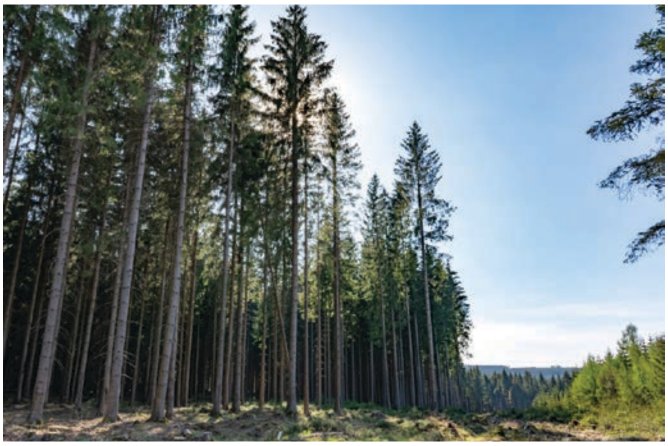
Tax for trees

Julie Butler and Fred Butler explain the various tax advantages for woodlands and the relative importance of such property to the tax treatment of farms.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Much has been written about the UK incentives to plant more woodland in the agricultural and national press. Such moves please environmentalists who are concerned about global warming and they enable landowners to take advantage of the increased prices of softwood, such as spruce and larch, and hardwoods such as oak and beech. However, despite the increasing price of woodlands and forests there is still great disparity between the value of woodlands and agricultural land in much of the UK. Many consider the high price of UK farmland is the result of generous tax reliefs. For example, the potential for inheritance tax relief in general and capital gains tax relief for the 'rollover buyer' – often, farmers wanting to rollover development gains.

The Scottish government has set high targets for the new planting of woodlands and the demand by potential purchasers for bare land to fulfil this need is reflected by the incentives available. The worry had been that the price of farm and agricultural land was so far in excess of woodland values that reducing the value by tree planting was unattractive; in other words, buying bare land to replant was commercially negative. However, in Scotland, for example, the bare land price has now reached commercial viability.

Ironically, that previous bare land conundrum has changed of late – the price of the felling of softwood and hardwood has increased dramatically. The value of dedicated woodland has multiplied in a positive way compared to pure agricultural land; environmentalists are content with more tree planting, and the future looks positive for subsidies in this direction.

Key points

- There remains a disparity between the price of woodland and agricultural land.
- Will the tax reliefs for woodland overcome the potential commercial devaluation if agricultural land is used for planting.
- Woodlands may be eligible for inheritance tax business property relief.
- Will woodland satisfy the 'character appropriate' test or the 'Balfour matrix'?
- If woodland is 'ancillary to agricultural land' it can benefit from agricultural property relief.
- Timber sold from investment woodlands is outside the scope of capital gains tax.

But what of the tax treatment? It is fair to say that the smaller woodland activities on a mixed farming enterprise are often forgotten about in terms of commerciality, accountancy and tax. However, with the increased commercial potential of woodland combined with their current tax advantages, many farmers are having to question the present and potential use of the woodland that is included in their farming operations.

Inheritance tax advantages

HMRC has been looking very closely at woodlands for inheritance tax purposes at many levels. The department is perhaps exploiting the fact that smaller woodlands have historically been overlooked by advisers when considering the contribution they make to the farm's overall profitability and such property should now be reviewed in more detail for tax purposes. Because the cost of harvesting woods was often more than the return on sale, it was common for some form of barter to be entered into; for example, free thinning of the wood in return for the work.

Consideration should be given as to the inheritance tax relief that could be claimed on the woodlands depending on the requirements of the estate. If there is a greater need for relief on the farmhouse then, if applicable, a claim for agricultural property relief should be made on the woodland to increase the agricultural activity associated with the farmhouse for the 'character appropriate' test (see HMRC's *Inheritance Tax Manual* at IHTM24050). Alternatively, if there is a greater need for trading activity a claim for business property relief could be made to improve the 'Balfour matrix' – the relative importance of trading and investment activities – and move away from any investments in the farming activity because woodland can now prove to be commercial. See *AM Brander (Earl of Balfour's Personal Representative)* (TC69).

Woodlands can benefit from agricultural property relief if they are ancillary to farmland, such as 'shelter belts' or where firewood and fencing are taken. This relief also applies if the activity of short rotation coppicing is carried out.

After woodlands managed on a commercial basis have been owned for the two-year minimum time of ownership, they can benefit from 100% business property relief. The reality is that, on many farms, the woodland income has become part of the diversified activities of the operation and is now a commercial income stream.

The key criteria is that if the woodland is 'ancillary to agricultural land' and pasture it can benefit from agricultural property relief because it will then qualify as agricultural property (IHTA 1984, s 115(2)). In its *Inheritance Tax Manual* at IHTM24032, HMRC notes that such woodlands will usually consist of game coverts, shelter belts, coppices grown to provide fencing material for the farm, clumps of amenity trees or spinneys.

However, there has been much more activity from woodland investors who are buying bare land for planting to take advantage of current subsidies and future ones that are predicted under the Agriculture Bill which was published in November 2018 (tinyurl.com/y8d9bslh). Regardless of the possible 'gamble' of future subsidies, environmentalists are demanding that billions more trees are planted in the UK.

Commercial woodlands and income tax

Woodlands are deemed commercial for tax purposes if trees are grown to sell as timber. The commercial occupation of woodlands is not classed as a trade, so tax would not be paid on any profits (ITTOIA 2005, s 11(1)) from timber sales nor can relief be claimed for losses. However, the traditional model of commercial woodlands has now progressed to much greater productivity as the price of timber has increased significantly and business property relief can be claimed.

Timber sold from investment woodlands is also outside the scope of capital gains tax (TCGA 1992, s 250). Land taken up by commercial woodlands can qualify for agricultural property relief (see *Inheritance Tax Manual* at IHTM25021) if it is 'agricultural' as part of the farm as explained, together with business property relief. The rollover relief is restricted to the bare land when the woodland investor or entrepreneur is involved.

If the income of the woodland is 'outside the scope', then likewise the cost of 'harvesting' the woodland must be disallowed. If such an operation is a farm, all the associated costs must be analysed and considered as to what is and is not allowable. However, with press headlines such as 'Britain must plant billions of trees say climate chiefs' there has to be a future change in the industry.

Long-term tax planning

Woodland and forests should be considered on a case-by-case basis by tax advisers. There are times when the short-term commercial and tax benefits can be taken advantage of by the elderly farmer or landowner. However, in general succession planning, such property should be considered in terms of long-term planning and profitability. There are many tax, environmental and commercial advantages, which is an unusual combination, indeed some might argue a very intoxicating 'cocktail mix'. With rollover buyers and other tax reliefs keeping the price of agricultural land high, for many the potential commercial negatives will remain by reducing the value of land with tree planting. However, if advantage can be taken on pockets of low value, bare land by tree planting without devaluation, there are opportunities and alternatives to consider.

The need for more trees is creating woodland investors who are not farmers and the tax reliefs and protection must be considered. Woodland can contain the potential for other sources of income – for example, wind turbines, especially in Scotland – and tourism, particularly in national parks. Tax advisers must be aware of all the changes to values, subsidies, commerciality and the long-term need for more trees.

Scottish woodland

With a clear ambition to increase woodland cover, the Scottish government has published its forestry strategy for 2019 to 2029 (tinyurl.com/yxlerjpv). It has the following three key objectives.

- Increase the contribution of forests and woodlands to Scotland's sustainable and inclusive economic growth.
- Improve the resilience of Scotland's forests and woodlands and increase their contribution to a healthy and high-quality environment.
- Increase the use of Scotland's forest and woodland resources to enable more people to improve their health, well-being and life chances.

By 2032, the aim is for 21% of the country to be covered in trees, compared with 18% now. To achieve this, the annual woodland creation target will increase from 10,000 hectares to 15,000 hectares a year by 2024-25. This will include creating between 3,000 and 5,000 hectares of native woodland each year. The tax implications are thought provoking.

Planning point

The commercial occupation of woodlands is not classed as a trade, so is not liable to tax on profits from timber sales nor eligible for loss relief. And timber sold from investment woodlands is also outside the scope of capital gains tax.

Author details

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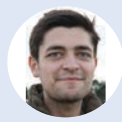

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