Into the woods

OMB Personal tax



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Julie Butler and *Fred Butler* provide a guide on maximising tax relief from woodlands

Key Points

What is the issue?

HMRC are increasingly scrutinising woodlands, exploiting the fact that they are often ‘forgotten’ about by both farmers and farm advisers alike.

What does it mean for me?

With a large number of tax advisers already acting for farmers, landowners and woodland investors and the growing interest in forestry investment, the importance of understanding the complex tax issues is more prevalent than ever.

What can I take away?

Not everything is what it seems with regards to woodland taxation and it can often seem contradictory. What was once the afterthought for tax planning and protection has to be brought to the forefront.

It is fair to say that the woodlands activity on a farming enterprise is often forgotten about in terms of accountancy and tax. However, with the increased commercial potential of woodland combined with their current tax advantages, many farmers are having to question the current and potential usage of the woodland included in their farm. This article is looking at existing usage of woodlands, and then the increase in activity that is needed to protect tax reliefs. HMRC have been looking very closely at woodlands for inheritance tax (IHT) purposes at many levels. HMRC are perhaps exploiting the fact woodlands are often ‘forgotten’ about by farm advisers at a time when the farm should be utilised and helped to make a contribution to the overall farm’s profitability and closely reviewed for tax purposes.

Commercial woodlands

Woodlands are deemed commercial for tax purposes where trees are grown in order to sell as timber. The commercial occupation of woodlands is not classed as a trade and so it would not receive relief nor pay tax on the profits (ITTOIA 2005, s 11 (1)) nor claim tax relief on the losses. However, the traditional model of Commercial Woodlands has now progressed to much greater productivity. Many investors in woodland report strong capital growth within the past decade, showing that commercial plantations can be purchased as a top-performing asset type after the appropriate due diligence. Many top land agents present woodland as ‘strong tip’ investments as Commercial Woodlands benefit from a number of tax advantages. Timber sold from such woodlands is outside the scope of Capital Gains Tax ((CGT) (TCGA 1992 s 250) and Income Tax (ITTOIA 2005 s 11). Land taken up by Commercial Woodlands can qualify for Agricultural Property Relief (APR), (see Inheritance Tax Manual at IHTM 25021 and below) where it is ‘agricultural’, together with Business Property Relief (BPR).

The tax protection required for woodlands is to ensure there is forensic analysis of what is really going on, especially where the woodland is combined with the farm or other trades. Whilst the sale of the timber is ‘outside the scope of Income Tax’, the reality of the operation must be considered. If the holding is just, say, woodland attached to a farm then the overview of the operation must be understood to protect IHT.

If the income of the woodland is ‘outside the scope’, then likewise the cost of ‘harvesting’ of the woodland must be disallowed. Where such an operation is a farm,

all the associated costs must be analysed and considered as to what is allowed and not allowed.

Another advantage of a commercially run woodlands is that they are regarded as commercial property suitable for investment into a SIPP. The tax benefits attached to a SIPP can make it an efficient vehicle for an investment of this nature, with tax relief being obtained on the initial in-specie contribution, and any subsequent increase in the value of the property being free from CGT. Advice does need to be taken however, as some of the other advantages of a SIPP, such as tax-free income and protection from IHT, can also be achieved by woodlands outside of a SIPP. The biggest issue with having woodland in a SIPP, is that there can be no personal benefit or enjoyment from the asset. It is however possible for the original owner to put a lease in place on a commercial basis, but this would still preclude any benefits being provided over and above those that would be available to anyone else who leases the land.

Agricultural property relief

As mentioned above with regard to inheritance tax (IHT), woodlands can benefit from APR where they are ancillary to farmland, such as ‘shelter belts’ or where firewood and fencing are taken or where the activity of short rotation coppice is carried out. However, once 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 activity. The use of woodland can also be part of the agricultural activity in a vast number of ways, for example, with ‘fly tipping’ and other problems of intrusion of boundaries being a common threat, many farmers use the woodland to make their farms more secure and their agricultural activity more productive through fencing and boundary protection. The key criteria is that where woodlands are ancillary to agricultural land and pasture it can benefit from APR as it will qualify as agricultural property (IHTA 1984, s 115 (2)). It is noted within IHTM 24032 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; and fox coverts. The practice of growing and harvesting short rotation coppice, which entails harvesting the stems of high density perennial tree species at ground level at intervals less than ten years, is regarded not as forestry but farming (IHTM 24063). Furthermore, tree nurseries could possibly also benefit from APR

(IHTM 24062). Therefore the accounts must clearly reflect the exact nature of the business activity of any woodland and, furthermore, any ‘barter’ transactions involving the woodland must be accurately recorded and reflect the two-sided entries of the barter, e.g. what the wood is swapped for. In practice HMRC will ask what the activity in the woodland is when they try to verify APR and it will be necessary to provide evidence with detail from the farm books and accounts.

Consideration should be given as to what IHT relief should 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 APR should be made on the woodland to increase the agricultural activity associated with the farmhouse. Alternatively, if there is a greater need for trading activity then a claim for BPR could be made to improve the ‘Balfour Matrix and move away from the investment line.

Game coppice

The use of the working ‘game coppice’ has led to the assumption by HMRC on ‘woodland used for shooting for pleasure’. There is a temptation for farming landowners to fall into a very dangerous trap of letting out their shooting rights in return for a few days shooting. It must be remembered that such provision of ‘shooting rights’, or what many would consider is the letting of woodlands, is a supply that is subject to output VAT. Such barters should be correctly disclosed.

There is a lot of ‘barter’ operating in the shooting industry which MUST be reflected, whether it is in the form of:

1. Separate days shooting in exchange for the shooting rights of the woodland
2. Guns on the shoot in exchange for shooting rights of the woodland

With regard to the second point, clearly the landowner needs to supervise the geographical logistics of the shoot, check the shoot for health and safety etc or a combination of these tasks. There is a distinct difference between a landowner taking a whole day’s shooting (1) as opposed to checking the correct operation of the shoot whilst joining in the shoot (2).

Purchase of woodland

Where there is the purchase of an area of woodland, Stamp Duty Land Tax (SDLT) will be payable if the consideration is greater than £150,000. New business plans should be prepared and evidence of activity should be considered, be it recreational, commercial, agricultural, or a combination of these, to maximise both the return and the tax relief.

Diversified commercial activity – CGT and IHT

When disposing of woodland the capital gains tax (CGT) can be complex. Where the commercial activity within the woodland is forest schools, paintballing, 'glamping with tree houses' or maximising off-road driving then Holdover Relief, CGT Rollover Relief and Entrepreneur's Relief (ER) should be achieved as long as the woodlands and the business within them are sold or valued as one entity and the business that uses them qualifies for the CGT reliefs. As mentioned, the commercial woodland enterprise could benefit from IHT BPR but a stand-alone commercial woodland may not achieve ER (though this is a widely debated topic).

If owned woodlands are solely used for recreational purposes by the landowner, his family and his friends then it will not benefit from any tax reliefs nor will it be within the scope of any of the taxes. This is one of the strong reasons why the tax adviser must understand exactly what is happening with the shoot. However, there could be a case for mixed use woodland, i.e. private and commercial, whereby ER can apply to the whole sale as one asset as long as the other conditions are met. Additionally, if the woodland forms part of a larger farming estate then ER may apply to the sale of woodland as a component part of the sale of the entire estate.

If the woodlands are used for business purposes following a period of recreational use, it may also be possible that the CGT relief previously mentioned could be due. The relief gained will be restricted by reference to the previous period of non-business use and ownership unless a gift, sale or change in ownership structure can be achieved in order to start the business clock.

The recent IHT tribunal case of *Vigne* (see *W Vigne (deceased) v HMRC* [2017] UKFTT 0632 (TC)) and *Ross* (see *M Ross (deceased) v HMRC* [2017] UKFTT 0507 (TC)) have emphasised the importance of 'enhanced' services to maximise IHT relief. The parallel with woodlands can be seen in the need to increase activity to generate more sales for BPR, and to use more of the woodland product for the farm

to achieve APR. As shown by these cases, evidence is key.

Recreational activity

Private woodlands are appreciated and loved by different areas of society; perhaps the question of ‘recreational activity’ brings into debate the definition of what is private use. It is fair to say that when farming is more profitable on areas of, say, food production, then perhaps less emphasis has been placed on woodland as the harvesting costs were so great. However, harvesting methods have now improved with enhanced machinery and integrated harvesting strategy allowing for cheaper extraction. Every acre on a diversified farm has to be utilised to maximum potential and used for maximum production. This is often known as ‘making the assets sweat’. With a change in farming operation and a generic move to diversification of the farming enterprise, the woodland activity is changing and so too is the tax relief associated with it. Advisers must move with these changes. It is essential that for every question asked at every level by HMRC about what is really going on there must be answers that protect the tax reliefs available.

VAT

A sale of land with standing timber is exempt from VAT. However, the sales of timber itself are standard-rated, and a grant of a right to fell and remove timber is also standard rated as is the sale of Christmas trees.

Action strategy

Knowing how the woodland is owned and occupied is essential for tax compliance and planning. Whether the woodland is held as part of a farm as a commercial investment or partly for recreational activity, this must be understood so that tax planning can be maximised and activity can be increased if required. HMRC will ask questions asking for justification that IHT relief can be claimed. The time to plan is now – ensure that barter transactions are clearly reflected in the accounts and consider the VAT implications of the various sides of the recording.