

# CAP reform – Impact on IHT reliefs

It can be argued that the current Common Agricultural Policy (CAP) Reform has basic impacts on IHT planning. It has been difficult to undertake succession planning whilst uncertainty over subsidy entitlement is in the background. It is key to understand what the outcome of the new basic payment scheme (BPS) will have on the ability to claim IHT reliefs.

## Succession planning for farmers

With regard to the question of succession planning and being able to pass the farm down to the next generation etc, a lot of research has found that the farming community is lacking in ensuring that the basic legal agreements and paperwork are in place before they can venture forth into more complicated estate planning. Examples of this would be that farmers often do not have up-to-date legal agreements; that there is no evidence of the land titles being transferred to the correct party on various changes. There is often complete uncertainty as to whether the land that is being farmed is actually owned by the individuals or as a partnership property.

The key is to ensure 100% Business Property Relief (BPR) as opposed to 50% BPR as there is the risk of the fact that land made available to the partnership only achieves 50% BPR, which is a real problem. It is therefore suggested that the way forward for all farms is to embrace the understanding of the latest CAP Reform and ensure that all the legal foundations are in place. It needs to be understood who owns what and why it is owned in that way, whilst considering the most tax efficient way for the farm to be owned. It is important everything ties up to maps and permanent files so that the Accounts reflect that understanding. It is also deemed imperative to sort out all the legal agreements relating to the farm now that greater understanding of the CAP Reform is evolving.

## The new basic payment scheme

DEFRA, the Rural Payments Agency (RPA), Natural England and the Forestry Commission have together published more information on how the CAP will work in a document called "An introduction to the new CAP schemes in England." DEFRA and the RPA say that most of the £11.5bn plus funding under the new CAP will be paid under direct payment schemes to farmers. The new basic payment scheme (BPS) which will include the greening payment and the young farmer payment, will replace the single farm payment (SFP).

## The active farmer test

Any landowner who applies for the BPS will have to pass the "active farmer" test. Under BPS an active farmer needs to be able to demonstrate that he or she is carrying out agricultural activity on the land – namely production, rearing or growing of agricultural products, including harvesting, milking, breeding animals and keeping animals for farming purposes. However, payments should not be made to claimants who hold "naturally kept land" which is in a state suitable for grazing or cultivation but who do not carry out on that land the minimum activity as defined by member states.

This is still being consulted on but it would appear that if over 50% of the agricultural area is naturally kept land and the claimant cannot demonstrate that production or rearing of agricultural products is taking place on the land, then they will need to demonstrate that a minimum agricultural activity is being carried out on the land. At present naturally kept land types are being considered but may include fen, marsh, swamp, saltwater, bog, acid grassland and rough low productivity grassland. There may be a height ceiling added to this definition where areas above a certain height are in some way exempt. The minimum activities may include grazing to a minimum stocking density, mowing, weed control, mechanical topping, burning or flailing.

Claimants who merely graze land with a third party grazier may need to re-address their farming arrangements in light of the new regulations to ensure they remain classed as an active farmer.

Applicants will need to have at least five hectares of eligible land: again, more about what constitutes eligible land will be available soon. Finally, applicants must have at least five BPS entitlements. The rules on entitlements are complex, but basically anyone who already has SFP entitlements will see them become BPS entitlements from 1 January 2015 – although their values will change depending on what type of land they're associated with. Just like the SFP, under BPS farmers will have to meet cross compliance rules to secure their payments.

## The BPS test and the link to the IHT tests

As it is now official that HMRC are looking closely into the claims for APR and BPR, the active farmer clause in the CAP Reform will be an important guide for the eligibility for IHT reliefs.

The importance of the active farmer test for IHT purposes is key with the current scrutiny of APR and BPR claims. It is fair to say that so much of the HMRC attacks seem to focus on active involvement by the farmer, looking very closely at the activity of the last two or seven years as appropriate. What is clear is that anybody undertaking inheritance tax advice or planning must also be fully aware of what the extent of the activity is.

## Further small scale grants

The new scheme will offer annual small scale grants for certain activities such as hedgerow laying, coppicing and gapping up, or stone wall restoration. More details about the new scheme will be available later this year. In 2015, farmers will be able to apply for an agreement which will start on 1 January 2016. However, payments for some woodland capital items will be available during 2015. More information about CAP Reform and the discussions which are taking place – including the DEFRA consultations – can be found at [www.gov.uk/cap-reform](http://www.gov.uk/cap-reform).

## Woodland grants and tax impact

With regard to grants available for the likes of hedgerow work, coppicing, woodland etc, it will be essential to ensure that the income is correctly treated for tax purposes. Income from woodlands can be exempt from income tax but therefore the associated expenses of harvesting the wood that gave rise to that income also have to be exempt, ie it is not just the income that has to be added back on the tax computation, it is also the related expenditure that is disallowed. This can actually result in a tax disadvantage rather than a tax advantage and it is worth trying to sort through what the additional grants will mean in terms of woodland income and commerciality.

## Commercial woodland

Currently it has been possible to harvest woodland at a profit, ie the cost of harvesting is less than the income receivable, and this will help hugely with arguing that woodland is commercial and qualifies for BPR. However, great care must be taken by those recording the income expense and those declaring it to HMRC as exactly how it is treated for income tax purposes, ever mindful that woodlands do qualify for three types of inheritance tax reliefs. The start is deferral relief under s125 and then also BPR and APR. The current rise of the woodland in value and income terms should not be overlooked by any farming operation looking at inheritance tax planning.

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