# Out of the woods

**Julie Butler** looks at the tax definition of woodland when it comes to the vexed question of inheritance tax, and how practitioners can advise clients looking to claim tax reliefs

Recent guidance on the matter of forests and inheritance tax (IHT) has been given in both the revisions to chapter 24 of HM Revenue and Customs' (HMRC) IHT Manual, and in the *Earl of Balfour v HM Revenue and Customs* [2009] UKFTT 101 (TC) case, in which, in the statement of facts, it was assumed that forestry qualifies for agricultural property relief (APR). Perhaps, then, the question should be asked – when does a woodland become a forest and, perhaps, vice-versa? In the meantime, it is possible to look at the tax definition of woodlands and the allowability for IHT relief. This relates to small areas of woodland, ancillary to a large forest.

## 'ANCILLARY' WOODLANDS

Chapter 24 of HMRC's IHT Manual re-states section 115 of the Inheritance Tax Act 1984 (IHTA 1984), and helps give clarity on the meaning 'ancillary' woodlands (those occupied supplementary to the main farm activity) and the availability of IHT relief: "Agricultural property is defined in IHTA 84 / s115(2) and is restricted to property in the United Kingdom, the Channel Islands and the Isle of Man, by IHTA / s115(4). It means

Agricultural land or pasture (IHTM24042) which includes woodland (IHTM24043) and any building used in connection with the intensive rearing of livestock or fish (IHTM24044) if the woodland or building:

- Is occupied with agricultural land or pasture (IHTM24111); and
- The occupation is ancillary to that of the agricultural land or pasture."

Provided the woodland is occupied by the same occupiers as the agricultural land, and that occupation is as part of the agricultural operation, then it seems appropriate to make a claim for APR. The woodland should be supplementary and / or supporting to the main activity of agriculture, and it will be necessary to show evidence of this, such as maps, accounts and notes of how the woodland is used.

## AGRICULTURAL PROPERTY

Chapter 24 goes into more detail on when woodland is defined as agricultural property, on which APR can be claimed: "Woodland is only agricultural property if it is occupied with, and that occupation is ancillary to, agricultural land or pasture. It will include woodland shelter belts, game coverts, fox coverts, coppices grown for fencing materials on the farm and clumps of amenity trees or spinneys.

Woodlands occupied for other than agricultural purposes such as amenity parkland or woodland used for the production of commercial timber will not be agricultural property. However, they may be eligible for woodlands relief (IHTM04371) or business relief (IHTM25251).

This will also be true of agri-environmental schemes (IHTM24055)."

This should be evidenced, where possible, with photographs, and the evidence of fencing and so on should be shown.

Thus, if the woodland is run commercially, then the IHT claim should be for business property relief (BPR), as opposed to APR. This may also be true where the trees are grown commercially other than as timber (for instance, Christmas trees).

## BEYOND 'OCCUPATION'

The owner-occupier of woodlands may also carry on a trade by undertaking activities which go beyond the occupation of the woodland, such as making and selling wooden items, marketing firewood or even selling processed timber. Is this

agriculture? The occupation of woodland is, essentially, the growing of timber and the normal preparation for marketing timber as timber. Once processing progresses beyond the planking stage, it is not regarded as being part of the occupation of the woodlands – that is, it is not agriculture. However it may well qualify for BPR.

## WOODLANDS IN EUROPE

The decision in the European Court of Justice in *Theodor Jäger v Finanzamt Kusel-Landstuhl* (C-256/06), the European Commission suggested that the UK's IHT APR should be made available for farmland in the European Economic Area (EEA). The European Commission also suggested that the IHT relief under section 125 of the IHTA 1984 (woodlands deferral relief) should be made available for woodlands in the EEA. There are many tax advisers who would not consider this decision significant, as BPR would have been claimed.

## NEW WOODLAND

Does new plantation under the agricultural / environmental schemes qualify for APR? Chapter 24 gives guidance here:

"There are many other agricultural / environmental schemes that can apply to agricultural land.

The Farm Woodland Premium Scheme is administered by MAFF, now DEFRA, and exists to promote the establishment of woodland by offering annual payments to compensate for the agricultural income foregone.

It is only available to farmers who must at the same time apply for grants under the Woodland Grant Scheme, the reason being that the environmental and silvicultural standards of the latter must be satisfied before an FWPS application can be approved.

The scheme is open to farmers who, either personally or through a manager, run an agricultural business that includes the land to be converted to woodland. Agriculture is defined in the Rules and Procedures and is broadly in line with that included in section 96(1) AHA 1986; keeping horses for recreational and / or sporting purposes is specifically excluded, as is fish farming.

Once accepted into the scheme the woodland must be maintained in accordance with good forestry practice and not returned to agricultural use for at least:

- 30 years after planting in the case of woodland receiving payments for 15 years (generally more than 50% by area with broadleaves);
- 20 years in the case of woodland receiving payments for 10 years (generally 50% or less by area with broadleaves).

Agricultural relief cannot be available as the whole purpose of the scheme is to take land out of agriculture.

You should refer any cases involving schemes not covered by these instructions where it appears that the land is not occupied for agricultural purposes (IHTM24101) to TG (Technical Group)."

Thus, if APR cannot be claimed because they are taking land out of agriculture, tax relief must be obtained from deferral relief or BPR. Which is the most beneficial? This is explored below.

There have been those who promote that, for successors to the land, the Farm Woodland Premium Scheme grant continues but, as this is not received as compensation for their loss of farming income (because they have never had any farming income from the woodland), the grant is deemed to arise from the woodlands themselves, and is, therefore, exempt, as normal woodland income.

Care must be taken for two reasons. First, where expenses could exceed income, the tax loss opportunity could fail, and second, there could be concerns over the availability of BPR. This proves how important it is for all tax planning to be looked at in the round.

## DEFERRAL RELIEF

Woodlands qualify for deferral relief for IHT under sections 125, 127 and 128 of the IHTA 1984 (note this is not an exemption). However, with the alternatives of APR or BPR at 100%, does deferral really present the most tax-efficient alternative?

The first choice for tax relief should be APR, and the second BPR (under section 110 of the IHTA 1984, as part of the 'net' business), with deferral coming a distant third, as a tax relief of 'last resort', when there is no possibility of APR or BPR – possibly where areas of woodlands and forestry are purchased in isolation. The relief does provide a deferment of tax until the timber is felled, but a 'tax penalty' is exacted under sections 126 to 128.

The disposal proceeds are taxed as if they formed the part of the estate in respect of which the relief was claimed and are, therefore, taxable at the highest marginal rate of IHT.

In effect, the heaviest tax charge is levied on something which was not even part of the estate, namely the growth which has taken place after the death. It would seem deferral relief is to be avoided at all costs, and the tax planner must look to APR, and then BPR, as a preferred choice.

## PART OF THE MAIN BUSINESS

Clearly, the key to being able to claim APR and BPR on woodland and forestry revolves around the agricultural activity that the woodland supports, and the ability to establish a business that the woodland is part of.

It is assumed that, in the *Earl of Balfour* case, the agricultural activity was so large that even the Scottish forestry was 'ancillary' to the agricultural activity, and the woodlands were clearly not all newly planted under grants to replace agriculture. But this clearly does not apply to the majority of small and large woodlands.

## ACTION PLAN

Review all areas of woodland, new planting and forestry, for each client. Some may consider themselves involved in farming, and some may have just invested in long-term forestry. Ensure each client is aware of the benefits, but also the complexity, of the IHT reliefs available.

When making a claim, it should, ideally, be accompanied by farm maps and cross-referenced to accounts and photographs. The purpose and use of all the woodland must be clearly identified, understood and reflected in the accounts and the income tax computation.

A Forestry Commission grant scheme includes a statement of management priorities, making it good evidence of the intention to manage a wood commercially, as is the appointment of a forest manager, involvement in the grant schemes, the formulation of a management plan, clear separate accounts for the woodland, and making sales of produce, where possible. ■

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