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Taxation of environmental land management and ecosystem service markets Consultation[1]

Response by the Chartered Institute of Taxation

1 Executive Summary

1.1 The Chartered Institute of Taxation (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.

1.2 We are grateful to have had sight of the extensive response prepared by the Association of Tax Technicians. We have avoided duplication and are pleased to endorse their detailed paper.

1.3 We have confined our comments to additional points on the Inheritance Tax (IHT) questions at Part 2. We agree that having a clear and comprehensive approach to the IHT issues is essential to unlock the willingness of landowners and farmers to commit their land to long-term environmental schemes.

2 About us

2.1 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.

2.2 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.

[1] Published on 15 March 2023 M4114_and_M5086_-_Call_for_evidence_and_consultation_on_tax_and_environmental_land_management_-_FINAL_VERSION.pdf (publishing.service.gov.uk)

2.3 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.

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

3 Introduction

3.1 Part 1 of the Consultation is a call for evidence on the tax treatment of the production and sale of ecosystem service units to understand commercial operations and areas of uncertainty in respect of taxation.

3.2 Part 2 of the consultation aims to explore the extent to which the current scope of agricultural property relief (APR) from Inheritance Tax may represent a barrier to agricultural landowners and farmers making long-term land use changes from agricultural to environmental use. It also explores a recommendation from the Rock Review to restrict the application of 100% APR to farm business tenancies (FBTs) of at least 8 years or more under the Agricultural Tenancies Act 1995 and secure agreements under the Agricultural Holdings Act 1986.

3.3 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.

3.4 Our comments are on Part 2 alone.

3.5 Government policy to encourage farmers and landowners engaging in environmentally enhancing schemes will be severely compromised unless it is clear that entering into such schemes will not result in the overall position of the landowner worsening. In relation to the IHT position, this effectively means that the tax due on a transfer will not be more than it would have been had that land remained in its existing use.

3.6 Our comments are constrained because the government has not taken the opportunity to review the purposes of APR more widely. There are several areas in which the policy rationale for APR is unclear and that, in turn, makes it difficult to anticipate what neutrality between APR and an environmental scheme looks like. Our answers to the various questions in the Consultation should therefore be read subject to this overall caveat. We recognise that in the time available, the focus is on the narrow issue of how to ensure that farmers and landowners are not put off entering into environmental schemes due to the loss of APR. We would encourage the government to review the whole relief more widely rather than adopting piecemeal reform which will, inevitably, just layer complexity on top of an already imperfect system.

PART 2 Consultation on Agricultural Property Relief from Inheritance Tax and environmental land management

4 Q1: What are the areas of concern in respect of agricultural property relief and environmental land management? Please provide evidence and scenarios, including the relative scale of the concern by explaining where decisions about land use change have and have not been influenced by the scope of agricultural property relief.

4.1 Members indicate that the concerns expressed in paragraph 3.29 of the Consultation that the potential lack of APR is inhibiting farmers from embracing the more innovative environmental schemes and from agricultural landowners allowing their tenants to do so are valid. Full re-wilding is a clear example.

4.2 In addition to any impact on the availability of APR to the specific land being considered for any such scheme, there is the need to consider the wider impact on the availability of APR to other assets that may be affected by the decision. For example, the availability of APR to farmhouses, farm cottages and farm buildings is dependent on whether they are of a character appropriate to the land being farmed and are occupied for the purposes of agriculture. Similarly, some assets (eg woodland) can obtain APR if they are 'ancillary' to the agricultural land occupied with them. It follows that a reduction in the agricultural land and activity will potentially reduce the ability to obtain relief on such assets.

5 Q2: Do you agree that the qualifying conditions for relief would need to be underpinned by live undertakings and ongoing adherence to those undertakings at the point of transfer?

5.1 These seem fair in principle. However, experience of minor failures in cross-compliance leading to a reduction in payments from the Department for Environment, Food and Rural Affairs (DEFRA) would indicate the need for caution. Perhaps relief should be withdrawn only when the majority of undertakings have been breached?

5.2 Alternatively, if the new system is based upon undertakings then we suggest that there should be (a) discretion for HMRC to ignore minor or inconsequential breaches of those undertakings and (b) a grace period to put right more significant breaches of undertakings.

6 Q3: Do you agree with the potential proposed approach to the list of Environmental Land Management Schemes that could qualify for relief where the activities covered relate to land being taken out of agricultural use?

6.1 It is clear that land managed under Countryside Stewardship and Landscape Recovery Schemes should qualify for relief under a re-cast IHTA 1984, s,124C. However, it is not inconceivable that agricultural landowners might undertake environmental recovery schemes outside of the DEFRA parameters. The new provisions should be wide enough to embrace such innovative environmental activity. To save having to amend the section whenever a new statutory scheme is introduced, the new provision should include the power to add such schemes by secondary legislation.

7 Q4: Could the government remove the list of existing enactments for land habitat schemes in the existing legislation? Are you aware of any land continuing to qualify for relief now under any of the existing enactments?

7.1 We did not receive any feedback in response to this question. It is incumbent upon HMRC and DEFRA to ensure that no live cases are inadvertently denied relief.

8 Q5: What agreements that meet high verifiable standards and have robust monitoring could be added to any list of qualifying Environmental Land Management Schemes? Please explain, including any potential unintended consequences or tax planning opportunities that might need to be considered and how they could be addressed.

8.1 We agree that land managed under innovative schemes such as (but not restricted to) those statutory schemes mentioned in the Consultation should be eligible for APR. We leave it to those who have the expertise in accreditation and verification to deal with the detail. Provided the accreditation and verification processes for private sector, non-governmental schemes are sufficiently robust, we do not anticipate unintended consequences.

8.2 Complying with agricultural bureaucracy is sufficiently difficult already that no-one is going to put themselves through the pain of a 'high verifiable standard' just for the sake of tax. Farmers will do it because it is the right thing to do commercially (counting tax as one of the commercial costs). But just because tax may be among their commercial motivations for adopting a particular standard, that of itself should not be viewed as unacceptable tax planning.

9 Q6: How could the government achieve its intention not to expand the scope of relief beyond agricultural land that was being used for agricultural purposes? What would the practical challenges be for those claiming relief and how could they best be overcome?

9.1 We recognise that the scope of this consultation is not to expand APR beyond land currently used for agricultural purposes. (We comment at 3.6 about whether there is a missed opportunity to consult more widely).

However, a consequence of restricting the consultation in this way is that a future time will come when two otherwise identical blocks of land, used for identical environmental purposes, may have different IHT statuses because block A was previously used for agricultural purposes and block B was not (it was always used for environmental or non-agricultural purposes).

That distinction is likely to lead to significant future difficulties. There will be compliance costs in maintaining records of historic usage; there will be extensive due diligence needed (eg when land is sold) to prove its historic usage; there will be significant valuation differences (as IHT-free land is likely to command a premium). And that, in turn, will lead to future calls for reform – either to bring more land into IHT relief, or claims that giving relief to land A over land B just because (30) years ago it was used for agricultural purposes is unjustified and that relief should be withdrawn.

9.2 The risk of this environmental relief being seen as too generous (and therefore being withdrawn in the future) might well cause farmers and landowners not to take up environmental schemes – because of the lack of a guarantee that (when they die in 30 years' time) the relief will still be available.

Taking land out of agricultural production is a long-term decision, not easy to reverse. So, if any reform is to be successful here it too needs to take a long-term perspective. Of course, no Parliament can bind its successor, but the government should consider taking a cross-party approach here with a view to getting something on which there is broad political consensus. It will only be with a broad consensus that farmers and landowners will take the long-term decisions necessary.

9.3 Those considerations aside, the other possibility is to consider some sort of automatic review clause for this environmental relief (as has been the case for the Enterprise Investment Scheme / Seed Enterprise Investment Scheme and state aid limits for instance) – so that the relief is specified to continue for (say) the next (15?) years but will expire after that unless renewed. The period needs to be long enough to enable landowners to take a commercial decision to take land out of agricultural production. While a review clause might seem to run counter to the aim of incentivising, we think that there is a case (in giving clarity as to the duration of the relief) that removes the risk of future knee-jerk reactions (which could result from the current proposal) by building the limits into the design of the relief from the start.

9.4 In relation to the current, restrictive policy we understand that government is not looking for a fixed cut-off date, eg land used for agricultural purposes before [date]. We do think that a date fixed before the commencement of the current environmental land management schemes (ELMS) may nevertheless have the benefit of simplicity. Alternatively, to maintain the link with current eligibility, perhaps the condition might be along the lines of 'immediately before the adoption of an ELMS, the agricultural land was within the Basic Payments Scheme'. The difficulty with any condition requiring evidence of previous usage lies in the taxpayer (or their personal representatives after a death) retaining sufficient information to able to prove it. DEFRA and HMRC should take steps to publicise any requirement that may be decided upon.

9.5 Any cut-off date or linkage with previous usage introduces complexity. A simpler approach would be to dispense with the link to previous agricultural use and instead have eligibility for relief of environmental land determined by its status at the date of the IHT transfer. If the wider environmental objectives are achieved in the case of, eg former pony paddocks or wasteland, then we suggest that government might reconsider the policy to include such obviously societal benefits. The current minimum time requirements militate against obvious death bed avoidance.

9.6 Revision of the operation of APR provides an opportunity to bring consistency into policy and bring land let for the generation of solar power or the installation of wind turbines into scope.

10 Q7: How could the environmental land be valued most appropriately? What would the practical challenges be and how could they best be overcome?

10.1 The Consultation fairly sets out the challenges to valuing environmental land. We leave it to those with the expertise in valuation to answer definitively, but our initial assessment is that the approach set out at paragraph 4.18 (to use market value of environmental land subject to the special assumption of a restriction to its existing use, thereby excluding hope and development value) looks like a realistic direction of travel.

10.2 In the future it may be that environmental land commands a premium (for instance because of some sort of market in carbon credits which attach to it) over agricultural values. In which case, there is an argument for saying that the relief should be restricted to the lower of environmental value and agricultural value – but such a refinement would introduce further complexity.

11 Q8: Are there any other design issues that would need to be considered if the government decides to update the land habitat provisions in agricultural property relief?

11.1 One key aspect is relief for the farmhouse. There is already the 'character appropriate' test in IHTA 1984, s.115(2), but that is linked to the agricultural land and so would have to be re-cast to include environmental land. But that would raise novel questions as to what would be appropriate to environmental land, where the existing case law is unlikely to be adequate. As the policy intention appears to grant APR to environmental land that previously would have qualified for APR, that objective could be achieved by 'grandfathering'. We do not envisage any difficulties where the environmental land is managed alongside predominantly agricultural operations. It becomes more problematic where the environmental land is a large part of or constitutes the entire holding; active management from an on-site farmhouse may be less necessary. On the other hand, to deny APR on the farmhouse in such circumstances may act as a major disincentive to farmers who may otherwise have been favourably inclined to enter into an ELMS arrangement. We recognise that this is a policy matter of considerable complexity.

12 Q9: What would the impact be of restricting 100 per cent agricultural property relief to tenancies of at least 8 or more years?

12.1 The opinion of our members is that such a move is likely to reduce the amount of agricultural land available to tenants: the probable response of many landlords would be to bring the land in-hand or enter into a contract-farming arrangement. The experience of many landowners in relation to the existence of old AHA tenancies which provide only 50% relief has been negative. A significant number have taken steps to try to restructure such tenancies (often via some form of surrender and regrant) which has resulted in significant cost to landowner. It is unlikely that they will risk losing the 100% relief that they now have and if there is again going to be action in relation to tenancies to alter the availability of reliefs it follows that the logical 'safe-haven' is to take the land in hand.

The fact that post 1995 tenancies offer 100% APR will have had the impact of creating a level of tenant farming that would not otherwise exist. Had the '8 year rule' been in place it seems likely that more farming would be carried out in-hand and there would be fewer tenant farmers.

We are aware that certain professional advisors of agricultural clients are already raising the possibility of taking land in-hand as a response to the possibility of the change outlined in this consultation.

12.2 We assume that the 8 year requirement would operate on the basis of a minimum 8 year term being granted (which would qualify for APR even though the relevant transfer occurred in, say, year 4) rather than 8 years being required to run at the relevant date.

12.3 The proposal would add a further layer of complexity to family structures, that are often, for valid historical and commercial reasons, already extremely complex. It might well be the case, for instance, that – perhaps to solve a family dispute – the land is owned by daughter A but farmed by son B (or son B's company, or a family partnership perhaps) under a FBT of less than 8 years. This is not for tax reasons, but as the resolution of a dispute, or a divorce situation, or perhaps because parents' Wills were designed to leave the land to daughter A, but also to give son B (who had always farmed it together with some other land, perhaps) a reasonable length of time to make alternative arrangements. An artificial deadline of 8 years might well disturb structures which have nothing to do with tax. Our members' experience pre-1995 was that the complexity of AHA tenancies made resolving family disputes much more difficult and the freedom that the 1995 reforms gave made it possible to construct sensible family arrangements without having to worry about creating tenancies

with three generations of succession rights. If an 8 year limit is introduced, it would need a carve-out for 'connected party' situations like this.

12.4 Would the intention be for agricultural land let for less than 8 years to be denied any APR, or at a reduced 50% rate? If the former, the present 50% rate for old AHA tenancies would seem anomalous and ripe for abolition, so that APR would be granted in all cases at 100%.

13 Q10: What exclusions would be necessary and how could these be defined in legislation if the government pursued this approach?

13.1 The fact that exclusions are being considered points to the difficulties inherent in the main proposal. Adding exclusions would pile complexity onto complexity. We leave the detail to those with greater expertise in agricultural operations.

14 Woodlands

14.1 We take this opportunity to raise an issue over woodlands. We understand government policy is for more trees or woodlands to be planted, for sound environmental reasons.

14.2 If that is a commercial woodland, typically ranks of conifers, then it is likely to qualify for business property relief, which applies to the total value (trees and land, including any development value of the land).

Yet if it is a woodland of hardwoods (especially native trees, perhaps with a wildlife pond also to maximise the environmental benefits) it is not clearly commercial, and the only IHT relief is the much less attractive woodlands relief. Woodlands relief applies only to the value of the wood (ie timber) and is only a deferral of tax. Claiming woodlands relief is likely to increase the tax ultimately payable. It is also restricted to IHT charged on death. Generally, it does not afford much relief as indicated by its trivial cost to the Exchequer.

14.3 The position is further complicated by the fact that (a) some woodland is ancillary to agricultural use (eg shelter-belts) and (b) some woodlands can be used for commercial purposes other than growing of softwood timber (eg coppicing; mushroom growing; forest schools, etc.).

14.4 Our conclusion is that tax relief for IHT appears the wrong way round to achieve government policy. It encourages commercial woodlands of limited long-term environmental value and correspondingly discourages hardwood planting which is more likely to benefit to the natural environment.

15 Business Property Relief

15.1 The consultation points out that many farm businesses would potentially benefit from both APR and Business Property Relief (BPR). For those it is arguable that BPR is the more important of the two as it applies:

- to the full value (not just agricultural value) of the property;
- where a business is not wholly or mainly one of holding investments.

15.2 The consultation concentrates on ensuring that APR remains available but does not address the (possibly greater) issue of ensuring that BPR is not lost. The Consultation example at 3.26 can be used to make the point. In the final sentence it states that 'as the individual's business is still mainly one of farming….' - which in the

example is likely to be the case. However, if larger areas are turned over to such schemes on an already diversified estate where there are, for example, also let cottages, it is possible that it may throw into doubt whether the business would retain its 'qualifying' trading status or whether it has crossed the line to being one of 'wholly or mainly holding investments'. Given the significant ramifications that this would have it is likely that diversified businesses would wish to steer clear of environmental schemes regardless of the APR position.

16 Acknowledgement of submission

16.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

9 June 2023