This has included the CAAV publications *Beyond Brexit: The UK's New Agricultural Policies*, *Reviewing a Business* and *Future Rural Land Uses in the United Kingdom* as well as materials on environmental agreements, and sustainability for valuations of property and businesses (including that section of *European Valuation Standards 2020*). He has written *Taxation: Agricultural Productivity, Land Occupation and Use after Br*exit and more specifically on the Irish Republic's use of Income Tax relief on farmland lettings to promote productivity.

With a long involvement in agricultural tenancy matters, Jeremy saw through the FBT reforms of 1995, is a member of the Tenancy Reform Industry Group (TRIG) for England and Wales and works on tenancy issues elsewhere in the UK. He was on both the Macdonald Farming Regulation Task Force Implementation Group and DEFRA's Future of Farming Group and sits on DEFRA's Agricultural Productivity Task Force.

Having now co-authored the fifth edition of *Agricultural Valuations: A Practical Guide*, he has worked, written and spoken on a wide range of other legislation from taxation to the recent Electronic Communications Code governing masts and cables, also addressing conferences abroad from Portugal to China. He is tackling emerging issues such as soils, climate change adaptation and mitigation, and natural capital and public goods alongside the productivity challenge for farming and the debate on land value capture from development.

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A REVIEW OF SOME IMPEDIMENTS TO FARMERS ENTERING ENVIRONMENTAL LAND MANAGEMENT AGREEMENT COMMITMENTS

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EXECUTIVE SUMMARY

1. Farmland is typically held by individuals in families over generations who work it to achieve a living. It is not only the premises where farming happens but is also fundamental to the operation of farming, akin to its plant and machinery. It is seen as a store of financial and moral value for those who own and occupy it, often with a view to passing it on, improved, to the next generation, keeping options open for them. Its value, use and preservation are typically significant to those who hold – often all the more so for those with smaller patrimonies. [2.1-2.3]

2. A significant area of land is let by owners to farmers, whether on long term tenancies, as under the Agricultural Holdings Act or longer Farm Business Tenancies, or shorter lettings. The tenant is the occupier controlling the land in which the landlord has the long term interest. It will matter how far their interests coincide in seeing environmental agreements as attractive. [2.9]

3. These issues pose challenges for those asking farmers and owners to consider applying their land to environmental uses, some potentially changing its character significantly. This paper considers the key hurdles in this task, including taxation and tenancies but also the softer issues around language and approach. It concludes with recommendations for positive changes on points that are amenable to public policy actions that would remove barriers to landowners and farmers entering environmental agreements and summarised here.

4. Taxation [2.5-2.8] - Beyond the design of its own schemes and framework for innovations such as Biodiversity Net Gain**, the single most critical policy change available to the government to give confidence to owners of rural land in positively adopting environmental commitments is that this be recognised by relief from Inheritance Tax [2.5.5, 2.6.5-12, 2.9.23, 4.2, 4.12-14].** If owners fear that entering a significant environmental agreement risks a 40 per cent charge to Inheritance Tax on the value of their land, few will want to take this venture [2.6].

5. The equivalent change in 1995 for letting land was very effective in supporting use of the then new Farm Business Tenancies [2.6.9, 4.13].

6. The natural model for this is the inclusion of land in recognised agreements within Agricultural Property Relief (APR), using, say, the template of s.124C of the Inheritance Tax Act 1984[1]. This approach achieves an equality between environmental and agricultural uses and does not require trading activity, so reassuring landlords as well as owner occupiers. [2.6.8, 2.6.10, 4.12, 4.14]

7. Such a change would be both a practical answer to a real issue in the marketplace and, of at least equal importance, a clear signal instilling confidence that environmental management is not a risk in managing a long-term and relatively illiquid asset.

[1] https://www.legislation.gov.uk/ukpga/1984/51/section/124C

8. That should be supported by clear guidance from HMRC and reinforced by the practical work of professional and representative bodies, applying and clarifying such a relief. That does require such a change in tax law to be made [2.5.5, 4.15].

9. Land Tenure [2.9] - The position of agricultural tenants has to be recognised but beyond the new s.19A's powers for a 1986 Act tenant to challenge a refusal of consent or a term of the tenancy as regards a new DEFRA scheme (but not any private scheme such as Biodiversity Net Gain), there may be little to be done by law without a serious breach of the property rights of landlords and so undermining the confidence of owners in letting their land at a time when a greater use of letting may be important for the economic restructuring of farming.

10. The variety of tenanted situations needs to be appreciated, ranging from a farm rented long term from an environmentally minded landlord to bare land with development prospects let on a short term agreement. Rotational arrangements as for specialist vegetable cropping will be part of the matrix. Generally, tenants are anyway more likely to want to focus on options that are consistent with the farming use that is their practical purpose as well as within their time horizon while some landowners may more naturally see a wider range of possible uses.

11. Again, it would be helpful to support the development of practical approaches for longer term tenants to have access to environmental options that the landlord does not see as adverse to the land and which, with increasing familiarity, can lower the costs of agreements. [2.9.9, 2.9.18]

12. It may yet be that as schemes develop, they could influence the periods for which tenancies are granted. Policy stability is needed if longer lettings are wanted; policy uncertainty and change drives both would be tenants and landlords to seek shorter agreements rather than assume risk. Imposing a minimum term will simply deter many owners from letting land, an adverse outcome. [2.9.15-16]

13. Issues in Promoting Agreements - That wider task of making environmental land management seen as a normal activity for a landowner or farmer to consider would be aided by:

- the **levels at which payment rates are set** such that it is a rational and competitive use of relevant land being seen as an enterprise with margins alongside wheat, milk, and lamb.
- the **language** used for this needs to be positive and in terms that will resonate with farmers, perhaps more feasible for improved biodiversity than for mitigating climate change, but an issue for all advocates of change. [2.4]

14. Seeing Private Sector Activity as a Natural Part of the Picture – This will come from many quarters. While water companies were early pioneers, others in the supply chain are likely to drive commitments. Biodiversity Net Gain and nutrient neutrality may offer substantial payments to some for long term commitments, based on their link to development value. [1.4]

15. The Framework for Markets – All markets need confidence in what they are selling and buying to give proper pricing and full benefits. That requires shared definitions of what is being bought and sold and how it is measured (as with the Biodiversity Metric). These markets face the extra question of additionality and the differing interpretations of it – likely to be a more problematic issue than many currently perceive. It is important to have general clarity about such agreements involve – including what is being sold, what restrictions are being imposed, what penalties would apply for failure or breach and what cannot then be sold separately – to help establish confidence and the proper identification of value that will underpin the trust needed for these long-term relationships. [4.6-7]

1. The Developing Landscape of Environmental Land Management Agreements

1.1 Overview and the Basis for this Review

1.1 The accumulating awareness of issues founded on climate change (with its mitigation and adaptation) and biodiversity is promoting the development of potentially interlocking public schemes and private sector initiatives opening up new income streams and markets for landowners and occupiers. The Government is also developing the regulatory structures that will enable private markets as by Biodiversity Net Gain, Nutrient Neutrality and Carbon offsetting with the necessary underpinning measurements offered by the Biodiversity Metric, the Woodland Carbon Code and the Peatland Code.

1.2 The Lancashire Wildlife Trust has commissioned this review to help with the development of a DEFRA-funded Test of its proposed Environmental Land Management schemes (ELMs) in the peri-urban areas of Greater Manchester. DEFRA is particularly keen to hear why farmers and land managers working on the edges of towns and cities have not readily taken up agri-environment schemes in the past and so how the new scheme could encourage greater participation.

1.3 Early discussions with farmers and the Test's Advisory Group have highlighted the difficulties of taking land out of agricultural production and its impact on the taxable status of the land and land values. Tenant farmers are showing concern that landlords might not support entry into an ELM scheme that ties land into long-term non-agricultural uses such as wildlife habitat, and limit future options and land value. Landowners are unsure of the tax implications of scheme related decisions. Clarification was requested on the real and likely barriers to uptake of the ELM scheme and other stackable funding options.

1.2 The Government's Larger Approach

1.2.1 The Secretary of State at DEFRA, George Eustice, recently outlined the Government's desired policy outcomes:

> "These are to halt the decline in species abundance by 2030; to reduce our greenhouse gas emissions; to plant up to 10,000 hectares of trees per year in England; to improve water quality; to create more space for nature in the farmed landscape; and to ensure that we have a vibrant and profitable food and farming industry which supports the government's levelling up agenda and helps safeguard our food security." (Speech, 2nd December 2021)[2]

1.2.2 Where this is a matter of public money rather than the regulatory baseline, it is a voluntary offer as farm businesses find their own way forward in the new context. George Eustice set this out:

> "The new policy will be optional, but open to all. It will be modular. Farmers will be free to choose which elements work for them. In some landscapes and in some sectors, some businesses may decide to embrace it extensively. For others, the scheme may be a smaller part of their business model, but they may make space for nature on less

[2] https://www.gov.uk/government/speeches/environment-secretary-speech-at-cla-conference-2-december-2021

productive parts of their holding. It is not the role of the government to tell farmers what to do, but rather to offer market-based payments to willing participants in order to incentivise the uptake of schemes on the scale required to deliver the policy outcomes that the government has set itself."[3]

1.2.3 The broad framework for pricing the payments for the new schemes was set out by DEFRA in its Payments Principles paper of June 2021. That outlined the change from the EU's compensatory, income foregone, approach to pricing to one intended to be attractive to farmers while being value for the money given. As George Eustice told the 2022 Oxford Farming Conference:

> "We now have legally binding targets for the environment, most notably a target to reverse the decline in nature by 2030. And we have a responsibility as a Government to ensure that the payment rates we make are attractive enough to incentivise the uptake of our schemes on the scale needed so that we can hit the targets we've set ourselves and to which we are legally bound to deliver.
>
> "The key difference with our future schemes is that we are seeking willing participants who are attracted to the schemes because of the payment rates we're making."[4]

1.2.4 That approach to pricing, as it develops, could in time assist farmers and owners to see the environment as an economic enterprise among their choices as to the possible mix of uses for their land to achieve an economic output. That has the potential to integrate environmental operations and outputs from farming into assessments of total factor productivity, that is, the efficiency, profitability and competitiveness of the business.

1.2.5 Access to public money is also being linked by DEFRA to the potential interest in such matters by private sector supply chains and investors. Building on that Payments Principles paper of June 2021[5], DEFRA's December 2021 policy paper, Sustainable Farming Incentive: How the Scheme will work in 2022[6], advised that:

> "Farmers will be able to enter land into SFI if that land is in a private sector scheme (such as carbon trading, payments for natural flood management, biodiversity net gain credits, or nutrient trading). They can also enter land into such schemes after they join SFI. In other words, a farmer can engage in SFI and a private scheme for the sale of environmental outcomes on the same area of land, subject to the rules and requirements of those schemes including on additionality and verification.
>
> "We will ensure that we are not crowding out private finance and that land managers are better off where they access private markets. We also wish to avoid paying for the same actions that are already being paid for in a private scheme."

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[3] ibid

[4] https://www.gov.uk/government/speeches/environment-secretary-shares-further-information-on-local-nature-recovery-and-landscape-recovery-schemes

[5] https://www.gov.uk/government/publications/environmental-land-management-schemes-payment-principles/environmental-land-management-schemes-payment-principles

[6] https://www.gov.uk/government/publications/sustainable-farming-incentive-how-the-scheme-will-work-in-2022/sustainable-farming-incentive-how-the-scheme-will-work-in-2022

1.2.6 In short, DEFRA's pricing of its schemes appears to bear in mind the potential for the commitments to be achieved by commercial private sector agreements. Feed-in Tariffs for renewable energy generation offer a previous example while the Woodland Carbon Guarantee Scheme expressly provides agreements that can be taken on by the private sector when it is willing to pay more for that carbon.

1.3 Government Measures

1.3.1 The measures to be introduced under the new Environment Act 2021 include:

- the Government is to establish and be held to a number of long term targets including ones for species abundance, soil health, water and air quality, all of which have the capacity to be relevant to the use of rural land
- a local planning structure of Local Nature Recovery Strategies, guiding habitat development, again relevant to affected landowners for whom it may bring opportunities or restrictions
- a requirement for development to deliver biodiversity net gain, on-site or off-site, on at least a 30 year commitment, with conservation covenants provided as a new legal tool available for this, involving recognised "responsible bodies"

1.3.2 In England, DEFRA is developing a suite of schemes, progressively repurposing what was previously the CAP money spent in England, to promote environmental land management with:

- the Sustainable Farming Incentive (SFI) now developing with measures that can accompany farming
- the Local Nature Recovery Scheme, likely to promote more significant change in habitats to support biodiversity/species abundance and ancillary goals, including woodland creation and peatland restoration
- the Landscape Recovery Scheme, doing that on a larger scale as perhaps for parts of a catchment.

In the later years of this decade, each of these is intended to take a third of the environmental share of this spending. With those schemes to be fully available from 2024, a number of bridging schemes are operating, including the England Woodland Creation Offer (EWCO), Farming in Protected Landscapes (FiPL) and the revised Countryside Stewardship Scheme, now seen as a "a bridge to Local Nature Recovery"[7].

1.3.3 In general and subject to issues of interpretation, government schemes can be seen to be paying for changes in practices or the creation of habitats, not the sale of assets with accompanying controls on the farm. The one exception is the Woodland Carbon Guarantee Scheme which buys carbon (and, with woodland, effectively bars substitute uses of the land in the future).

1.4 Private Sector Involvement

1.4.1 The private sector has a diversity of reasons to become more involved in these areas:

[7] https://www.gov.uk/government/speeches/environment-secretary-shares-further-information-on-local-nature-recovery-and-landscape-recovery-schemes

- water companies have a record of seeking agreements for changes in farming practices, generally to improve water quality and save downstream costs in purification though the Rewetting of the Exmoor Mires project was more about continuity of supply
- other businesses where buying an environmental solution (such as a reed bed) is a more cost-effective answer than a traditional engineering solution
- a small but growing market in biodiversity offsetting for development is now to be taken forward by biodiversity net gain tapping into the development uplift in value that such agreements could unlock as approved by local planning authorities, with a parallel process also emerging for nutrient offsetting (phosphates and nitrates) for development
- supply chains are increasingly seeing processors or purchasers seek specified standards from suppliers, whether to protect reputation (in the wake of "horsegate") or security of supply (as with Nestle for bottled water) or assure investors and lenders requiring climate change or environmental improvement
- businesses driven by policies or circumstances to seek to offset their environmental impact, with varying balances as to whether this is as a substantive measure or for presentational purposes.

1.4.2 A number of these require more than simply commitments to changes in practices but rather the guarantee, alienation or sale of outcomes (such as carbon sequestration) to benefit a third party – in that sense a purchaser of "assets" rather than of services. With such a purchaser having the right to the delivery of the environmental achievement that has been agreed with restrictions on and potential penalties for the contracted farmer. Such issues have been exposed by the summer 2021 fires in California destroying forest areas pledged for corporate offsetting of carbon.

1.4.3 Behind these actions lie analysis and pressures from central banks and insurers, conscious of the risks posed by continuing climate change and other environmental questions with issues such as flood, storm, fire and drought. That is driving growing financial intervention and regulation to encourage both their mitigation and practical adaptation to the new threats. This has prompted global initiatives such as the work of the Task Force on Climate-related Financial Disclosures (TCFD) and is beginning to influence both domestic corporate reporting policies and the relative costs of capital to businesses considering their options.

1.4.4 In turn, that drives discussions of relevant standards (such as a taxonomy of what counts as "green"), associated doubts about the validity of much offsetting and so a more rigorous definition of "additionality" to exclude green investment from outcomes that could already be expected to happen anyway.

1.5 The Mitigation Hierarchy

1.5.1 One effect of internationally agreed environmental principles has been the mitigation hierarchy so that, in sequence, the priorities are:

- to prevent or avoid damage
- to minimise it
- to restore damage that has nonetheless occurred
- only last, to offset it elsewhere.

1.5.2 For farmers and landowners, especially those facing the challenges for agriculture to be net zero, this will bear on:

- the expectations on their own businesses, as, for example, for the management of carbon (which may include the sectoral distinction for emissions reductions between agriculture and land use) or the reduction of potential pollution
- the external demand from those seeking offsetting.

1.5.3 The balance between what needs to be done by the farm, can be done on the farm for others on the right terms and other objectives (such as income) will vary from case to case and between individuals with their circumstances. However, and aside from the small scale of many ownerships limiting what could be offered, there are some general reasons for owners to be cautious on entering into these relatively new areas which can perhaps be crystallised as:

- psychology, with self-image, motivations and reluctancies
- language
- retaining future options
- taxation

and, for tenants, practical issues of business and land tenure.

2. The Landowner's Typical Concerns

2.1 Motivators and Deterrents - The Farmer

2.1.1 While, like all other people, farmers frequently surprise, there is a recognised range of motives for farming that can be seen as a spectrum from the transactional businessman to those who farm because that is what they are. Typically, many have a blend of the motives, with different aspects predominating according to circumstances and pressures. These have recently been reviewed for the Welsh Government in a study by IHS Markit, *Understanding Farmer Motivations: Very Small and Small Farms*.[8]

2.1.2 That study was focussed on farms with a standard output under €125,000 and, in Wales, overwhelmingly grassland livestock grazing farms. They would thus not necessarily be representative of commercial vegetable famers and horticulturalists or of dairy farmers but many smaller arable farmers might be similar. One principal difference from much of Lancashire and its peri-urban areas is Lancashire's greater proximity to the wider and urban economy. That said, only 32 per cent of the Welsh sample had no off-farm income. The Survey reported that they were primarily focused (91 per cent reporting this) on trading income from agricultural produce as a source of income. That came ahead of Basic Payment (76 per cent), off-farm earnings (64 per cent) and environmental payments (54 per cent) with pensions, diversification and investment income with less salience. On being asked about post-Brexit changes, the only common response for this future was that 64 per cent expected to start providing public goods. In summary, production is their focus but Basic Payment is important (alongside other income sources) with environmental options seen as of prospective interest.

2.1.3 Four motives for farming were tested, albeit they can be seen to overlap and reinforce each other:

- instrumental – to achieve something, commonly an income, potentially expanding the business
- social - place in the community
- expressive - pride of ownership, self-respect, exercising special abilities and aptitudes
- intrinsic - enjoyment of work, value in hard work, independence.

The survey found that the overwhelming motives were intrinsic ones with instrumental reasons least cited. That fits with the larger view that farmers should not be assumed to be motivated to maximise income but are rather driven by a sense of identity with the supporting will to survive.

2.1.4 In economic terms, the range of financial and physical performance between farms of similar types is vast with the upper end viable in almost all circumstances and the lower end already, on standard farm business accounting approaches, losing money by farming even with subsidy. That latter position is sustained partly as much that might be drawn into account (including own labour and depreciation) does not see the immediate movement of cash while off-farm household income can sustain the identity of being a farmer.

[8] https://gov.wales/sites/default/files/publications/2021-08/understanding-farmer-motivations-very-small-small-farms-full-report.pdf (IHS Markit, 2021)

2.1.5 In considering how environmental agreements might attract in future, some work done by DEFRA, under the compensation basis of the EU's approach to income forgone/cost incurred, points to:

- payments having tended to more than compensate grazing farms with the sense of a consequent higher take up by them
- combinable cropping farms being about fairly compensated
- dairy farmers finding the schemes unattractive by failing to compensate for economic loss on what are often tightly managed and well-benchmarked businesses.

It remains to be seen how that will evolve as the application of DEFRA's Payments Principles paper of June 2021[9] adopts a more transactional approach. What is there to be sold as public goods and what is to be paid for them?

2.2 Motivators and Deterrents - The Land

2.2.1 Farmland, a relatively illiquid and non-fungible asset, is typically held by individuals for the long term, commonly with an expectation of family continuity. As an illustration, it appears to be only the significant sector of the economy for which the 1982 base date for Capital Gains Tax assessments is of continuing relevance. Turnover by sale has fallen from perhaps 700,000 acres a year after the last War to somewhere between 100,000 and 200,000 acres, partly as the scale of landholding has grown.

2.2.2 It is typically conceived as being held for farming purposes (commonly an integral part of the identity of the owner) even where the farming is substantively done by others (as by a grazier or contractor). There is in that something of a service ethic, valuing farming as a moral activity in its own right, reinforced by a historic sense of feeding the nation (aided by over 70 years of explicit and implicit support for commodity production). Especially in areas of marginal farmland, this is compounded by the self-respect bound up in land having been hard-won by the work and improvements of past generations and then hard-kept. It can be felt a defeat for that land to be seen as "abandoned", become "parkland" or go for commodity forestry, such changes allied to a sense of reduced economic and social activity and lost cultural features. The underlying bias is then combined with, as noted below, an intuition to keep options open.

2.2.3 However, there will be a consciousness of farmland's value for development where that is potentially feasible, widely understood as an opportunity for a significant access to increased value. Thus, land is not, in the generality of cases, held absolutely for farming but there is a common and strong bias that way.

2.2.4 An obvious exception (that perhaps proves the rule) lies in solar farms, typically achieved by a long lease (now between 30 and 40 years) to a developer paying some £800, £1,000 or more an acre in rent, without having sold the land. That is understood as a commercial venture on terms that are attractive and accepted.

2.2.5 Farmers do though see themselves as, by definition, close to nature, working out of doors and in the elements, generally wishing to do the right thing though judging that through

[9] https://www.gov.uk/government/publications/environmental-land-management-schemes-payment-principles/environmental-land-management-schemes-payment-principles

the prism of their own understanding and expectations, not necessarily those of environmentalists unconcerned with farming income or on-site practicalities. Farmers may not always be aware of the off-farm impacts of farm management or that the present condition of land might not be optimal. With a mis-match between what differing interests see as "good" (for example, the differing views over livestock and grassland management vis-à-vis carbon), there has though been much useful work on both sides to build bridges here but it is a continuing task. That task included building a body of knowledge and understandings as to issues and answers shared across farmers, owners, government, the various private sector bodies and the differing environmental groups. That corpus has then to evolve as scientific understanding develops and circumstances, including the climate, change.

2.2.6 Except perhaps on some dairy farms, there is commonly some land that can be released for environmental uses, whether from interest or public spirit, its lower productivity, it being rendered surplus by the management of land for particular machinery or irrigation or to improve amenity and sporting activity. Much of this may already have been done. The release of some more land might be prompted by the changes in support if less money flows to rewarding occupation of land that is farmed and more to land that is environmentally improved but other changes in farming occupation might unlock greater productivity potential from farming (as might stronger produce prices). However, better farmers may often be better environmentally through better management.

2.3 Preserving Options

2.3.1 Land is bound by its location with the opportunities and restrictions that imposes. It is reasonable for an owner not to want to act in ways that shut off future options with irreversible changes in land use. Woodland is an obvious example but so too is the designation of land as having an environmental status. However, some making more serious land management changes do so on the prompting of their children, the ones who might carry a biodiversity agreement and its consequences into the 2050s.

2.3.2 Making one substantial and irreversible change in land use may be seen to shut off other options, including those as yet unknown. Many farmers have lived to see policy changes be ineffective, perverse or reversed and they commonly have the capacity to endure longer than governments. The specific fear over substantial changes in land use to create new habitats for biodiversity is that it will lead to an externally imposed designation, such as an SSSI, permanently fettering the land. That is understood to be a significant fear for the well-publicised management of land for nature at Knepp Castle in Sussex with the concern that positively intended actions could prove to be a trap, as happened to those in the Breckland who fostered the stone curlew on their lands. Such designation is seen as a detraction not an attraction by private landowners and illustrates how prescribing protection for an outcome can make that outcome less likely to be achieved.

2.3.3 Perhaps less perceived but accompanying the cost and practicalities of any reversal, the effect of the Forestry Act 1967 is to make conversion of land to woodland a one way process. The commerciality of that should be understood. Woodland or forestry anyway have a longer time horizon, a different pattern of cash flow and a different approach to farming such that it is more likely to happen at scale on a change of land occupation than by the voluntary choice

of an existing farmer. However, that does not rule out establishing smaller blocks consistent with farming though their management might not be intuitive to the farmer.

2.4 Language

2.4.1 Where changes in land use have commercial appeal, they also need to be seen as normal for them to have traction as an option for many farmers.

2.4.2 As a wider observation, it is likely to be hard to take people through a period of change that is seen as potentially inconvenient, disruptive or expensive in ways appearing to outweigh the immediate benefits, especially where they intrude on the day-to-day immediacies of life's pressures and call on scarce resources. This appears particularly true of climate change mitigation where actions required may seem awkward, intrusive and costly with no individual action showing a benefit. Biodiversity, now increasingly closely linked to climate change policies, may less often see the language of the hair shirt and feel more positive. People can see change with new habitat but that will often be on farmland.

2.4.3 This means finding a language in which the changes required will be seen as positive and with a sense of shared mission. The nation did not double-glaze its windows so much for virtue or financial benefit but for comfort, and that neighbours were doing it – to the point where volumes in the market made double glazed windows cheaper and more available than single glazed ones, making them the norm. Creating the sense that some long term changes for biodiversity are normal actions for a conventional farmer to consider alongside other options will make them much easier to achieve.

2.4.4 The nature of farming as multi-generational business can add a dimension of time to that assessment of what is normal – not only what is conventional for other farmers to do now or what respected farmers are seen to be doing but also with the perspective of previous generations, some living and some dead. In some cases, the sense of what father or grandfather might think shadows current decision making, indeed current farming methods though, as ever, today's urgencies can pull against that.

2.4.5 The label and language of "re-wilding", for example, is seen as antipathetic to farming, partly because of its apparent meaning and partly the way it has been presented by some of its protagonists. There may often be a different farming response to James Rebanks than to George Monbiot or Chris Packham even when making perhaps overlapping points with probably similar practical effects in the real world.

2.4.6 Yet, in practice the models held up for "re-wilding" do not necessarily exclude farming activity and full re-wilding might on occasion be perverse for species abundance. With a natural tendency to fixate on labels, people often do not look beyond them at the actual realities but be misled by a label – this is material for taxation and land tenure – when more analysis might see a farming system that delivers both biodiversity and an improved financial margin. The language used would have deterred that outcome.

2.4.7 While more fundamental habitat change is rare, conventional agri-environment schemes, part of the scene for over 30 years, are now unexceptional. However, they are not

universal with even the generally undemanding Entry Level Stewardship scheme not attracting all. Some will not see it as suitable to their farm and some will not see it as financially attractive – these both often coming together for many dairy farmers. However, other farmers have been attracted where the options on offer are consistent with other interests, including shooting itself a factor for many in adopting agri-environment practices.

2.4.8 The prospective phasing out of Basic Payment may well be a factor behind the higher entry now seen for Countryside Stewardship which may then transfer to the new schemes. As these are schemes intended to buy change and so carry costs, these will though not offer the apparent financial margin of Basic Payment, the loss of which is likely to drive pressure on other costs and change business structures. It may become apparent in some cases that, perhaps particularly for some beef and sheep businesses, a more extensive approach with much reduced costs could offer a higher financial margin. A simple transfer to a new scheme is not intended to buttress profit as a substitute for Basic Payment but may be of particular assistance to some.

2.4.9 When confronted with an option that does not have to be taken and is not commercially overwhelming but which might affront the sense of being a farmer and steward of family land as well as not being as normal for "people like us", it is common to fall back on a more objective constraint as a reason for rejecting it, validating those more inchoate grounds that do not then need to be articulated. Here that constraint is typically taxation and, within that, Inheritance Tax which does anyway impose a powerful reason for farmers to be cautious about the changes they understand they may be asked to make.

2.5 Taxation – Introduction to a Major Constraint

2.5.1 With that background, the taxation treatment and consequences of differing land uses is both the root of much generalised caution among farmers and their advisers and a genuinely important factor in its own right. This concern focuses on capital taxes, particularly Inheritance Tax but also Capital Gains Tax with their potential tax liabilities and significant reliefs. Other taxes, notably Income Tax are also relevant.

2.5.2 As will be developed in the following sections, farmers, owners and advisers have an appreciation that changing the use of land can change its status for taxation, with liability attracted or relieved according to the change. Farmland is the basis for a farming business, with a functional role that can be seen as equivalent to its plant and machinery as much as its premises. It is as an illiquid, location-based asset owned overwhelmingly by individuals. Its market value as used for tax assessment is typically high when compared to its income potential. Those factors come together for most owners with Inheritance Tax as an issue for each generation of the owning family. Without relief, Inheritance Tax would take 40 per cent of the asset's value. That prospective charge with its potential to diminish, break up or destroy a farming business focuses minds and drives caution.

2.5.3 That analysis holds where the situation and issues are known and stable but it holds even more in times of change with the uncertainties that new challenges bring – such as we now face with the prospect greater environmental use of farmland. While, as will be shown, many of those uses may, in practice, still qualify for the established reliefs from Inheritance Tax as positive husbandry for agriculture as business would continue, some will not. That is

perceived to bring the risks of a destructive tax liability with an accompanying caution about taking any step that brings that jeopardy. That prompts a generalised caution about new schemes with new commitments requiring change, especially where the labels used are about the environment and not agriculture or business. That caution, reasonable or not, acts to inhibit change as farmers and owners avoid the fire that they feat could burn their fingers.

2.5.4 With similar, if less stark, issues holding for other taxes, these points combine to make farmers, owners and advisers cautious about entering serious and longer term commitments with non-agricultural objectives and labels, such as Local Nature Recovery, Landscape Recovery, Biodiversity Net Gain and conservation covenants.

2.5.5 As will be reviewed, properly answering those deep inhibitions requires both:

- substantive policy change in tax law to give the real assurance needed to open minds to these new land uses that are the increasing object of public policy
- improving practical understanding of the actual issues which will involve both guidance by HMRC and the explanation and guidance that can come from professional and representative bodies and others.

2.5.6 These are aside from any issues over the positive or negative effect of an environmental agreement on the value of the land.

2.5.7 In the context of environmental management agreements, this note does not consider the taxation treatment of "credits" that might be created as assets under some private sector agreements.

2.5.8 It has to be stressed that there is much that is as yet unknown or untested at this early stage in the development of this approach, for example:

- it is taken that off-site Biodiversity Net Gain payments might be essentially for management of land and so assessed to Income Tax with a one-off initial contribution by the developer brought into tax in annual portions over the 30 years or longer life of the agreement but some might prove to be partly or fully capital in nature
- whether agreements transferring rights in carbon (whatever that might mean) to a third party might in at least some cases constitute a part disposal of land for Capital Gains Tax or are really for management.

2.5.9 At present, HMRC[10] only recognises carbon credits as VATable where they are traded in the official and regulated UK Emissions Trading Scheme covering a limited part of the industrial economy in which they are deemed to be for consumption by the business buying them. All other carbon trades are seen as outside the scope of VAT, apparently because they are much less formal. It is possible that boundary might move over time.

2.5.10 Nonetheless, the live issue is the interaction of new agreements with Inheritance Tax, both actual as is analysed below but also as it may be perceived or feared by those not wishing to jeopardise the availability of important reliefs from it.

[10] https://www.gov.uk/hmrc-internal-manuals/vat-supply-and-consideration/vatsc06584

2.6 **Inheritance Tax** (IHT)

2.6.1 This tax on death or potentially on lifetime gift is particularly material for farming where land values are for many reasons much higher than is explained simply by farming economics. That magnifies the possible effect of a tax liability based on those values, as expressed in the concept of being asset rich but cash poor with the fear that that would drive breaking up the farm to pay a tax that is charged at 40 per cent of liable value. Two particular tax reliefs from Inheritance Tax are in place in response to such fears, both more complex than summarised here:

- Agricultural Property Relief (APR) on the agricultural value of agricultural land and pasture with ancillary property such as qualifying farmhouses and neutral for decisions as to whether land is let or farmed in hand
- Business Property Relief (BPR) on the market value of assets in the business, unless the business is found to be wholly or mainly one of investments (essentially passive operations such as lettings).

2.6.2 The Treasury paper, *Non-Structural Tax Reliefs and Objecetives*[11], issued on 30th November 2021, has confirmed that the Government's purpose for APR is:

> "To ensure agricultural businesses or farms do not have to be sold or broken up following the death of the owner."

Similar words are used for BPR in terms of the business rather than the farm.

2.6.3 An owner-occupied farm typically qualifies for both reliefs but APR has a salience in farmers' and advisers' minds and particularly offers relief in respect of let farmland and farmhouses. A landlord as such typically only qualifies for APR.

2.6.4 The fear is that those important reliefs could be jeopardised by changing the land use away from agriculture and business use. While limited changes in land use with continuing agricultural activity may cause little issue for private owners of rural land, consideration of more substantial diversion of land into essentially environmental uses, whether peatland restoration, minimal grazing, biodiversity gain or full re-wilding, will be heavily influenced by those questions which are now reviewed in closer detail.

2.6.5 Agricultural Property Relief (APR) – With few prescriptive definitions, this relief is on agricultural property" which is defined as agricultural land or pasture, whether used by the owner or let out. Where those are present, then ancillary woodland and intensive livestock buildings can be considered together with any farmhouses, cottages and farm buildings as are of a character appropriate to that land[12]. Not only must the property identified be used for the purposes of agriculture for a required periods of time before a death but a dwelling will only:

- be a farmhouse if the day-to-day farming is conducted from it[13]

[11] https://www.gov.uk/government/publications/non-structural-tax-reliefs-and-objectives
[12] S.115(2) Inheritance Tax Act 1984
[13] See decisions in cases such as *McKenna* – properly *Arnander v HMRC* - https://www.bailii.org/uk/cases/UKSPC/2006/SPC00565.html

- qualify as agricultural property if it is of a "character appropriate" to the land it serves, in practice a broad test of how the house fits the context[14].

In general terms, that means that reducing the scale of the agricultural operation reduces the ability of a house to be of a "character appropriate" to it while if there is minimal activity it might not qualify as "farmhouse" at all.

2.6.6 So core questions in considering APR in the context of an environmental agreement include

- does all, some or none of the land remain "agricultural land or pasture"? To the extent that land is no longer properly described as such, then it drops out of APR
- whether the land that is accepted as agricultural land or pasture and the continuing activity supports the status of a dwelling as a farmhouse that is of a character appropriate to it
- where the combined agricultural property is used for the purposes of agriculture for the qualifying period before the unknown date of death (two years for an owner-occupier, seven years where someone other than the owner is farming it).

2.6.7 This might be tested in the context of an agreement for major peatland restoration. Is the re-wetted peat still:

- properly described as agricultural land or pasture?
- occupied of the purposes of agriculture?

If the answer to either of those questions is "No" then it does not qualify for APR. Further, that land would then not assist any dwelling to be accepted as a farmhouse for APR.

2.6.8 To an extent, such issues were avoided where land was committed to environmental purposes by agreements under the Habitats Regulations (applying EU policy) in each part of the UK by the statutory extension of APR to that land by s.124C of the Inheritance Tax Act[15]. While that limitation to the Habitat Regulations of 1994 and 1995 means that this is not of current use, this provision offers an established template for a wider relief for land in recognised environmental agreements (or otherwise meeting some objective test) that might do much to answer the fears of private landowners in this regard.

2.6.9 The parallel would be with the role of the enhanced rate of APR on let farmland given in 1995 to accompany the introduction of Farm Business Tenancies[16]. That gave the signal that land subject to new letting decisions had fiscal parity with land farmed in hand and so stimulated the let sector for some years. Such a signal here could be very important.

2.6.10 The relevance of adapting APR in this way rather than taking any other approach is that this would directly achieve fiscal neutrality between agricultural and environmental uses, both for the land and any associated "farmhouse". In making no test of trading business activity,

[14] See cases such as *Antrobus 1* – properly *Lloyds v CIR* - https://www.bailii.org/uk/cases/UKSPC/2002/SPC00336.html - and then *HMRC v Hanson* - https://www.bailii.org/uk/cases/UKUT/TCC/2013/224.html

[15] https://www.legislation.gov.uk/ukpga/1984/51/section/124C

[16] See CAAV Agricultural Land Occupation Surveys - https://www.caav.org.uk/resources/agricultural-land-occupation-survey

this would also achieve the same outcome for agricultural landlords, removing a key reason for them to resist tenants considering more significant environmental agreements.

2.6.11 For shorter term uses, such as agreements for rotational cover crops within an arable regime this HMRC observation in the June 2005 Special Edition of the Tax Bulletin[17] might be relevant:

> "Agricultural land which is taken out of production can still qualify for APR (including GAEC land) because section 117 IHTA does not require the land to be in production either continuously or at a specific time (though there must be an intention or expectation that the land will be back in production at some time in the future). So, for example, agricultural land set aside to rotational, or even permanent, fallow can still qualify as agricultural property within the definition of section 115(2) IHTA 1984 and as occupied for the purposes of agriculture within the meaning of section 117 IHTA."

2.6.12 That analysis by HMRC combined with the 1995 change for land in the then Habitats Regulation agreements points to the need to relax this consistent, as by recognising use of land for environmental agreements as "productive" or as "agriculture", whether actual or deemed.

2.6.13 Business Property Relief (BPR) – Provided a business has operated for at least two years, the basic test for BPR is that the business does not consist wholly or mainly of investments. Let property, whether farmland, cottages or other buildings, counts as investment activity as, on case law, do almost all furnished holiday lettings.

2.6.14 Where the use of land is considered, the question will be whether, with tests such as those seen in the decision of the Northern Irish Court of Appeal in the BPR case *McCall*[18], it would be seen as an investment activity or not rather than a bona fide active business. The decided cases invoke the concept of what a practical businessman would regard as a business.

2.6.15 For rural land, this can be summarised on the basis of cases such as *Charnley* [19](an APR and BPR case largely concerning a grazing farm in Lancashire) considering whether there is positive husbandry of the land. So if land is used for, say, biodiversity as well as agriculture, is positive husbandry undertaken?

2.6.16 Even if there is no positive husbandry of this land but it is part of a larger active business, that larger business could still qualify for BPR when viewed in the round under the principles of the decision in the decided case *Farmer* [20](also the *Brander/Balfour*[21] decision of the Upper Tribunal) unless the balance between the parts was such that this project (in combination with any other investment activity in the business) predominates, so excluding the whole business from BPR.

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[17] https://webarchive.nationalarchives.gov.uk/ukgwa/20060715160918/http:/www.hmrc.gov.uk/bulletins/tb-se-june05.htm

[18] https://www.bailii.org/nie/cases/NICA/2009/12.html

[19] https://www.bailii.org/uk/cases/UKFTT/TC/2019/TC07425.html

[20] Farmer v IRC 1999 STC (SCD) 321

[21] https://www.bailii.org/uk/cases/UKUT/TCC/2010/300.html

2.6.17 Again, these issues might be tested by reference to major peatland restoration. Once the drainage grips are blocked and the land is re-wetted, is there any positive husbandry? The income might be seen as a passive return.

2.6.18 A floodplain washland might, in itself, be passive (subject to the summer use of the grass) but the full traditional management of a water meadow could be seen as more active, aside from any other commitment under the agreement.

2.6.19 Other changes, such a coastal land in managed retreat, creating grazed saltmarsh and other wetland margins, pose similar issues. There might, as say with salt marsh lamb, be opportunities for the land use to support specific agricultural production maintaining the tax status of the land. However, if agricultural activity withdraws from or becomes nearly impossible in these areas, then there will be no positive husbandry.

2.6.20 As that illustrates, analysis needs to look beyond the labels used. An operation that is labelled "rewilding" may, nonetheless, see continued agricultural use of land or pasture within a business, even if it looks different to the more conventional farming before it. However, if agricultural production ceases and no further positive business activity continues, the land could have dropped out of all reliefs and so be fully exposed to tax.

2.6.21 That land would then only be relievable from tax by its gift to a charity. While that would be a gift of all its value, where more than 10 per cent of a deceased estate is given to charity, the tax rate on the remainder is reduced to 36 per cent. That would defeat the common desire to pass the land to the next generation.

2.6.22 With the new issues here posing new tests of the boundaries, it may now take case law to clarify matters and so give or withdraw confidence for landowners acting in this area. As few people have a real and sustained desire for the strain, litigation risk, possible cost and publicity of being a test case, that discourages the risk-averse from venturing far into such new uses.

2.6.23 Woodland – Woodland needs specific consideration. Government grant schemes for creating woodland generally state that the woodland cannot then qualify for APR.

2.6.24 APR would not cover woodland save where:

- it is ancillary to the agricultural land or pasture and so could, for example, be shelter belts (this is taken to be a matter of its function) or a minor parcel (in reality perhaps a de minimis point)
- it is short rotation coppice, specifically included by the Finance Act 1995 and which would naturally be in blocks of any size but while potentially part of carbon reduction strategy might not fit with other environmental management
- the woodland is part of the agricultural use as with wood pasture or agro-forestry (for which an SFI standard to come, in conjunction with continuing agricultural use) but, again, that would not cover blocks of woodland.

2.6.25 As a specific footnote to those requirements establishing woodland corridors for connectivity between larger blocks would not, in its own right, qualify for APR.

2.6.26 With those possible exceptions (and then only on the agricultural value of that woodland), woodland will only qualify for relief from IHT in its own right where it is used for a business. Indeed, the occupation of commercial woodland is directly recognised as a business for this (s.105, IHTA 1984). With the long-term production cycle typical of woodland operations, a commercial management plan would usually be expected, both demonstrating and delivering intent with other possible hallmarks being:

- evidence of active management with external advice
- evidence that the management is for the realisation of profits rather than, say, sporting or non-commercial conservation objectives
- the preparation of annual accounts
- use of a business bank account.
- a VAT registration.

2.6.27 This established approach has yet to be tested in circumstances where substantial harvesting becomes excluded (say, as part of carbon sequestration policies) but other business activity continues to use the woodland. That might still see the woodland in commercial occupation but not for the harvesting of timber, a difference not considered in the drafting of the present legislation with options on the spectrum between another business activity using woodland to the woodland being commercially managed for income from biodiversity or carbon purposes.

2.6.28 Woodland Relief from IHT is essentially a deferral of liability on the value of the growing timber (not that of the underlying land) rather than a more substantive relief and so less attractive than the BPR route discussed. Where relevant, it deters the immediate felling of trees to pay the tax.

2.6.29 The Climate Change Committee's December 2020 report, *Policies for the Sixth Carbon Budget and Net Zero*[22], recommended a review of the tax treatment of woodlands so that it could be amended as necessary to ensure there was no disadvantage for farmers converting to forestry. This is a matter for some care as an enterprise with a cropping cycle running over several decades or more looks for confidence in its fiscal treatment.

2.6.30 Conditional Exemption from IHT – While private owners are typically very nervous in these matters about creating habitats that could then be given an official designation such as an SSSI, it might also be that such an outcome could assist with securing conditional exemption from Inheritance Tax where the land is regarded as being of outstanding importance which might be high hurdle unless specifically tailored for this to be encouraged.

2.7 Capital Gains Tax (CGT)

[22] https://www.theccc.org.uk/wp-content/uploads/2020/12/Policies-for-the-Sixth-Carbon-Budget-and-Net-Zero.pdf

2.7.1 This is a tax on the gain made on the disposal of capital asset such as land, whether by sale, gift, on compulsory purchase or otherwise. Where that asset is on the list of qualifying assets (which includes land) and is in the disposer's business use, there are business reliefs:

- rollover relief allows the deferral of the tax where the gain is reinvested in a replacement qualifying business asset so removing a major impediment to business reorganisation (see s.155 of the Taxation of Chargeable Gains Act 1992)
- Business Assets Disposal Relief (previously Entrepreneurs' Relief) gives capped access to a lower 10 per cent rate of tax where a business is sold or where its assets are sold after it ceases. For that business to qualify it must not consist substantially of investments, commonly taken as where non-trading activity is above 20 per cent of all activity, a lower threshold than the 50 per cent of BPR.

2.7.2 Further, where an asset qualifying for APR or BPR is the subject of a lifetime gift, the recipient can use Holdover Relief to adopt the donor's base value, again deferring the liability to tax until a final disposal.

2.7.3 For woodland, the disposal of trees from woodland that is managed on commercial basis is outside CGT (s.250 of the 1992 Act).

2.7.4 Thus, where the use of land under an environmental agreement:

- takes it out of business use, the owner will lose access to the business reliefs and hold over relief
- means it is no longer agricultural land or pasture used for agriculture, holdover relief is unavailable

2.7.4 Where a right is being bought over the land (as under a restrictive covenant or, soon, some uses of a conservation covenant), that might be a part disposal of the relevant land for Capital Gains Tax. This might most naturally be where future use of land is to be restricted to being more passive in nature or some particular activity is being positively prohibited. That might be where agricultural use is to be abandoned for phosphate offsetting, perhaps for a century. Official woodland schemes bind the land so that, under the Forestry Act 1967, it is to be replanted should it be felled.

2.7.5 This issue might raise a point for some peatland restoration agreements where the re-wetting might not require the exclusion of agricultural use but, in practice, have that effect. Some might see it as preferable to have the payment as a capital receipt.

2.7.6 However, not only is this less salient in farmers' and advisers' minds than Inheritance Tax but it appears probable that:

- a willingness to commit land to habitat change is consistent with a desire to retain that land and manage it appropriately
- the effect of Local Nature Recovery Strategies would be to limit potential development with its uplift in values in the areas most likely to be used for Biodiversity Net Gain agreements or Local Nature Recovery agreements

making Capital Gains Tax less relevant, save for lifetime gifts. The effects on land prices, and so taxable gains, of the opportunities for or being subject to such agreements and changes of use have yet to be seen.

2.8 Income Tax

2.8.1 Where the payments are for the management of the land in a business, it is likely that they would be seen as revenue with associated costs of that management to be set against it for liability to Income Tax, generally following Financial Reporting Standard (FRS) 102. Any relevant plant and machinery would qualify for capital allowances (including, as available, the Annual Investment Allowance). Works of construction might qualify for the Structures and Buildings Allowance, since 2020 roughly aligned to the 30 year period here.

2.8.2 Even where, as is likely for a biodiversity gain agreement, there is a single original lump sum payment, that money would, following accountancy practice, be spread over the years of the agreement, drawn into account for each year that passes.

2.8.3 Similarly and as with some agri-environment options and other farming options such as orchards, where costs are incurred for works to establish long term habitats and secure the payment, those costs would become a matter for the stocktaking for annual accounts, taken to be drawn into account over the life for which the cover is to last.

2.8.4 Where the landowner (including as relevant a tenant) is a farmer, there may be a question of whether this activity falls within farming as a trade or business, defined for Income Tax (and also for Capital Gains Tax) as

> "the occupation of land wholly or mainly for the purposes of husbandry" (s.996, Income Tax Act 2007)

or forms another trade. That might perhaps usually turn on whether the land remains with the farming operation, perhaps a more extensive use and even while producing the required environmental output. Many environmental land management options and uses are likely to fall within the meaning of "husbandry", albeit with little case law on this definition. However, the more passive uses might not be seen as "husbandry" and so could be capable of resulting in income that would lie outside the farming trade (or any trade) and be separately assessed. Where that reduces farming income (already likely to be reduced by the phasing down of Basic Payment) that could risk interaction with the "hobby farming" rules that can exclude a farm.

2.8.5 Were the environmental activity properly recognised as a separate trade, then limitations on sideways loss relief might in some cases be relevant as where the new enterprise made substantial early losses that could not be fully set against existing business operations.

2.8.6 If farming use by the landowner ceases, then payments might be accounted for differently. As the June 2005 Special Edition of the Tax Bulletin[23] noted:

> "Where there is no actual production then there can be no occupation for the purposes of husbandry and therefore no farming trade."

[23] https://webarchive.nationalarchives.gov.uk/ukgwa/20060715160918/http:/www.hmrc.gov.uk/bulletins/tb-se-june05.htm

2.8.7 In the context of the then new Single Payment Scheme (since replaced by the Basic Payment that is itself is now beginning to be phased out), that Bulletin noted three options

- where only part of the holding is no longer used for production but the farm as a whole continues to be worked, the farming trade continues (if not on the land no longer used). It allowed that if all production ceased temporarily for planned changes HMRC could accept that the farming trade continued if the farm's infrastructure was maintained.
- where there is a permanent cessation of all production then the trade will also have ceased. If there is no trade, then the Single Payment was to be chargeable to Income Tax as miscellaneous income (Chapter 8 of Part 5 of Income Tax Trading and Other Income Act 2005 (ITTOIA)).
- there might be a new trade in place of farming. If it can be shown that the land occupied is still managed on a commercial basis with a view to the realisation of profits, then that occupation will still be a different trade under s.10 ITTOIA and so existing unused losses would not be available to relieve profits in the new trade.

2.8.9 Where the land is made available to a third party to graze, the treatment of income would depend on the husbandry undertaken by the owner on that land. If there is no husbandry beyond the third party grazing, then the income would be property income

2.8.10 The approach adopted for Income Tax would then drive the treatment of the land for CGT on any subsequent disposal and so, if there is a business, access to roll over relief and Business Asset Disposal Relief.

2.8 11 Woodland – Income arising from the commercial occupation of woodland is not liable to Income Tax (s.768, ITTOIA). That presumes demonstrable commercial management with a view to realising profits with hallmarks for this discussed above for Capital Gains Tax, typically including a management plan. It also means that the costs of establishing and managing woodland are not deductible for tax, further showing how different forestry is as a business model from farming – forestry being broadly content with this approach.

2.9 Land Tenure

2.9.1 Around a third of England's farmland is tenanted. A tenancy is a contract creating an interest in land which the tenant holds against the landlord subject to the obligations and restrictions of the agreement, including rent.

2.9.2 Tenancy Law - Around half of the let area is under the Agricultural Holdings Act 1986 which provides a structure of protection such that what appear to be tenancies from year to year have substantial security, potentially for a lifetime, and some still have the opportunity for a qualifying family member to take on a further such tenancy.

2.9.3 The other half of the let farmland area is held on Farm Business Tenancies (FBTs), created under the Agricultural Tenancies Act 1995 with much greater freedom of contract. Many lettings are of bare land for relatively short terms but some are for larger, more equipped

units on a longer term basis. Those are matters for negotiation between landlord and tenant for which the 1995 Act gives much greater freedom.

2.9.4 Under either statute, the qualification to be an agricultural tenancy rests on using the land for agriculture in a trade or business:

- "a contract of tenancy relating to any land is a contract for an agricultural tenancy if … the whole of the land comprised in the contract, subject to such exceptions only as do not substantially affect the character of the tenancy, is let for use as agricultural land" with agricultural land defined as "land used for agriculture which is so used for the purposes of a trade or business" (s.1 Agricultural Holdings Act 1986)
- s.1 of the Agricultural Tenancies Act 1995 requires that a farm business tenancy at its commencement meets both the "business condition" and either the agriculture or the notice conditions. While that requires predominant agricultural use in a business at the start of the tenancy, this structure that can allow greater diversification once the tenancy is in place.

2.9.5 Those requirements can be seen in broad terms to be aligned with the analysis above for Inheritance Tax with the key reliefs of APR and BPR. Much of what would be in the Sustainable Farming Incentive and adopted while farming is likely not to be problematic while more radical habitat change, especially at any scale, may require close thought. As examples, where an agreement under Landscape Recovery or Local Nature Recovery requires the longer terms restoration of peatland, the creation of new heathland, the recreation of a fen or mere landscape, or the planting of woodland to an extent that excludes agriculture and is not plausibly structured as a trading business, that land looks unlikely to qualify for:

- APR (with a prejudice to that relief for a dwelling currently qualifying as a "farmhouse")
- BPR (with the potential for that to reclassify the entire operation as an investment business outside BPR even where the remainder is still trading).

2.9.6 It is possible for a tenant to slip out of these legal structures, as was graphically demonstrated by the Scottish case, *Fyffe v Esslemont*[24], decided on similar law and applicable in England, where the tenant was found not to be using the land for agriculture in his business. He lost the protection of the equivalent Agricultural Holdings Act and so lost the tenancy of the farm.

2.9.7 Both statutes are framed with productive agriculture in mind. That is particularly true of the 1986 Act, itself a consolidation of legislation as it had evolved from a major re-casting in 1947. The Rules of Good Husbandry provided by s.11 of the Agriculture Act 1947 are similarly geared to production rather than environmental improvement.

2.9.8 That statutory approach has been tempered at the margin, as for example by the constraint on a landlord's ability to seek consent for a Certificate of Bad Husbandry to terminate a 1986 tenancy by requiring the Tribunal to:

> "disregard any practice adopted by the tenant in pursuance of any provision of the contract of tenancy, or of any other agreement with the landlord, which indicates (in

[24] http://www.scottish-land-court.org.uk/decisions/SLC.77.18.html

whatever terms) that its object is the furtherance of one or more of the following purposes, namely—

(a) the conservation of flora or fauna or of geological or physiographical features of special interest;

(b) the protection of buildings or other objects of archaeological, architectural or historic interest;

(c) the conservation or enhancement of the natural beauty or amenity of the countryside or the promotion of its enjoyment by the public." (Para 9(2), Schedule 3)

2.9.9 As that indicates more may be achieved by negotiation between landlord and tenant, as might be prompted by the economic opportunities that may be available through the choices and actions of a tenant interested in environmental work. This will be assisted by care in drafting appropriate agreements, rather than the unthinking adoption of standard templates. It can take some effort for a farmer to see that the cost of this is an investment or an insurance.

2.9.10 While a landlord cannot drive a tenant to undertake environmental improvement, it is equally difficult for a landlord to take land back from a 1986 Act tenant for such uses. The 1947 framework carried forward in the Act allows that security of tenure can be broken for non-agricultural development that requires planning permission with that planning permission being the basis for an incontestable Case B notice to quit. There is no secure route to do this for a non-agricultural use that does not require planning permission; it is usually taken that many environmental uses do not require planning permission (use for forestry does not). If the tenancy agreement allows, part only of a tenancy can be taken, though a separate provision anyway allows part of a tenancy to be taken back for the planting of trees (s.31(2)(e), 1986 Act). Resumption of possession in any of these circumstances can be with limited compensation and potentially at short notice.

2.9.11 The land is owned by the landlord who will receive it back when the tenancy end (the landlord's interest in the land is often called the "reversion"). The landlord has an interest in the land being looked after and the condition in which it returned. The landlord might not want the land returned in a substantially different state, whether under trees or as what the landlord might see as a bog.

2.9.12 Practical Issues – A farm tenancy is taken as a business commitment in hope of earning a living with the obligation of rent and the need to reinvest, and potentially provide for retirement. Any significant engagement with environmental improvement is going to be a business decision by someone who will generally hold a tenancy with its costs, obligations and opportunities in order to be a farmer. Especially for the more recently let FBTs, the tenant will have been chosen by the landlord, in the main for farming qualities. Tenants could, as a generality, be seen as self-selecting as a group of people committed to farming.

2.9.13 Of course and as many tenants (perhaps especially those now looking for tenancies) will agree, environmental improvement might not only be consistent with good farming but as regards soil health and other measures be supportive of it. However, major habitat change is

less likely to be seen as consistent with farming while, for example, peatland restoration might be seen as a substantial retreat from it.

2.9.14 In practice, woodland has conventionally been excluded from farm tenancies. Almost all agreements reserve trees and timber to the landlord. If woodland is viewed as an economic proposition (with the carbon value being trivial), not only is its economic cycle on a timescale beyond that of most farmers but well beyond that of most tenancies while it calls on different skills. Both are more consistent with landownership than with the normal status and outlook of a tenant. Unless having a particular commitment to new models such as agro-forestry, farm tenants are unlikely to be significantly interested in substantial tree planting. However, they might more often look for hedgerow trees or limited planting of areas of less productive land. Even being there to farm, that might be prompted by supply chain pressure to reduce the farm's net carbon footprint (mitigating climate change) or, for livestock farmers, adapting to climate change with shading for animals.

2.9.15 With that background though, the tenanted sector can be considered at three levels:

- those with long term interests in land, typically a 1986 tenancy with many years to run (and a possible succession) but also long term FBTs. These farmers have protection and, as the world changes, do not want to be disadvantaged in comparison with their owner-occupier neighbours. That has to an extent been addressed by the amendment made by the Agriculture Act 2020 to the 1986 Act (s.19A) creating a ground of challenge for the tenant where the terms of the agreement or a landlord's refusal of consent prevent a tenant from entering one of the new DEFRA schemes ("financial assistance schemes") with recourse to binding arbitration. These people are unlikely to want to make radical changes to the landlord's reversion (the land as the landlord would receive it back on the tenancy ending) as by major woodland creation but want greater economic freedom to adapt as circumstance changes. That might be seen by a landlord to support the rent and/or capital value of the holding but lesser changes might still affect the opportunities for the reversion
- shorter term tenancies that are more likely to be held for outright commercial reasons where SFI-type options may be practical in what they ask as well as the period of commitment but the tenant will not generally have taken the land for habitat change. In such a case though the opportunity for changing management will come up in the near future as the tenancy can be ended.
- vacant land that has been let or for which letting is a management option, where the new schemes may offer an additional option to the owner alongside sale, farming in hand or re-letting. That makes these schemes a potential competitor with letting. However, and depending on what the favoured scheme is, the land may still need more management than the owner is able to provide and so a different form of letting might be one means by which this is achieved but so might a non-tenancy management option. The outcome here is entirely at the landowner's discretion who will not normally have to let the land to an agricultural tenant.

2.9.16 That last point is the key reason why it would not be advantageous to restrict APR for landlords to land let on a length of term consistent with the life of more serious environmental agreements - some argue for a minimum ten year qualifying period. However, that would have

the opposite effect to that intended as that is more likely to deter most such owners from letting at all as the change policy to protect their position. There would be fewer tenants as a result and no reason to suppose that there would be more land engaged in environmental agreements.[25]

2.9.16 Tackling this in Practice - In general, the answer is in the adoption of realistic and pragmatic mutuality and co-operation to unlock value where it is available to the benefit of both parties. That is a function of the nature of the parties and their relationship, including its history, and how far their objectives are capable of being consistent with each other.

2.9.17 The interaction of more significant changes with the landlord's reversion means that answers may include a re-working of the agreement between the parties, needing careful advice. It should be recognised that not every new idea may be viable whether because of the farm, the skills and resources of the people involved or their objectives.

2.9.18 Perhaps especially in the early days of the new schemes, whether Biodiversity Net Gain or any of the environmental land management schemes, that raises issues of the costs and effort in the advice, negotiation and drafting needed for the effective creation of bespoke changes to existing tenancy agreements or in the preparation of new ones. The smaller the area of land, the more that might appear a significant cost which may be seen as disproportionate. That risks either deterring ventures into environmental commitments (as just too difficult) or the use of templates with little or no tailoring which may be of greater or lesser relevance to what is actually being done and so be an inadequate answer setting unforeseen traps for either party as future events arise.

2.9.19 Taxation - Taxation in general and Inheritance Tax in particular is, again, a factor, here particularly for the landlord.

2.9.20 While the tenant will face the same Income Tax issues noted above as an owner-occupier farmer who is considering new options, the present structure of capital taxes is of much less concern to a tenant (unless being paid to surrender the tenancy). The full relief available from Agricultural Property Relief since 1995 and Business Property Relief since 1992 has removed the potential issues faced by a few tenants under Inheritance Tax.

2.9.21 However, the landlord's exposure to Inheritance Tax is material as it is the tenant's use of the land that will dictate whether or not it qualifies for Agricultural Property Relief (typically the only relief available to the landlord). Save for powers that may be available under the terms of the tenancy agreement or as required by the conditions of a scheme, the landlord has no control over this potential liability to a significant cost. That encourages caution.

2.9.22 In the context of a substantial change in use, key questions are:

- does the land remain agricultural land and pasture?
- is any woodland only ancillary to that land?

[25] See the modelling summarised in Section 3.5 of Taxation: Agricultural Productivity, Land Occupation and Use After Brexit - A CAAV Discussion Paper (CAAV, 2017)

- is any dwelling on the holding used for the day-to-farm farming of the holding (and so is a "farmhouse")?
- has the agricultural property been occupied for the purposes of agriculture and been used for the seven years (in the case of let land) before the landlord's death or gift of the land?

Where the answer is negative, the landlord faces a potential tax liability of 40 per cent of the value of the holding as let. Many will take that as a good reason to be cautious about consenting to changes that might jeopardise access to APR. Awareness of that may in turn reinforce any innate reluctance of the tenant in looking at such changes.

2.9.23 Again, extending APR, as on the model of s.124C of the Inheritance Tax Act 1984, to cover such situations would achieve the fiscal neutrality that would be both a significant signal and a practical reassurance to landlords and would-be landlords.

3. Situations and Applications

Caution - This review of issues and situations is largely without consideration of what effects new circumstances might have on land values, taken to be a function variously of supply and demand, planning and local nature strategy policies, and available income flows, whether from production of food and timber, support and state payments or private environmental payments.

3.1 General

It is possible that some Biodiversity Gain Agreements could offer sufficient value to enhance that of land but the rates of payment under DEFRA schemes might not be strong enough for that. Indeed, DEFRA is intent on not crowding out private money.

3.2 Additionality

3.2.1 However this concept is interpreted, it is a practical consideration in approaching commitments and agreements, perhaps especially those for offsetting, such as for Biodiversity Net Gain or carbon.

3.2.2 The concept has a variety of meanings:

- with DEFRA using it:
    - expressly to mean paying for public goods above those required by the prospective regulatory baseline
    - implicitly by saying that it will not pay for the same thing twice, a relatively soft definition
- with the British Standards Institution[26] and others, reflecting scepticism about the track record of offsetting, requiring that it will only allow recognition of and payment for something that was not going to happen anyway. BS 8683 defines "additionality" as

    > "property of measures to achieve biodiversity net gain, where the conservation outcomes it delivers are demonstrably new and additional and would not have resulted without it"

That latter approach, increasingly seen in external commentary and among investors, is more rigorous. It can be seen to be excluding many renewable energy projects and now much commercial forestry from this market because they are viable anyway. Perhaps of more immediate concern here, where an agreement for, say, biodiversity is also likely to deliver carbon sequestration as an ancillary attribute, that is then going to happen anyway and so should not be paid for. That points to the need for it to be recognised at the time in how the transaction is structured to secure the best value.

3.3 Stacked and Blended Finance

3.3.1 While there is general public favour (and express DEFRA approval) for these concepts, there is limited experience of them. As elsewhere in this subject, we are looking at often untested, nascent markets.

[26] BS8683 - https://shop.bsigroup.com/products/process-for-designing-and-implementing-biodiversity-net-gain-specification/standard

3.3.2 Stacking finance is taken to mean the ability to secure different income streams from different services from the same land. That is looking increasing vulnerable to more stringent definitions of additionality. One possible way to tackle that is by more careful management to align the different purchasers in simultaneous or combined transactions or some other means of arbitrage following a transaction. That might, in reality, be hard to achieve for biodiversity gain when the developer's simple motive is to unlock the development project.

3.3.3 Where feasible as separate transactions, it could, in addition to stacking separate state or separate private agreements, see either:

- a DEFRA scheme being supplemented by a private scheme. It is noted that, at least for SFI 2022, DEFRA is now clear that a biodiversity gain agreement can apply to land in SFI 2022 and vice vera
- a private agreement overlaid by a DEFRA one, possibly in time more likely if any significant number of private schemes offer more money. That might, for example, already be where there is already land required to be used as compensatory habitat for an infrastructure scheme and the owner then looks at what DEFRA schemes might add to that, by greater commitments or by bringing more land to the operation.

3.3.4 Blending finance is taken to mean bringing two or more streams of finance together in one project. As noted above that might be one way of achieving stacking. However done, it will require co-ordination to meet the requirement of all purchasers.

3.3.5 The real challenge is for all parties to have a clear understanding of what is being bought and sold and between whom, what the arrangements are to protect that with what restrictions on use and what penalties and then have it properly priced for those terms.

3.3.6 As discussed above for the agreements needed between landlord and tenant, these important agreements between varied parties to bind land and its use. They could well involve not only farmer and DEFRA but also a landlord or mortgagee (the lender with a loan secured the property and so interested in its value) and the source of third party private finance which might be at least one of an NGO, an investor or a business in the supply chain. That will have costs in the advice, negotiation and drafting needed with all parties aware of the transaction and judging it to be in their interests for its terms and its price. There will be key issues requiring care over definitions of what is bought and sold and the commitments required. Much of the present discussion is of concepts, such as "natural capital" that are not precise terms of art with legal meaning, so reducing them to good, lasting, fair and trusted agreements, whether conservation covenants or otherwise, will take analysis and work.

3.3.7 As with tenancies, that cost may appear particularly large in relation to small blocks of land or less valuable agreements making this approach less attractive. Time and experience may develop more standardised approaches that are recognised as fair between parties together with an understanding of how they may be tailored to common situations. However, it must be recognised that higher transactions costs deter transactions.

3.3.8 Where more than a single buyer and a single seller are involved, further care needs to be had with the structures used. Conservation covenants are required by law[27] to involve a "responsible body" as a party and, where Biodiversity Net Gain is involved, the local planning authority might also be a party.

3.4 Biodiversity Net Gain

Note – *In general terms, the issues discussed here seem likely to apply as appropriate to long term offsetting agreements for nutrient neutrality, both offering possible significant value by their link to uplift in development land values.*

3.4.1 While there are existing examples in a number of areas of biodiversity offsetting for development, this will not be fully in place until it is implemented under the Environment Act. It might yet be that practicalities drive a phased implementation and some relaxation of some of the more formal principles currently advanced. Operationally, it may have an inherent bias for development to be on environmentally undistinguished greenfield land and used to secure environmental improvements on other such land but not to the extent that it ceases to be farmable. More radical habitat change might perhaps be less likely, at least where it compromises a farm.

3.4.2 The payments will be drawn from the uplift in the value of development land with permission and so compete with other calls on that uplift, such as s.106 commitments and affordable housing but will also have to attract a landowner where off-site gain is required. In some cases, the land may be adjacent and so part of the development package, whether sold or retained by the owner (in a way akin to land pooling).

3.4.3 The Environment Act expects that Biodiversity Net Gain agreements will be for periods of at least 30 years[28] (with the Government indicating a longer period where related to a Nationally Significant Infrastructure Project) meaning the first will only end in the early 2050s (and could then be subject to an environmental designation – a point that troubles many owners). That 30 term is comparable to the length of solar farm leases that are now being granted but that shows the payment that might be required for some owners to commit at least some land for that term. Others may view the possible loss of future options and the impact on the rest of the business as unacceptable

3.4.3 The landowner as freeholder of the property is (subject to any concerns of a mortgagee about devaluing property used as security for a loan) free to enter into such an agreement according to its personal or commercial appeal but in competition with other objectives, including any sense of lost options. The relevant external factor will then be taxation and the issues here will turn on how far the land changes its use:

- if a significant area moves out of farmland into scrub and production is excluded that would lose the benefit of APR from Inheritance Tax on the land that has changed. It would potentially weaken or remove the claim for APR on what was the farmhouse, according to what fraction of the overall area of farmland was changed. If there is no

[27] S.117(1), Environment Act 2021

[28] Paragraph 9(3) of Schedule 7A to the Town and Country Planning Act 1990, inserted by Schedule 14 of the Environment Act 2021

business activity, that land is either outside the scope of BPR or weighs in the balance against the more active use of other land when judging access to BPR.

- however, if the land is made species rich meadow with better hedges and continues to be used for agriculture, it would typically retain both reliefs.

While most uses that are likely to be taken up in practice on reasonable farmland might thus qualify for the same reliefs, the risk is of a folk wisdom fear of risking them by engaging in this. If such a fear become widespread (even if only stimulated by a particular and strange case), it would be very difficult to overcome.

3.4.4 Where the owner is looking to the future of the land in the hands of next generation (whether for farming or to release its value), that might colour attitudes.

3.4.5 The tenant, not owning the land, does not face those issues so directly but for the 30 year or longer agreement required for biodiversity net gain will almost certainly need the landlord to join in the agreement for any developer to want to deal on this land. The tenant could not usually guarantee the management control of the land for the 30 or more years required. In substance, the tenant cannot operate in this market without the landlord – and Inheritance Tax considerations are likely to matter to private landlords.

3.4.6 If the tenant did enter such an agreement and the tenancy terminated, the tenant could be liable:

- to compensate the landlord for dilapidations on any loss in value of the reversion from the change
- for any failure thereafter of the land use changes under the Biodiversity Net Gain agreement.

3.4.7 The ordinary landlord would be concerned about:

- any loss of APR for the landlord's estate through the tenant's actions removing the agricultural status of land
- the potential limitations and obligations for the landlord should the tenancy end during the life of the agreement, including how they might bear on choices as to future uses including development
- the possible effect of any environmental designation being applied to the land, limiting its future use and value, especially where this was done without the landlord's involvement.

3.4.8 While there has been no discussion of this outcome, there is perhaps an extreme situation where a use (perhaps such as peatland restoration) was lucrative giving value to a tenancy but by which both farming and business activity ceased. That tenancy might then be liable to an Inheritance Tax charge by having value that would not be relieved. The proposition that a non-assignable tenancy can nonetheless have value for Inheritance Tax and other purposes has been upheld in a number of tax and other cases.

3.4.9 The Payment – Aside from these issues, an off-site Biodiversity Net Gain agreement is likely to see an initial substantial payment to buy long term change. At this stage, the treatment of this payment can only be considered in general terms and from first principles. So

far as it is a payment for management, it is likely that it would be brought into tax in annual stages over the life of agreement (with a need to keep track of it for 30 years or more). Aspects might relate to capital works. There might be other features of an agreement that could amount to a part disposal for CGT. The interaction of this with subsequent sales of the land remains to be tested.

3.4.10 However, these issues are not (at least as yet) salient in the minds of those considering such deals.

3.5 Carbon

3.5.1 While there is the potential for significant value to be achieved from Biodiversity Net Gain (and equivalently elsewhere in the country from nutrient offsetting), carbon poses different problems, from a combination of its expected importance to the business, its relatively low value and the scale of restrictions on and consequences for a farm if carbon is sold away. Farmers risk being seduced by current discussion into deals that could result in seller's remorse.

3.5.2 While much talked about and now the focus of much public policy, carbon is actually of low value at farm scale, and not only because of inadequately developed markets. Simply to illustrate that, an acre of oak trees might, after 80 years of successful growing, have just over 100 trees and a carbon value of perhaps £800, after 80 years at the values (c.£20/t) revealed in the first four auctions of DEFRA's Woodland Carbon Guarantee Scheme. While carbon credits might trade at £50/t (now with gas prices at £75/t) on the UK Emissions Trading Scheme, trading values outside that seems to be in the range of £7 to £15/t. While it is logical to expect higher values in coming decades, any post-COP26 framework for international trading could temper that.

3.5.3 Where a landowner has alienated carbon to benefit another business, there would be management commitments with penalties to ensure the carbon is and remains sequestered. These are very likely to fetter the practical operation of the farm (and possible other uses) over the years as farming is, in part, the management of carbon from soil to plant to animal and back again.

3.5.4 Further, with agriculture responsible for, say, 8 per cent of UK emissions, its task in reducing that figure is large enough without trading carbon away by means that make the farm's task more difficult still. It appears possible on many soils (though not the more organic ones) to sequester more carbon in the soil than by growing trees on it.

3.5.5 None of that is to suggest that farmers should not be managing carbon and reducing emissions but instead that they should do so within the business. Supply chains as well as public policy are likely to require that, with especial stringency on cattle farming but not limited to it – how might root vegetables be net zero?

3.5.6 The practical answer is that where policies and payments support management practices are consistent over time and area with sequestering carbon in soil (and where appropriate in hedges and such like), they can both reduce emissions and support productive farming. The important thing is that they do not pretend to take ownership of the carbon (or indeed any other

attribute, whether for flood attenuation, biodiversity, nutrient neutrality or otherwise, and certainly not without paying fully for it).

3.5.7 Where this has been discussed in terms of letting a new tenancy, it seems very difficult in practice for landlord to do more than record a base line (so far as that is feasible, affordable and useful for whatever the future might then have wanted) and have relevant management clauses in the tenant's obligations part of the tenancy agreement. Defining carbon sufficiently to control it appears technically difficult (there are similar issues more generally about "natural capital") and, if done too stringently, could mean that reduced economic activity reduced the rent. In reality, this is as much a matter of tenant selection as of what is in the agreement. That opens the way to an alternative approach of an accompanying management agreement alongside the tenancy agreement.

3.5.8 In some cases, the preference might then be not to let but to retain control, even if with a contracted manager.

3.5.9 Where forestry (more than amenity trees or woodland) is concerned, the buoyancy of commercial forestry is such that carbon is again relatively minor and, while it might appear to add value, it risks the controls required to ensure the century long sequestration that could reduce or deny its predominant commercial value. Commercial forestry extracts its value from carbon by the growing demand for low-carbon uses in construction and elsewhere, tapping directly into those markets rather than by offsetting with the problems around that. Increasingly, the viability of commercial forestry is such that it fails the rules for strict additionality as it would be held to be viable anyway without offsetting money – at least in much of Scotland and a growing area of Wales.

3.5.10 Taxation – This will depend entirely on the transaction in question. So far as the payment is for management, the payment is likely to be a matter for Income Tax and so far as agricultural and business use is maintained is unlikely to disturb existing expectations unless there is substantial land use change.

3.5.11 While favoured on carbon and biodiversity grounds, achieving woodland by natural regeneration (which might look like abandonment) is likely to lose both agricultural and business status for tax.

3.5.12 Transactions that appear to be sales of carbon have yet really to be analysed and more will depend on their substance than their label. However, the permanent alienation of carbon rights from land could be found to be a part disposal of that land for CGT.

3.6 DEFRA's Environmental Land Management Schemes

3.6.1 Sustainable Farming Incentive – With more of the developing detail now available for this scheme, its three year agreements and options that are generally consistent with continuing farming pose few issues whether for tax or for tenancies. DEFRA is not requiring landlord's consent for a tenant's entry but leaving it to the tenant to resolve any issues as a matter of contract. However, a practical issue is for tenancies with an insufficient term to cover the life of agreement. For SFI 2022, DEFRA is allowing a two year break for tenants as part

of its experimental approach to SFI but environmental schemes generally require a longer term commitment and so longer tenancies. These may emerge in negotiation in the new circumstances.

3.6.2 Perhaps the only obvious issues seen so far are:

- for tenants with tree planting as timber is normally reserved to the landlord, albeit that, in practice, tenants are often not interested in trees (for reasons noted above) but serious planting would require mutual agreement
- for those with common rights, the need of the moorland standard in SFI 2022 for testing the depth of peat goes beyond a right to graze and so requires the consent or participation the owner.

3.6.3 The more substantial tax and other issues are likely to be found with Local Nature Recovery and Landscape Recovery. At present and subject to future evolution, these schemes seem more likely to be focused on habitat change than on access, education and heritage issues.

3.6.4 Local Nature Recovery – In practice, we wait on serious information about this scheme though it appears that woodland creation and peatland restoration are likely to be integral parts of it. So far as it requires habitat change, it potentially raises questions for:

- taxation if there is an issue of changing use and/or business status which will depend on what is actually proposed and how far it is compatible with farming use
- tenancies in terms of:
    - whether the change is one acceptable under the tenancy agreement (subject to negotiation and the 1986 Act tenant's new powers of challenge under s.19A in respect of new DEFRA schemes)
    - whether the tenancy is of a length to support the change required.

3.6.5 Landscape Recovery – This looks to pose similar issues to Local Nature Recovery with the additional strain on the likely collaboration across the identified area with issues of having efficient arrangements including those for cross-liability and enforcement between participants. That said, there is some track record of facilitated farmer clusters.

3.6.6 However, some estates may be well placed to marshal collaboration for such a larger scale entry.

3.6.7 It may be that, as with commons for SFI 2022, DEFRA will want to negotiate and agree with single entity acting on behalf of the participants, leaving it to them to sort all matters out between them. The structuring of that arrangement may create a separate taxable entity and then commercial relationships between it and the participants.

4. Some Lessons for Policy

4.1 While this paper is set against the background of longer term cultural, psychological, economic and practical factors that largely lie outside the reach of policy, the paper identifies some points on which policy could shift attitudes to entering agreements for the environmental uses of land.

4.2 Beyond the design of its own schemes**, the single most critical policy change available to the government to give confidence to owners of rural land in positively adopting environmental commitments is that this be recognised by relief from Inheritance Tax.** The natural model for this is the inclusion of land in recognised agreements within Agricultural Property Relief (APR), using, say, the template of s.124C of the Inheritance Tax Act 1984. This would be both a practical answer to a real issue in the marketplace and, of at least equal importance, a clear signal instilling confidence in both owner occupiers and landlords that environmental management is not a risk in managing a long-term and relatively illiquid asset.

4.3 While normalising environmental land management as an option is a larger task, it would be aided by:

- the **levels at which payment rates are set** such that it is a rational and competitive use of relevant land being seen as an enterprise with margins alongside wheat, milk, and lamb. DEFRA's Payment Principles paper is inevitably a very open textured paper but has opened this road. SFI rates are now to be tested; Local Nature Recovery will require stronger payment rates to buy greater change.
- the **language** attending the whole project which needs to be positive, perhaps more feasible for improved biodiversity than climate change, but an issue for all advocates of change. As an example, the proposed Lump Sum Exit Scheme might yet be more attractively labelled as a Farm Progression Scheme with the more positive implications that could then come with that; many farmers do not seek exit or retirement but are capable of supporting progression.

4.4 Seeing Private Sector Activity as a Natural Part of the Picture - All involved should fully recognise the potential for private activity in this area as the road first pioneered by some water companies becomes more travelled. The link to development value gives the possibility of substantial payments for change for both biodiversity gain and nutrient neutrality though these are really for landowners rather than tenants. Relevant to all tenures and likely to be more widespread will be the requirements of farmers that could be made by purchasers and processors in the food supply chain.

4.5 DEFRA is currently redeploying money released from Basic Payment into the developing environmental land management schemes but is anxious not to crowd out private money. We may, in time, see some of the present funding as pump priming these changes in the way that Feed-in Tariffs paved the way for commercial market in on-farm renewable energy generation.

4.6 The Framework for Markets - As well as the recognition that DEFRA is clearly offering, such markets are created by regulation to define the assets being transacted and how they are measured. The Biodiversity Metric is a leading example of what is needed for soils and other areas. Markets need confidence in what they are selling and buying to give proper pricing and full benefits.

4.7 That, especially with the issues of additionality, points to a strong need for supporting general clarity about such agreements involve – what is being sold, what restrictions are being imposed, what penalties would apply, and so forth.

4.8 Tenancies - The position of tenants has to be recognised but beyond the new s.19A's powers for a 1986 Act tenant to challenge a refusal of consent or a term of the tenancy as regards a new DEFRA scheme (but not any private scheme), there may be little to be done without a serious breach of the property rights of landlords.

4.9 What might happen on a farm rented long term from an environmentally minded landlord will naturally tend to differ from a land with development prospects let on a short term agreement. Rotational arrangements as for specialist vegetable cropping will be part of the matrix. Generally, tenants are anyway more likely to want to focus on options that are consistent with the farming use that is their purpose as well as within their time horizon while some landowners may more naturally see a wider range of possible uses.

4.10 It may yet be that as schemes develop so they could influence the period for which tenancies are granted. History (as reported in the CAAV's annual Agricultural Land Occupations Surveys[29]) shows that requires a period of policy stability as policy uncertainty and change drives both would-be tenants and landlords to seek shorter agreements rather than assume risk.

4.11 Taxation - With those points made, the one real policy tool that would both remove an impediment and give a clear signal supporting confidence in this area among landowners would be to show clearly that their Inheritance Tax position, now largely covered by APR and BPR, would not be jeopardised by entering into substantial environmental commitments.

4.12 The obvious model for that is s.124C of the Inheritance Tax Act 1984[30] which was an extension of APR to cover land within agreements under the then Habitats Regulations. Building on that, now effectively spent, template by defining land subject to recognised environmental improvement and management agreements (including woodland established under agreements for climate or other environmental purposes) would be a very powerful lever.

4.13 That was illustrated in 1995 by the extension of full APR to newly let land to give landowners confidence in letting land under the new Farm Business Tenancies, achieving fiscal neutrality with keeping land in hand. That proved to be a very effective signal in reviving the

[29] https://www.caav.org.uk/resources/agricultural-land-occupation-survey
[30] https://www.legislation.gov.uk/ukpga/1984/51/section/124C

previously haemorrhaging let sector until it was countered by the policy changes of the Single Payment Scheme with their emphasis on rewarding the occupation of land.[31]

4.14 The importance of adapting APR in the style of s.124C, rather than any other route is that this treats environmental and agricultural uses alike, with a level playing field for Inheritance Tax. It also answers the situation where an environmental use is not a trading activity and, in that, also so gives equal assurance to existing and potential landlords when considering the position of tenants.

4.15 The powerful reassurance that would give should be reinforced with clear guidance from HMRC and the practical and operational support that professional and representative bodies can deliver.

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[31] See CAAV Agricultural Land Occupation Surveys - https://www.caav.org.uk/resources/agricultural-land-occupation-survey