Wood for the trees

People choose to buy woodlands for many reasons, from timber production to wildlife habitat preservation, but, cautions **Julie Butler**, those looking to do so as an investment need to understand the complexities of the tax implications before they buy

Further to my article on woodlands and inheritance tax (IHT) relief, 'Out of the woods', in the January 2010 edition of *PS*, this article looks at woods as a tax-efficient investment.

You could certainly be forgiven for asking why anyone would want to buy a wood or a forest. They can be expensive to maintain, harvesting the timber can cost more than the proceeds of selling it, and the public liability insurance is high. However, there are obvious practical and recreational uses for woodland, such as to own shooting rights, as game covert, for wildlife habitat preservation, or for the harvesting of firewood for adjoining farms, belts, fencing, or timber. Or buyers may be looking simply for shelter from suburban and urban pressures, and somewhere to observe wildlife. The list of uses is endless and, in fact, simply appreciating the beauty of woodlands can be at the top of it. And in addition to all this, there are considerable advantages to woodlands as an investment, particularly in terms of tax efficiency.

At the time of writing, timber prices are on the increase. However, forestry is a long-term investment where the crop often takes 35 years to mature, so such increases cannot be relied on as the basis of an investment. Some investors are buying bare land and planting it, perhaps with not only commercial conifers, but also broadleaves, and also using the land for a mix of other rural activities, so that the investment is not wholly reliant on timber prices. It is generally considered that the biomass market is competitive and could lead to further increases in timber value. Tree waste has commercial value, and English Christmas trees were in strong demand in December 2009, due to the strength of the Euro.

Many consider that, with current world food and fuel shortages, any wood or forest must have long-term commercial advantages. But tax reliefs need to be considered – and not just one-dimensional inheritance tax (IHT) angles or income tax exemptions, but in the round.

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For instance, Christmas trees grown by specialist nurseries will be categorised as market gardening (under the HM Revenue and Customs (HMRC) Business Income Manual (BIM) 55210), qualifying for business property relief (BPR). Where, however, Christmas trees are grown on part of a farm, HMRC practice is that the activity may be incorporated in the other farming activities conducted (see BIM62601) – that is, they will be considered as part of the farming income, qualifying instead for agricultural property relief (APR).

Tax reliefs on woodlands therefore need to be handled with considerable professional care to make sure the result provides the best solution for the owner. This article considers the various tax angles of the ownership of woodlands, so practitioners can effectively advise current and potential owners of the woodlands, and those proposing new planting programmes.

INHERITANCE TAX RELIEF

There are, essentially, three types of IHT relief available for holdings in woodland / forestry: APR; BPR; and deferral relief for the standard investment holding.

Woodlands are exempt for deferral relief under sections 125, 127 and 128 of the Inheritance Tax Act 1984 (IHTA 1984), but with the alternatives of APR or BPR at 100%, does deferral really present the most tax-efficient alternative?

The deferral relief should, in fact, be the last choice of IHT relief. It is 'what it says on the tin' – a deferral of IHT. It does not remove the tax and leave the beneficiary free to start again, whereas APR or BPR can remove the IHT on the asset, through 100% IHT relief.

In order to qualify for BPR, the wood has to be managed as a business or be part of a business unit – that, is a mixed estate with the woodland or forestry integrated with the main business activity and agricultural activity. The integration should show real evidence of being part of the main business. An investment in woodland can be converted to a business by incorporating one or more of the following types of activities:

- shooting and stalking rights;
- ponds for fishing;
- coppicing;
- on-site sale of firewood and woodchips;
- interaction of ponds for fishing;
- timber holiday cabins with visits;
- equestrian with nature trails; or
- games such as paint balling.

For the woodland to qualify for APR, the wood must either qualify as agricultural property, or it must be ancillary to agricultural property, for instance, ancillary to the main farming activity – that is, it must be an integral part of the agricultural activity.

LONG-TERM FORESTRY

Many forests are purchased as an investment with the specific aim of shelter from IHT. Instead of investing in, say, stocks and shares or bricks and mortar, the choice made by the investor is that of woodland for the IHT advantages, in the full understanding that the income is either low or negative – that is, expenses exceed income. There are many woodland management companies throughout the UK who take care of every worry involved with the running, organisation and management of the woodland.

Deferral relief provides a deferment of IHT until the timber is felled or sold. At this point, a 'tax penalty' is exacted, as the proceeds from the felled timber are taxed as if they formed part of the deceased estate, in respect of which the deferral relief is claimed, and taxed at 40%. The irony, it is argued, is that the relief was claimed on the woods and, therefore, what is taxed is the growth which has taken place after the death – which was not even part of the estate at death. Obviously, it is far better for the owner of the wood to try to achieve a full 100% relief of APR or BPR. In addition, there are other advantages of BPR.

INCOME TAX

Income from woodland held as an investment can be exempt from income tax, which seems very attractive. However, this exemption does mean that expenses cannot be claimed, and the tax exemption 'flagship' for woodland might not be as beneficial or attractive as it first seems. If the woodland is part of a farming operation, and the costs exceed the income from time to time, then effective loss relief can be obtained on this negative. If the woodland income is exempt, then so are the expenses.

If the land is predominantly occupied for farming and not commercial woodland, the receipts from felled timber may fall outside the exemption, and be taxed as farm income. For example, receipts from the sale of trees planted on farms should be included as part of farming profits (*Elmes v Trembath* [1934] 19TC 72). Short rotation coppice is specifically brought within farming.

AGRICULTURAL PROPERTY RELIEF

For a woodland to qualify for APR, it must qualify as agricultural property in accordance with the IHTA 1984, or be occupied with agricultural land and be ancillary to that farmland. The type of woodlands that qualify as farming / agriculture in their own right are short rotation coppices – that is, timber harvested every 10 years – and woodlands grown as an energy crop.

By definition, new planting that was the subject of a grant to take land out of agricultural use and must not return to agricultural use within 20 to 30 years, cannot qualify as agricultural property (and therefore for APR), as it is not agriculture. However, woodland can qualify as agricultural property because it is ancillary to farmland, such as game coverts or coppices grown or used for farm timber.

Woodland used for the production of commercial timber is not agricultural property. It is considered by many that guidance is given by the recent *Earl of Balfour* case (*Earl of Balfour v Revenue & Customs* [2009] UKFTT 101 (TC)), relating to a mixed estate in Scotland. In the statement of facts, the forestry was deemed to be agriculture, and therefore ancillary to a very substantial farming operation. Help can also be found as to the definition of agriculture in chapter 24 of the HMRC Inheritance Tax Manual, available from the HMRC website at www.hmrc.gov.uk/manuals/ihtmanual.

BUSINESS PROPERTY RELIEF

As mentioned earlier, in order for woodland and forestry to qualify as business property and, therefore, for BPR, the woods must be either commercial woodland or they must qualify as part of the farming business as a whole. There are further tax advantages of BPR for the hidden value of the wood. If part of the woodland might be developed at a future time, any 'hope value' will qualify for IHT relief, through the fact that it is part of the business. The woodland will not just obtain 100% relief at agricultural value, but also at market value, including the 'hope' of development value. This is because the woods are part of the business.

In relation to shooting rights, if, for example, in the case of probate, the district valuer wants to inflate or increase the value of the woods for a well-run shoot, BPR can be claimed against the shooting rights. Or if, for example, the woodlands contained wind turbines, these could also qualify for BPR as part of the business. If it is considered that the wind turbines are an investment with rental income that are part of an overall business operation, then BPR should be obtained on the net value under section 110 of the IHTA 1984.

But there are other considerations if the proportion of the income from the turbine is greater than the income from the woodlands – that is, the investment income exceeds the trading income. If this is the case, then section 103(3) of the IHTA 1984 will mean that the ability to claim BPR could be challenged. This would happen when more than 50% of income and value are found in investment activities.

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TAX PROTECTION ACTION PLAN

BPR and APR for woodland can be protected. The starting point is the accounts that reflect the woodland income – these have to be reviewed to understand the nature of the activity. Do these accounts reflect a business, an agricultural activity, or an investment activity? Perhaps they reflect all three – in which case where is the preponderance of activity?

Investment in woodland or forestry, whether a large forest for investment and enjoyment, or a small shooting covert to be added to a farm, does have the potential for superb tax reliefs, but they are not straightforward, and a full professional review should always be undertaken prior to any purchase. ■

Julie Butler F.C.A is the author of *Tax Planning for Farm and Land Diversification* and *Equine Tax Planning* (both Tottel).