

Ref: PC(UK)

30 June 2021

APPG for Rural Business and the Rural Powerhouse
Via Ms Rosie Nagle, CLA

Via email only: ruralpowerhouse@cla.org.uk

Dear Ms Nagle

CALL FOR EVIDENCE – AN INQUIRY INTO RURAL PRODUCTIVITY

Thank you for inviting the Chartered Institute of Taxation (CIOT) to give evidence to the All Party Parliamentary Group for Rural Business and the Rural Powerhouse on 12 May 2021.

The CIOT is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

In accordance with our area of expertise we limit our substantive comments to Section 5 of the paper relating to taxation. However before addressing those aspects, we should start by mentioning non-tax factors that we think significantly impact on rural productivity, in comparison with urban productivity. In our opinion they include:

- Fewer people
- Longer distances to travel
- Higher costs of travel and distribution
- Less access to fast broadband
- Less industry

5 Tax – does the tax system provide benefits or barriers to rural productivity?

5.1 *To what extent does the tax system actively encourage or discourage a land manager from investing in their farming/diversified farming business?*

The vast majority of farming businesses are operated as sole traders or partnerships (and not as companies) but Research and Development (R & D) tax relief is only available to limited companies. This does not encourage farmers to develop more efficient production processes. Accepting that the 230% R & D relief for companies liable to the lower corporation tax rate would be very costly if applied to income tax rates, a lower rate of relief could be made available to non-corporates.

Although structures and buildings allowances are useful they are not currently set at a sufficient level to encourage investment in buildings.

The 'default level' £200k Annual Investment Allowance (AIA) does not buy much in a reasonably-sized modern farming business: combine harvester purchases are frequently well in excess of this (even netted down after trade-in). The ability to carry forward/back unused AIA from earlier/later years would smooth out the years of heavy investment.

Additionally, in situations where a trust is one of the partners there is no AIA at all.

At the moment the tax system positively discourages farmers from significant non-trading diversification (eg letting redundant farm buildings for offices/ storage or letting land for solar or battery storage schemes) because they risk the loss of Inheritance Tax (IHT) Agricultural Property Relief (APR) on the part of the farm affected. A non-trading element can impact on the availability of other capital taxes reliefs: Capital Gains Tax (CGT) reliefs rely on the whole being at least 80% trading and IHT Business Property Relief (BPR) requires over 50%. Although the *Balfour* approach provides some leeway for diversification without losing IHT relief, in reality many farmers are already at or close to the 50% BPR threshold on one or more of the metrics and the well-advised will steer clear of anything approaching those ratios – to avoid jeopardising those reliefs it is more realistic in practice to aim (if CGT Business Asset Disposal Relief (BADR)) is the main objective) for around a 90% level of trading, and (if IHT BPR is the main objective) for around 65% of non-investment activity. Non-trading activity therefore creates an issue and as all activities and measures can fluctuate year to year the best advice (purely from a tax perspective) is to avoid non-trading activity unless absolutely necessary. Furthermore, the Office of Tax Simplification (OTS) suggestion that the BPR threshold might be increased to 80% would render many rural businesses ineligible for IHT relief on the entirety of their non-agricultural value.

The distortions are apparent in the case of farmers who, if they let some of their land for a solar array, would be better off in income terms (solar generates more per acre than agriculture) but would suffer a double IHT detriment of increasing the freehold value of the solar land whilst also losing eligibility for APR on that land.

The limitations on assets available for CGT rollover relief also stifle innovative activity. A farm business that wishes to dispose of a surplus cottage and buy further agricultural land is dissuaded from doing so by the tax arising on the disposal of the cottage. A rollover relief based solely on the type of asset invested into – akin to an Enterprise Investment Scheme (EIS) investment – would encourage investment in appropriate assets. This stimulus to fund productivity is necessary as most farms are asset-rich but cash-poor.

Farmers are generally older, and there is a difficulty in encouraging younger generations to get into farming. In addition, with the availability of APR and BPR on death, combined with the capital gains uplift, older farmers often find it sensible tax planning to hold on to their farms until death. Being older, they may be less likely to consider diversifying, or for example, moving to more environmental farming during their remaining years, especially when the broader factors mentioned in the introduction are borne in mind. Despite this challenging background it is perhaps indicative of the economic realities facing agricultural businesses that (as we understand it) something like two-thirds of farms have embraced some degree of diversification.

5.2 How can we simplify the tax system to encourage rural diversification?

The CLA have previously promoted the concept of the Rural Business Unit. This would encourage farmers to look at options beyond traditional agricultural production. Profitability from the activity of farming is likely to decrease in the years ahead and in many cases farming will be constantly loss making; the inability to continue to offset those losses sideways against other income generated from the Rural Business Unit creates a significant disadvantage. The concept of a single and combined profit generated from a Rural Business Unit would undoubtedly be favourable.

The restrictive definition of 'agricultural purposes' for APR could be expanded to allow for greater diversification (eg under the Environmental Land Management Scheme (ELMS)).

5.3 *To what extent does the tax system actively encourage or discourage farming or other land-based businesses from developing innovations that may improve productivity?*

See comments in 5.1 above on R & D and AIA, and the ineligibility of partnerships with a trustee member.

Additionally, as the vast majority of farm businesses are sole trade / partnerships, the tax liability on profit leaves less available for investment back into the farm. A limited company can reinvest net of (currently) 19% tax. The net cash available to a sole trader could be considerably less.

5.4 *Are there any aspects of way that businesses must engage with the administration of the tax system, now or as contemplated by the digitalization of the tax system project, that may hinder productivity?*

The number of multiple returns required for a farm business even with only minor diversification is astonishing. Under Making Tax Digital (MTD), in addition to the various returns already required, there will be separate quarterly returns (plus the catch-up) needed for, say, rental income (as that has a 5/4 basis) and farming income (that will almost certainly have a different year-end).

Not only is it frustrating that a farmer should have to file so many returns, the fact that some of those returns (eg those relating to farm performance not taking into account crop valuations / contracting balances) are meaningless adds both to the discontent and the cost.

5.5 *How can we best use tax levers to boost rural productivity?*

To address the broader factors mentioned in the introduction, possibilities include:

- Incentivising employment by rural businesses through NICs.
- Increasing investment allowances for rural businesses.
- Using tax incentives to increase the roll-out of high-speed broadband in rural areas.
- Rural areas are going to find the switch to electric transport harder than urban areas, so consider some sort of subsidy for rural businesses to adapt to these changes, or extend the timescale for rural businesses to move to electricity.
- Increase council funding through the tax system to help rural councils mend rural roads quicker.

There is also the likelihood that existing capital taxes reliefs encourage elderly farmers to 'hang on until death' rather than passing on to the next generation earlier when the younger person is more likely to be willing to take risks and innovate – which might lead to increased productivity. Furthermore, there are many instances of the younger generation working for an inadequate reward in anticipation of inheriting the farm later. Passing on interests earlier, would give security and avoid the growing number of 'one day all this will be yours' proprietary estoppel claims – a real issue, judging by the number of farming cases before the courts in recent years.

Diversification exacerbates that problem: there may be situations where the diversified assets do not qualify for CGT holdover relief and will only qualify for BPR if retained in the same ownership as all of the qualifying assets. Thus the elderly farmer may be driven by capital tax considerations to retain the whole business (and preferably non-diversified) until death. A real advantage in implementing the OTS recommendation to remove the CGT uplift on death, where the estate has 100% APR and/or BPR, would be to remove the major disincentive to lifetime succession planning.

In addition, it is likely that the availability of reliefs such as APR inflate land prices and so create a barrier to the younger, innovative generation entering into farming, thereby affecting productivity. That said, we would caution Government about making seismic change which could shock the economics on which the industry is structured before having thought through very carefully all of the consequences. For example, the effect of falling prices on existing collateral for loans and, if farmland became 'cheap,' would speculators just buy and sit on it, waiting for an inevitable return of relief to encourage farming? This is an issue that needs to be considered in depth.

Yours sincerely

John Bunker
Chair, Private Client (UK) Committee

The Chartered Institute of Taxation

The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.