A rock and a hard place

Julie Butler and Libby James discuss the merits of diversification into construction and aggregates for farmers.

© Getty Images

In these difficult times, farmers and landowners have to consider all forms of diversification and this can include aggregates, minerals and housebuilding. Aggregates generally include sand, gravel and crushed stone/rock. Despite the government's housing targets and infrastructure plans, it is possibly surprising that the demand for aggregates has not yet picked up significantly.

Mineral extraction is a long-term process, not only in the quarrying or extraction itself but also in achieving the appropriate planning permission. Obtaining planning permission typically takes anywhere from two to five years from the start of the process and preparing a site. Sand and gravel extraction may go on for ten to 15 years and sometimes significantly longer, while the extraction process for rock quarrying is more likely to run over at least 20 to 30 years. The use of the aggregates is generally kept as local as possible, but costs can increase significantly for the miles travelled. Farmers and landowners must build longevity into the plans for succession etc.

Thoughts about opportunities for further income streams that can be integrated with the minerals' operation have to be explored. For example, could the extraction create an opportunity for some sort of development, such as filling the void with clean, inert material, potentially creating a development platform for a farm building or other use. From a tax viewpoint, we are still awaiting the results of the working party on farming for the environment (promised very soon), which will help give guidance on a number of areas linked to such work.

Key points

- Farmers need to consider alternative uses for their land, including aggregates and mineral extraction.
- Aggregates extraction has not kept pace with housebuilding targets.
- To maximise income stream opportunities, farmers should also think about how to best use the land after aggregate and mineral extraction has finished.
- Proposed reforms to landfill tax may mean higher taxes and the loss of exemptions, meaning the liability for restoration potentially falls on the landowner or occupier.
- Tax advisers must make sure any legal agreement with the mineral extraction operator caters for biodiversity net gain.

Landfill tax changes

The government is proposing reforms to the landfill tax, on which a consultation recently ended. The proposals are to remove a number of important exemptions and transition away from a two-tier system towards a single-rate structure. There are fears such proposals could give rise to a dramatic increase in the tax rate, with the increased costs making some minerals projects and environmental restoration work more complex to undertake. Commerciality will directly impact the minerals industry, an industry that is very important for the government's wish to deliver its current growth, housing, infrastructure and net-zero plans. If higher landfill taxes and the loss of exemptions mean funds are not available for the required restoration of the land, the liability for this then potentially falls on the landowner or occupier. There are worries that landfill tax could encourage industrial fly-tipping, which is already a plague for farmers and landowners.

Farm tax advisers must be very aware of all such changes, and business plans must be prepared with detailed spreadsheets of cost analysis.

Land and mineral rights and royalties

Farmers and landowners have a great deal of work to undertake because of the need for alternative sources of income to the original task of food production.

It is possible, especially in certain areas such as Cornwall and north-east England, for mineral rights to be separated from the land ownership and to be under third-party ownership. Mineral workings need to provide biodiversity net gain (BNG) to offset any habitat damage and replace it with 110% of the baseline habitat. Advisers must make sure any

legal agreement with the operator caters for BNG and how it is to be dealt with. Such work may present an additional income stream opportunity for the landowner, for example in creating the habitat units needed, for an additional payment.

It is important that the landowner ensures they have some input into the planning process – ideally final approval and prior consultation – especially regarding restoration of the site, and the possibility of the mineral extraction being combined with restoration that enables subsequent development. It is essential to check the financial security of the operator and to have clauses in the agreement that protect the landowner.

Farmland tenants may also have opportunities, unless the landlord has reserved minerals out of the lease. Since damage may be done to the surface or subsurface of land, which may need to be remedied or restored, tenants may become involved as parties in transactions with prospectors or developers. A farmer may themself become a mineral prospector or operator. The business will be taxed as trading income separate and distinct from their business as a farmer. Mines, quarries, gravel pits, sandpits, brickfields, salt springs or works, waterworks and other 'concerns' of like nature are charged as trades notwithstanding whether under normal rules they would be trades (ITTOIA 2005, s 12 and CTA 2009, s 39). 'Concern' implies a degree of business organisation for the purpose of carrying on the undertaking (for general guidance on the scope, see HMRC's *Business Income Manual* at BIM60201). For individuals, the liability is to income tax; for companies, it is to corporation tax.

When extraction begins, the landowner will normally receive a minimum annual payment in the form of a 'certain rent', with royalty payments based on the volume of working at the site. The strength of the initial agreement is essential. Regular reviews of payments to landowners should be undertaken (via either periodic market or index reviews), as well as ensuring there are agreed payments for all the possible activities onsite, such as recycling, infilling and importing materials for processing.

Income tax treatment of mineral royalties

Income tax is charged on rent receivable in connection with what the legislation labels 'a UK section 12(4) concern' (ITTOIA 2005, s 335). This provision is subject to any application of the priority rule in ITTOIA 2005, s 261 (see paras 300-015), in a case where such rents are also income from a trade under ITTOIA 2005, Pt 2 ch 2. In *Henderson* (TC4730), the First-tier Tribunal determined that property income charged under ITTOIA 2005, s 335 was not part of the farming (trading) business, and could not be aggregated with that trading income.

To fall within this definition, 'rent' (as defined: see paras 302-810) must be receivable in respect of an estate, interest or right in or over land in the UK and that estate, etc must be 'used, occupied or enjoyed' in connection with mines and quarries (including gravel pits, sandpits and brickfields). The tax planning is essential from the outset as is the review and understanding of the legal agreements.

One of the first considerations is the management expenses. A deduction for management expenses is allowed in a tax year if:

a) a person lets a right to work minerals in the UK; and
b) the person pays a sum wholly and exclusively as an expense of management or supervision of the minerals in the tax year.

In calculating the amount of rent taxable under these chapter 8 provisions, a deduction is allowed for the sum for the tax year (ITTOIA 2005, s 339).

How the receipts are structured will significantly impact on the tax considerations as set out above and need tax planning. How the receipts of income will be treated must be considered in terms of the farm accounts and taxation in harmony. If the mineral rights are simply let to a 'third party' then the rental income (as opposed to trading income) could be a negative for tax purposes.

> "For an inheritance tax viewpoint, the more 'investment income' as opposed to trading income that the whole operation receives is a negative for business relief and the 'Balfour matrix'."

If a landowner sells the mineral-bearing land outright, or sells the minerals themselves, they will have made a part disposal for capital gains tax. Rollover relief or business asset disposal relief may be due. If the landowner sells their land to a mineral operator, with an option to repurchase when the working ceases, the price difference between sale and ultimate repurchase may fall to be treated as a premium chargeable as profits of a property business (ITTOIA 2005, s 284 and CTA 2009, s 224). In this case, the difference in prices is charged as such profits subject to a deduction of 1/50th for each complete year, ignoring the first, between the sale and the buy-back (for which purpose the date of completion rather than the contract date is used). As can be seen, the tax position on minerals is very complicated and must be considered in depth.

For an inheritance tax (IHT) viewpoint, the more 'investment income' as opposed to trading income that the whole operation receives is a negative for business relief (BR) and the 'Balfour matrix'. It is important to make sure that there is greater trading income and that the mineral royalties do not swamp this.

Likewise, for income tax, if there have been trading losses due to the farming problems for a number of years and there is a worry a restriction under the hobby farming rules may apply, a trading receipt is much preferred, so structure of income is important.

Mineral planning permission

It could be a wait of several years before the landowner receives any rental income. Even if the landowner has looked into mineral extraction before, it's worth reconsidering previous reports etc, because the supply chain and needs have changed. What might not have been commercially viable previously could be much more viable now because extraction and processing techniques have also improved.

The cost of achieving mineral planning permission can be large. Ideally, the arrangements should be with the mineral operator taking the lead and carrying the risk on this. Initially, landowners may be approached by mineral operators seeking an exclusive licence to survey their land, which involves drilling test holes. Once the results of viability tests have been analysed, the information is shared with the landowner and, if positive, the operator starts the planning application process, having agreed the necessary rights and structure with the landowner to include tax planning. The agreement with the landowner will set out the rent, royalties, restoration and other operational matters and this becomes effective on grant of planning permission.

The National Planning Policy Framework requires all mineral planning authorities (MPAs), usually county councils, to grant planning permissions when the site works to provide a steady and sufficient supply of minerals to meet demand and maintain reserves. However, MPAs produce a local plan more than a decade apart, and so there is often a mismatch between what these plans set out and changes in demand for minerals. This is important now, as most of the current plans were written before the 2024 general election, and housing targets that have followed that election. Achieving planning permission for mineral extraction is challenging, with permissions granted being well short of demand. It is considered that sand and gravel applications are being granted at about 60% of the rate of use, with crushed rock at 30%.

Like all commercial businesses, developers and mineral operators seek sustainability benefits of the extraction proposal. For example, a minerals operation may form an early part of a wider development scheme as part of farm diversification, with the minerals worked being used in the development, while the soils stripped to allow the development can be tipped into the void created by the mineral extraction. As mentioned, there may be other alternatives for the land where the extraction takes place, such as farm tourism diversification, leisure uses, fishing or water sports.

Author details

Julie Butler FCA is founding director of Butler & Co Alresford Limited. She is the author of *Tax Planning for Farm and Land Diversification* (Bloomsbury Professional), *Equine Tax Planning* ISBN: 0406966540, *Butler's Equine Tax Planning* (third edition) (Law Brief Publishing), *Stanley: Taxation of Farmers and Landowners* (LexisNexis) and editor of *Farm Tax Brief*. She can be contacted by email: julie.butler@butler-co.co.uk.

Libby James ACA CTA is a tax and accounts associate at Butler & Co, advising on income tax, inheritance tax and capital gains tax for rural clients and other professional firms. Libby can be contacted by tel: 01962 735544 or email: libby.james@butler-co.co.uk.

FIND OUT MORE
On Taxation.co.uk

- Quality farm valuations for IHT: tinyurl.com/5h4rnwj5
- Farm lifetime transfers after the Budget: tinyurl.com/yc7cn7pc