



SCOTTISH LAND COMMISSION  
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# Encouraging agricultural land lettings in Scotland for the 21st century

## A discussion paper

Jeremy Moody  
April 2018

### LAND LINES

A series of independent discussion papers on land reform issues

# Background to the 'Land Lines' discussion papers

The Scottish Land Commission has commissioned a series of independent discussion papers on key land reform issues. These papers are intended to stimulate public debate and to inform the Commission's longer term research priorities.

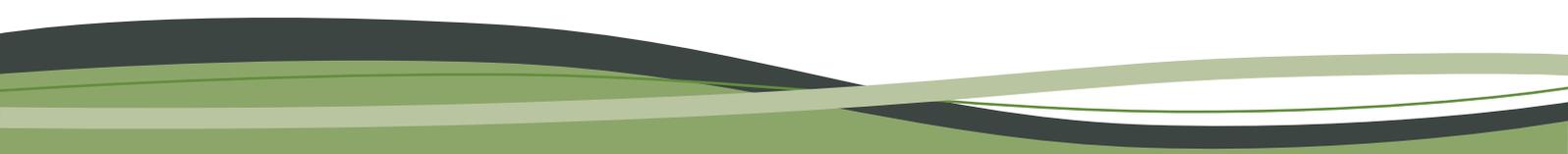
The Commission is looking at ways to stimulate and support the tenant farming sector as well as increasing the availability of agricultural land for new entrants, as detailed in our [Programme of Work](#). This, the fourth paper in the Land Lines series, looks at ways to encourage agricultural land letting in Scotland with a particular focus on potential changes to taxation.

The opinions expressed, and any errors, in the papers are the authors alone and do not necessarily reflect those of the Commission.

## About the Author

Jeremy Moody is the Secretary and Adviser to the Central Association of Agricultural Valuers (CAAV) and an Adviser to the Scottish Agricultural Arbiters and Valuers' Association. He is visiting Professor of Rural Land Management and Policy at the Royal Agricultural University.

Jeremy is also lead author of CAAV's Scottish Agricultural Rent Reviews and author of CAAV's Guide to the Amnesty for Tenant's Improvements in Scotland.



# LAND LINES

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# Summary

## Keywords

Tenancies; taxation; legislation; letting; agriculture

For agriculture to thrive it must have the ability to change with circumstances. The arrangements by which landowners can and will make land available to farmers, including tenancies, are critical to that process. Impediments that make those processes more difficult or costly are burdens on the sector.

Mapping the path of decline in the tenanted sector over the past century, this paper assesses the past and current issues facing landlords and tenants. It considers the supply of and demand for land, land prices, and wider questions around the political climate and future changes in the context of Brexit. The increasing complexity of agricultural holdings legislation, and the growing perception that tenancies are seen by landlords as “high risk and low return” are identified as two key barriers to land letting.

It is suggested that a simpler and shorter tenancy law, focused on essentials, would be more widely used and create confidence; and the flexibility of a more commercial vehicle that enables a business-minded approach could open up the let sector once again.

Whilst acknowledging the roles Inheritance Tax and Capital Gains Tax play in many cases, and recommending some changes, this paper proposes a new Income Tax relief as an innovative way of addressing increasing land availability. This tax-based approach, speaking directly to owners’ concerns, seems likely to release more land – with evidence from the Republic of Ireland suggesting a significant increase in lettings following the adoption of a similar relief in 2015.

However, it will not be enough just to change the law and “hard” policies. More is needed to build confidence so that a flexible let sector and wider agriculture can thrive. Ultimately, a vibrant ecology of letting arrangements requires the positive participation of landowners – there would be no tenants if no one was willing to be a landlord.

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# 1. INTRODUCTION

For agriculture to thrive it must have the means for it to change with circumstances. The arrangements by which landowners can and will make land available to farmers, including tenancies, are critical to that process. Impediments that make those processes more difficult or costly are burdens on the sector. These are most problematic when the challenge of change is greatest as it may be after Brexit.

This paper focuses on the question of what policy changes might stimulate more use of arrangements for an owner of farmland to make land available for another person to farm, whether by a tenancy or other arrangement. It does not consider wider questions of improving productivity (though the evidence is that moving land into the hands of the trained is a powerful driver for that) or other social or economic goals. It is not directly about stimulating entry into farming but the more opportunities there are, the more access there can be for new entrants of any background.

Naturally, a significant part of this paper does review issues that stand in the way of more tenancies as these are the main formal provision for this purpose, surrounded by legislative, fiscal and other structures. However, this paper also looks at issues for less formal arrangements and the interaction between the two areas when tackling issues around confidence of owners.

Finally, this paper reviews changes to legislation and practice that could open up the land market and generate more arrangements between landowners and those who would farm that land, with potential benefits for the long-term health of agriculture and the rural economy.

This rest of this paper is structured as follows:

## **2 – The Tenanted Sector**

Provides a brief overview of the current tenant farming sector in Scotland

## **3 – Legislation for Land Occupation**

What might be done to encourage more land for agricultural lettings

## **4 – The Way Ahead**

Some policy conclusions

In considering the paper readers are particularly invited to reflect on the following key questions:

1. What are the key factors that determine the supply of land for farm lets? Are the issues outlined in Section 2 the most important ones or are there other factors that have contributed to the downturn in farm lets in Scotland?
2. Are the options identified in Section 3 (consolidating legislation, changes in taxation, support payments and building confidence of landowners) appropriate mechanisms for stimulating the tenanted sector? Are there other approaches that should be considered?
3. Are there other socio economic benefits or risks that might arise from the suggested interventions?

## 2. THE TENANTED SECTOR

The formal let sector has been in long term decline in Scotland. That decline began early in the twentieth century, continued through it and has then accelerated in the opening years of the 21st century. It is over simple to ascribe this to any one cause.

The initial decline began early in the 20th century following long decades of agricultural depression from 1875 as estates generally ceased to be viable and country houses were demolished. Combined with war deaths and estate duty, tenants had the chance to buy. While often initially reluctant, many came to see this as advantageous. Security of tenure was then imposed on existing and subsequent tenancies in 1949. Landowners became increasingly uncomfortable with that outcome and re-lettings declined. This process was compounded by the structure and style of taxation, notably in the 1970s with a top Income Tax rate on rents of 98 per cent and the advent of Capital Transfer Tax, without relief for let farmland. This led to increasing experimentation with alternatives to letting and the use of the limited partnership tenancy.

In 2003, the 1949 regime (consolidated as the Agricultural Holdings (Scotland) Act 1991) was supplemented by the Limited Duration Tenancy (LDT) available at first for lettings of over 15 years (now 10 years) though with rules over their termination and the Short Limited Duration Tenancies (SLDTs) for lettings of up to 5 years. The tenanted sector's decline continued, indeed it accelerated.

Under the Land Reform (Scotland) Act 2016, Modern Limited Duration Tenancies (MLDTs) replaced LDTs for new lettings and Repairing Tenancies are to be introduced.

Throughout these years, the tenancy for a season's grazing or mowing was kept as just that.

Together with the Small Landholders Acts, the result is a complex environment of seven different arrangements each with their own, often overlapping, rules.

## 2.1 The Supply of and Demand for Agricultural Land

It is clear that promoting more arrangements between owners and farmers depends on unlocking a greater supply of land for this market. Land can only be used if someone is willing to offer it. This issue is not limited to large landownerships, such as traditional estates, but is, in reality, an issue for all landholdings including existing, potentially retiring, farmers.

Landowners for whom letting might be an option include:

- large public sector and charitable landowners who need others to farm their land (Scottish Ministers' Holdings, the National Trust, etc.).
- large private landowners, whether or not they also farm themselves.
- landowners farming in-hand who may once have let but moved away from doing so yet may need or be willing to consider new business opportunities.
- smaller owner-occupiers, who have never considered any form of leasing or tenancy, but would be willing to consider new business opportunities – particularly those facing succession issues.

If the let sector, however defined, is to grow again, owners in those latter categories have to see letting land as an attractive option. That requires not just mechanisms that make this practical but a climate of confidence in the system.

In each of these cases, the opportunities for farming arrangements, including lettings, are where owners wish to retain ownership but can see more advantage in someone else farming rather than them. That may be about income, risk, a means for land management or other factors. As one of the proofs of a thriving let sector is that new land is freshly let, one of the substantive acid tests for a potential policy is whether it will promote that process of retirement with new arrangements. Equally, post-Brexit circumstances could see some farmers wish to focus on parts of their business and release land used for other parts; an arable farmer might look for an arrangement with someone else for the livestock use of pasture.

The general view is that there is a strong demand for access to land to farm. That includes:

- new entrants of all ages, levels of experience and capital; and
- existing farmers needing to expand to protect or improve the viability of their enterprises.

Some would-be takers of land might be seen to fall in both categories, such as where a recent entrant is still establishing themselves, taking fields here and there, or where a member of an existing farming family establishes a business with family support. Stereotypes of who might be seen as a “deserving” new entrant perhaps only serve

to complicate and obstruct the development of the new structures; policy should be open to allow change as the challenges and stakes are too high for restrictive approaches to be helpful.

The supply of land seems the greater constraint. The strength and quality of the demand for it can only be tested in the market place as opportunities arise. This is an important part of farming's preparation for coming challenges post-Brexit (and indeed with some of the likely changes to the Common Agricultural Policy (CAP) were Scotland to remain in the EU). What might bring that land forward and make the market in farmland occupation more substantially contestable?

A review of the current and likely post-Brexit challenges and responses suggests that restructuring might no longer be predominantly about scale but more focussed, perhaps higher value, businesses seeking the land that suits them at the scale that achieves their income.

## 2.2 Land Prices

There are naturally questions about land prices as a potential bar to entry, especially as there is a limited area of farmland that may be subject to competition from both development and forestry. While transfer of landownership is tangential to the core of this paper, it is sometimes argued that lower land prices would ease structural change and allow entry.

Land prices, which can fall as well as rise, are essentially a result of the interplay of supply and demand, mediating the desires and constraints of potential buyers and sellers who are not solely motivated by farming. Indeed, in a liberal economy there are many reasons why people may wish to own farmland and participants' motives are by no means limited to the immediate agricultural opportunity or potential of the land. A thriving market in land occupation arrangements relies on owners who do not wish to farm.

More fundamentally, the case for a tenanted sector is that landownership is not needed to farm. Most other business sectors tend to rent their premises. There seems no reason to impose a model on agriculture that requires it to own premises, the market value of which has long been unrelated to the income that can be produced from it and so distort capital investment in the business. Such ownership can give existing owners the assets of security in their steading and access to collateral. However, it is not evident that price falls would open the market to new farming entrants rather than existing farmers and non-farmers.

A more active market in land occupation would bypass the extent to which the capital value of farmland is a barrier to entry. As a business, farming has a substantial demand for both long term and working capital without creating circumstances where farmers have to buy land.

## 2.3 The Larger Climate

“A secure 1991 Act tenancy that had previously been seen as a low-return/low-risk investment is now regarded as a low-return/high-risk investment.”  
(Scottish Government’s Agricultural Holdings Law Reform Group’s Interim Report, November 2014, para 195)

The reasons for the avoidance of tenancies cannot only lie in the structure of the legislation. The wider political climate can be seen to have discouraged many existing landlords and to have deterred owners from letting as an option. Whether or not substantial land reform is under way, the rhetoric accompanying the topic is deterring those anxious to avoid anything that makes their position less flexible, especially as the market for farmland is a relatively illiquid when compared to many financial assets. As owners, whether estates or farmers, typically have long term perspectives, they can reduce their exposure to such risks by using other arrangements or adopting other land uses, in turn reducing the supply of land to the formal let market.

The challenge is to create a climate in which owners will feel confident in letting for the varied terms that properly respond to circumstances. A market in land occupation arrangements, including tenancies, will not exist without owners (and some tenants) being willing to make their land available to others. The coming challenges to farming and the ways in which it may well have to adapt suggest that there will need to be more of such arrangements, as opportunities both for those who will be farming’s future and for those who may no longer wish to farm.

Several themes can be seen at work over recent years:

- **The opportunities of farm economics** – traditionally, larger land ownerships had conventionally let their land to tenants because management issues constrained the practical size of farming businesses. Business developments since the 1970s have steadily relaxed those constraints enabling much larger farming businesses, whether as larger ownerships farming more of their own land in hand or as farming businesses taking land from several owners.
- **The pressures of farm economics** – if it is to support a contemporary standard of living, the business of farming has to become progressively more demanding of skill and business sense, facing regulation and commercial pressure as well as technical issues. The model of expansion, often geared to commodity production and so reducing unit costs of production, may now be under pressure, testing interest, skill, appetite for risk and choice of land to farm. The key lessons from the modelling of potential pressures after Brexit points to high performance businesses being best placed to be resilient and thrive.

- **Limited movement in the land market** – We have a very thin market of land for letting as well as for sale with only a tiny fraction of the total area changing hands each year. A flexible industry would see land move between farmers in response to market signals, most fluidly done with least capital cost through markets in land occupation such as tenancies. As well as creating opportunities for change and growth, more contestable markets would also tend to encourage performance among existing occupiers. However, as productive land has moved into owner occupation over the last century, it has often been inherited, possibly now over several generations. While those farms have tended to stay owner-occupied, the current occupier is not necessarily the best farmer of that land; the next Olympics team would not be drawn solely from the children of past Olympians. Nonetheless, the present owners typically remain motivated to retain ownership, legal control and a sense of business use, such that they can consider themselves still to be farmers but holding land that might be more productive in the hands of others. Equally, there has not been any significant pattern of these owners letting land out; they have not naturally thought of themselves as potential landlords.
- **The influence of area payments** – these have paid an income on the basis of qualifying land occupation. This has constrained change in occupation where it might otherwise have happened, and increased rents.
- **Complex reforms** – the complexity of the tenancy reforms to date has hampered their use by limiting understanding of them and stimulating fear of traps, points that can be compounded by issues over the drafting of the legislation.
- **The political climate** – that has been compounded by rhetoric, as much as actions, that suggests that being a landlord is a point of potential criticism, a status attracting liabilities.
- **The temperament of the sector** – farmland is an asset that is held with some jealousy by its owners. Typically, owners have a sense of family commitment, are cautious and anxious to retain flexibility in control of their land. Those instincts can also colour discussion of tenancies with a tension between perceptions of them as naturally long term heritable interests in land (and so akin to an ownership subject to rent) or as business arrangements. While differing arguments can be made for either position, the “fixity of tenure” stance discourages new lettings and is perhaps generally consistent with poorer economic outcomes and a less adequate response to change, of which more is thought likely in a post-Brexit environment. Scotland seems to be steadily (if unintentionally) moving towards an owner-occupied landscape with farmland typically moving by inheritance but tempered by business contracts and informal arrangements. Letting is dying in Scotland; current measures can seem more about its palliative care.

## 2.4 Other Non-Tenancy Arrangements

Economic pressures on some owners to involve others in the farming of their land have seen the development of less formal arrangements, bringing greater skills, machinery, labour and management.

While this paper is expressed in terms of a landowner making land available, these non-tenancy arrangements may often be equally considered by tenants, particularly under the 1991 Act or other long-term agreements, subject to the terms of the lease in question.

Contract farming agreements exemplify this. These essentially see one farming business providing farming services to another farming or landowning business, often implicitly giving the benefit of capital that the business has been unable or unwilling to afford. Those services may range from specific operations to the stubble-to-stubble management of a crop or a whole farming operation but bring the benefit of skills, modern machinery and labour. The remuneration arrangements range from agreed rates to profit shares. While there is little data on the scale of the sector or the types of arrangement used, experience suggests that their use has grown substantially and is particularly effective as a vehicle for combineable cropping of conventional cereal, oilseed and protein crops. They have been adapted, with more or less strain, for other enterprises, including livestock.

“Share farming”, often mentioned but less often found, can see two independent businesses share a common output between them, dividing gross sales. There are various models for this according to whether both are farming businesses or one is simply a land provider taking no part in the farming.

Considering agreements requires appraisal of what the parties actually want to do. The agreement should be the servant of the parties, not the other way round; models and templates are useful aids but need to represent the actual intended arrangement. Both tenancies and contracting represent natural and common patterns of business into which owners and farmers may tend to default. Other arrangements may also meet particular needs but can risk being more clever than useful, inadequately understood and not followed in practice. The substance of the agreement and the parties’ behaviour matter, not its label.

Many of the problems here arise from the rural instinct for informality. Thus, some “share farming” agreements can in practice be found to be really operated as contract farming arrangements, partnerships, tenancies or even employment agreements. While the practice of “tattie lets” creates SLDTs (with the potato grower producing and selling his crop on someone else’s land being the proper Basic Payments Scheme [BPS] claimant), this is widely ignored in practice by owners and farmers (and in the supervision of the BPS regime). In practice, this works because the specialist grower needs new land from that or other owners in succeeding years.

The more informal the arrangement, the more it is likely that its risks may be better managed by an existing established business having it as an ancillary operation, rather than by a new business taking it on as its sole venture.

## 2.5 Age or Competence

Discussions such as this normally express concern about the age of farmers. However, it is not surprising that family businesses with a limited appetite for retirement typically has an adult head in their late 50s.

It is true that the British Isles generally has a large proportion of “farmers” over 65. In the United Kingdom and Ireland, this is around 28 to 30 per cent of BPS claimants. In some other countries, such as Germany (with a markedly better productivity record while having an area payments system) that figure is much lower at 10 to 15 per cent. A key factor appears to be that, in states such as Germany and France, self-contained agricultural social security systems exclude Basic Payment claimants from the state pension. That may not be possible with the general contributory system in the UK, where any link between retirement and pension age is now eroding fast.

In practice and despite many bad examples succession issues are more subtly managed within families with older farmers naturally being more likely to have successors, with enterprise management being devolved before business management, and asset transfer coming last, often on death. Opening up a stronger lettings market could enable full or partial retirement where there is no (immediate) successor.

Indecon’s 2014 agri-taxation econometric study for the Irish Government<sup>1</sup> showed, gains come from moving land into the hands of the “trained”, not simply to those below 65. That study showed a 12 per cent increase in production as opposed to something over 4 per cent from the occupation simply moving to someone younger.

That becomes more critical with the sense that we are on the edge of an unfolding technological revolution for agriculture with the deployment of big data, optical recognition, digital systems and biological techniques. Precision farming, still finding its way in the arable world and with potential for grassland systems, appears merely the start of a world of radical challenge and opportunity for those who will be farming in the future. They will need the skills and confidence to handle the new technology successfully.

<sup>1</sup>Part B of [www.agriculture.gov.ie/media/migration/foodindustrydevelopmenttrademarkets/agri-foodandtheeconomy/agri-taxationreview/AgritaxationRevFinal120315.pdf](http://www.agriculture.gov.ie/media/migration/foodindustrydevelopmenttrademarkets/agri-foodandtheeconomy/agri-taxationreview/AgritaxationRevFinal120315.pdf)

## 2.6 So, Where Next?

The concern here is to find and make available the vehicles for moving land between users that would best support the economic success of the agricultural sector, assisting good existing farmers and giving good new entrants access to land, and then offering opportunities for both to expand and/or adapt their businesses. Equally, creating these opportunities can provide the means for existing farmers and owners to withdraw from farming, whether in whole or in part.

There is a powerful historical logic to the core themes of the tenanted sector, with its division of risks, capital inputs, time perspectives and returns. The owner can retain land he may have for other reasons entirely, conventionally taking a longer-term perspective and a low but more secure debenture-style yield while the tenant invests working capital and more directly faces equity risk and returns. That division between investor and active business can offer a sound foundation for the sector but, in its present condition, needs to be nurtured by policy changes, a larger more positive approach to landownership, and those in the sector seeing it as a mutual opportunity.

These issues are given an additional urgency by the potential challenges and opportunities for farming and land use arising out of Brexit, with the likely need for flexibility in structures, openness to new arrangements and a focus on productivity. Subsidies seem likely to be under pressure in the EU, at least as much as they may be in the different parts of the UK, while Brexit brings a range of possible trade issues requiring greater competitiveness and market-oriented change. The pressures for change may become more acute if trade agreements reduce or remove tariffs on imported food; particularly important for livestock operations. Flexibility for current businesses to adapt and means for entry and exit are components of the responses needed for Scottish agriculture to meet these challenges.

With the variety of owners, farmers and situations, there is no “silver bullet” that will of itself resolve or ease the situation. This points to reviewing a range of issues, clarifying objectives and identifying possible ways forward. Key influences and constraints lie in:

- the legislation expressly intended to govern land occupation;
- the rules for agricultural support payments;
- the taxation regime.

Success also lies in “softer” issues around attitudes to and within the sector.

### 3. LEGISLATION FOR LAND OCCUPATION

In practice, the consideration of legislation concerns the law for agricultural tenancies, as:

- contract farming is only governed by the law of contract and has thrived on that basis where it is found to be a business answer. The same is true for the broader category commonly referred to as joint ventures (including the very loose references to “share farming”).
- a basic level of legislation gives a framework for the different structures of partnerships, limited partnerships and limited liability partnerships. These are business arrangements, not land occupation arrangements, and the simple law here seems not to need reform. Common within farming families, they rarely include third parties with joint and several liability seen as a risk too far, especially where land is involved.

There is a question as to why agriculture merits specific legislation. It is noteworthy that for commercial and business tenancies, Scotland has no equivalent structure to the “right to renew” to match that under Part 2 of the Landlord and Tenant Act 1954 for England and Wales and the equivalent order in Northern Ireland. There is no sense from the business sector in Scotland that absence of statutory security is an issue.

The case for specific agricultural legislation is not directly about security but about the particular relationship of the agricultural tenant with the land rented. That land can be seen to be as analogous to plant and machinery as to premises. It is not only *where* the tenant works but it is what the tenant works with, adding value to it and harvesting from it. A basic premise of land law is that what is fixed to land becomes part of the ownership, seeds, crops, fertiliser and so forth all become part of the landowner’s land. That is seen as distinct from how a shop, office or factory tenant ordinarily uses property. The development of agricultural tenancy law has protected the tenant’s rights to benefit from his work with provisions for end of tenancy compensation and disregards at rent review.

Where fully equipped farms are let, there can also be the added dimension of the tenancy including the tenant’s home. This is more rarely found in other areas of business. However, it should also be noted that such lettings are today by no means the sole form of agricultural letting with bare land lettings becoming dominant in the tenancy market and predominant for other arrangements. Indeed, a retiring farmer letting his land may often want to stay in his home, letting only the land, while someone with a home may prefer to keep it when taking land.

While Scottish agricultural tenancy law largely covers those fundamental points, it does so with much complexity and there are some issues about how that is done, for example:

- the limited and dated list of improvements that can qualify for statutory compensation on which the Tenant Farming Commissioner has recently published recommendations for revising the 1991 Act's Schedule 5, unaltered since 1949.
- the wording of s.36 of the 1991 Act apparently limiting the tenant's compensation where an improvement has been both jointly funded with the landlord and supported by grant.
- the absence of rules for tenant's fixtures and buildings under fixed term lettings in Scotland, a specific and recent exception from the general position across the United Kingdom since 1851.
- the current limitation of the disregard for tenants' works at rent review to those listed in Schedule 5 (the treatment of tenant's improvements under the change to be made by the Land Reform (Scotland) Act 2016 has yet to be determined).

While of operational importance, none of these factors are perhaps relevant to whether or not a tenancy is used to let land. Indeed, they could all be seen to favour owners as landlords.

The more significant point (and why such issues have rarely led to disputes) may be because the operational detail of much of the volume of Scottish tenancy legislation is actually little known or taken into account. The suspicion is that there are large areas of the Acts that have not been used in practice. If valid, that observation calls into question approaches based on providing detailed legislative solutions to issues felt worthy of them. With farming's bias to informality and the smaller scale of many issues, complex legal structures may thus not resolve the issues they were introduced to tackle.

The larger questions of protected security of tenure and matters such as rent review have been the focus of more argument. A legal requirement for all tenancies before 1991 to have largely open-ended security of tenure clearly deterred many existing landlords (as well as owners with no experience of letting) who first used the limited partnership alternative and then the fixed term options under the 2003 Act. The discussion of a possible right to buy deterred still more from committing themselves to letting land. Since 2003, almost no voluntary use has been made of the open-ended 1991 Act.

Comparison can be made with the developments of tenancy law in England and Wales, and also the Isle of Man.

The difference has been that the 1995 reforms in England and Wales have clearly had an effect in stabilising and slightly increasing the scale of the let sector while, in Scotland, it has continued its previous course of sustained erosion to the point where Scotland has the smallest significant let farm sector in Europe. That puts more strain on other forms of arrangements for access to farmland as they become the dominant means for handling the underlying drivers for changing who has the practical use of farmland.

While the reasons for this might not only lie in the structure of the legislation, this structure has to be considered. Having provided fixed term alternatives to protected security of tenure, there are a number of issues here that can be summarised as “complexity”:

- at the most basic legislative level, tenancy law is now spread over the three major statutes of 1991, 2003 and 2016, with the latter two often acting by amending the 1991 Act, and other supporting legislation. With more legislation to come, its operation is sometimes opaque to advisers, let alone actual owners and farmers whose concern is focused on finding a good business arrangement between them.
- we now have the prospect of seven different types of tenancy (1991 Act, grazing lets, SLDT, LDT, MLDT, repairing tenancy, small landholders – before considering crofting). While there have been reasons for each, the overall effect can be one of confusion, that might be better handled by a simpler framework for new leases.
- the law often provides, for reasons from good policy to special pleading, a level of detail over its operation that acts as a deterrent where people sense complexity and risks in complying. The double notice to quit procedures for LDTs and MLDTs are perceived as a set of traps with substantial penalties for mismanaging them rather than a considered structure.
- the same factors can lead to incoherence between different aspects of the law, as perhaps may be seen by the uncertain interaction between compensation for items that are qualifying improvements and compensation for non-agricultural uses.
- the problem of unreviewed old law meeting current circumstances (the recent review of the 1991 Act’s Schedule 5 is welcome).

A consolidated agricultural tenancy statute would be a helpful administrative step, to the extent that it might make the present law clear, it would also tend to highlight the problems within it. Some issues are a natural result of the incremental development and accretion of the legislation prejudicing original underlying principles. Other issues lie in the legislation resting on the assumptions of a different age which now faces the need to handle major change with no substantive voice for the tenants of the future.

While those points can be seen as operational, rather than strategic, they play their part in creating an unhelpful picture for owners and farmers of what a tenancy is and what goes with it. The substantive point is that, with the partial exception of the SLDT (whose use is restricted by its limitations), tenancy law in Scotland does not offer a vehicle that owners have wished to use but rather attaches restrictions that deter letting, especially for longer than five years. It is impossible to let for periods of between five and ten years, and more problematic for longer terms. As a result, the CAAV’s Annual Agricultural Land Occupation Surveys from 2012 to 2015 and 2017 showed SDLTs to

be a common vehicle for letting to the point where the law was acting to impose a five year maximum on the length of a tenancy. The CAAV Survey for 2016 however showed letting to have fallen so far out of favour that that was no longer the case, as few are letting other than those for whom longer term letting is the only option, producing the extreme outcome combining very few lettings but only at longer terms. 2017 saw more shorter lettings, some very short, dominated by bare land, not equipped units.

What we have is a series of separate answers for different problems, each attended by anti-avoidance provisions and supplemented by responses to issues that have arisen along the way. That structure of separate tools may be less apt for the flexibility needed today than a looser framework offering a spectrum of solutions.

The heart of any arrangement is the business agreement between the parties. If the law can provide a framework for that to be effective, support its operation and enable people to focus on their business rather than the law, it will have done much of its job. The current and future challenging economics of farming limit the sector's ability to carry the overheads of handling such complexity. The law should be an aid, not an imposition.

### 3.1 A Framework for New Lettings

A simpler, more comprehensive and principles-based framework for new lettings is required, to enable individual owners and farmers to find their answer and then express it in an effective agreement. The core of such an approach should see the following points covered:

- a broad, agriculturally based definition for new tenancies so that processing and non-agricultural diversification can be part of the agreement from its beginning and so for agreed renewals.
- no regulation of the length of a letting beyond a recognition of tacit relocation after the expiry of a fixed term as a support for continuity.
- default to a market rent basis for reviews (to avoid encouraging shorter lettings) but allowing other bases for review or variation while excluding upwards-only rent reviews.
- a broad principles-based recognition of value that the tenant has added to the unit and which remains available to a successor:
  - by a default disregard of physical and other improvements, fixtures and other work at rent review.
  - by compensation at the value to an incomer for physical and other improvements and tenant right matters at waygo and provision for tenant's fixtures.
- a simple effective disputes procedure with a default to expert determination.

Existing lettings would be left unaltered.

Such a model offers a commercial vehicle, tailored for agriculture, for a business-minded approach to open up the let sector once again. A simpler and shorter tenancy law, focused on essentials, is more likely to be used and create confidence, while the more complex legislation becomes, the less it is likely to be used or understood. Such a reform can be facilitated by supportive measures in designing support and taxation (both discussed below) as well as the “softer” changes reviewed in Section 4.

## 3.2 Support

Among the many purposes that farmland serves, the income support given by the CAP has provided a direct reason for those eligible for that support to remain in occupation of the land that entitles them to these payments. That has led to:

- stasis in the market in land occupation as claimants receive their money by continuing to occupy land and, achieving an overall return on their occupation, appear willing to lose money in farming or just maintain the land. If they left without finding an equivalent area of eligible land, they would lose that income.
- taxpayers’ support sustaining some operations that would otherwise have no economic rationale and not be defended in any other sector.
- higher levels of rent than might otherwise have been the case as those wanting land have had to bid against that alternative approach.
- natural processes of structural change and economic adaption to markets being impeded.
- reduced incentives to innovate and adapt.

Leaving the CAP, whether in March 2019 or at the end of the transition/implementation period, gives Scotland the opportunity to look afresh at such issues. While it is not the place of this paper to review the full scope of this challenge, this paper’s purpose makes it important to ask for the system that most allows the market in land occupation and farming arrangements to operate freely. That would enable lettings and other arrangements to be valid answers for owners and farmers individually, and assist the sector to tackle its productivity challenge.

While the link of subsidy to the occupation of land might be thought to offer comfort and support, it acts to insulate farming structures from change. Over time, that tends to the detriment of agriculture and to make any ultimate shock from changing subsidy payments, trading terms or tariff walls more abrupt and disruptive.

### 3.3 Taxation

*For a larger review of taxation issues reviewed here, please see the CAAV's paper: Taxation: Agricultural Productivity, Land Occupation and Use after Brexit, September 2017*

While the legislation for land tenure is specific to Scotland, the taxation regime for farming arrangements is essentially common across the United Kingdom.

The exceptions are:

- the Scottish Land and Buildings Transactions Tax, rather than Stamp Duty Land Tax, on transactions.
- the new Scottish Rates of Income Tax applying to income from property as well as earnings (though not to dividend income).

These differences are currently seen as relatively marginal in this review, especially as most owners of the long term, low yielding, illiquid asset that is farmland are typically more concerned about capital taxation, notably Inheritance Tax but also Capital Gains Tax.

As well as its role in the balance between different forms of land tenure, taxation can provide positive tools to promote full or partial retirement without leaving the farm. In encouraging arms' length letting outside the family, it can stimulate the owner's objective interest in the calibre and competence of the farmer who will use the land and pay the rent.

### 3.4 Inheritance Tax

There is much misunderstanding in and outside farming about the tax reliefs for agricultural businesses, with comment unduly focussed on Agricultural Property Relief. They are not automatic. They are not universal. They do not necessarily give full relief. Their operation in each instance is increasingly under scrutiny and challenge by the tax authorities. An aging population of owner occupier farmers is at risk of having worked to protect the reliefs for most of their lives only to fail on the facts as at death. Tenancies and other arrangements can help with this as well as providing an income in later years.

The main Inheritance Tax relief is Business Property Relief (BPR) offering full relief at market value on any privately owned business that has been owned for two years. While for companies that applies to shares, for farming's many unincorporated businesses it relieves the owners' business assets directly. For farming that includes agricultural land used in the business and so is of importance to an owner occupier who is farming as a business. It can relieve investment assets, such as let land or cottages, where these form less than half of the overall business but not when they predominate. However, it does not readily handle farmhouses.

Agricultural Property Relief (APR) specifically covers only farmland, farm buildings and farm dwellings where they are occupied for agriculture for a stated period before death, making it vulnerable for an in-hand farmer who does not farm in his final years. It is normally available on the full “agricultural value” (and so potentially less than the market value) of those assets where they qualify under the statutory tests as they have developed through case law. In reality, APR is only the more significant relief where there is value in a farmhouse (considered later in this Taxation section) or in let land. It has generally been a principle of APR since its introduction in 1981 that it should treat land farmed in-hand and let land equally so that tax does not distort land management decisions.

As these reliefs are generally available at 100 per cent (including any land let since 1995), there is little to be done by further relief (though possibly minor changes of definition could assist a little). Seeking to restrict APR to encourage particular forms of letting would overall drive land out of being let as, owners wanting flexibility then prefer the relief available from BPR.

### 3.5 Capital Gains Tax

This tax applies where there is a disposal of assets and is mainly at issue where land is sold for development. Where a let farm is sold it is regarded as an investment and so does not qualify for the ordinary form of rollover relief from Capital Gains Tax (CGT) nor for Entrepreneurs’ Relief (only even possible where the let land is less than 20 per cent of the business being sold (as might often be the case with “tattie lets”). However, with the relatively low volume of land being sold, this will not weigh in most owners’ minds to the extent that Inheritance Tax does.

### 3.6 Income Tax

There are differences between the treatment of rents and farming earnings but these are now perhaps less substantive than the close psychological association between farming and being self-employed, with the ability to offset justified operating costs against income.

## 3.7 A Tax Relief on Rent

There is however an entirely different way in which Income Tax could be used to encourage potentially retiring farmers to let their land. Following a thorough review of farm business survey data<sup>2</sup>, the Irish Government introduced in 2015 a much enhanced relief from Income Tax on rent from arms' length lettings of 5 years or more. This is capped at levels increasing with the length of term so that there could be relief from Income Tax on up to €40,000 of rent from a letting over 15 years (a period based on lending issues). The data for the first year's take up of that relief was published in August 2017<sup>3</sup> and showed an increase of 30 per cent in the number of landlords in that first year – a significant effect in a country that is effectively without landlords for historic reasons.

The findings of the preceding economic review<sup>4</sup> show that moving land out of the hands of the over-65s might see output (taken here as a proxy for productivity) grow by 4 per cent or a little more, moving land into the hands of the “trained” saw on average an increase of 12 per cent. Even applying a fraction of that 12 per cent to Scotland's gross agricultural output, net of subsidies, suggests a significant potential gain for the sector, the economy and rural areas as well as in taxable income. An apparently generous relief can achieve substantial economic change.

It is noteworthy that the previous reliefs, while intended to achieve this effect, were not of a sufficient scale to do so. The clear lesson is that such a policy needs to be designed so that it will really change people's attitudes and so be effective, rather than be a gesture yielding no practical results.

There appears a strong case for such a change in tax policy in Scotland to open people's minds to the potential of letting by tenancy. With a gross agricultural output for Scotland of around £3 billion (ex-subsidies) even an increase of a third of that 12 per cent would see an increase in annual output of £120 million. While it is harder to estimate the tax cost, it seems plausible that at least a significant part of it would be offset by such tax on a growth in income. Further, the point can be made that the tax cost is only incurred to the extent that it is taken up by the creation of qualifying arm's length lettings, making this self-regulating.

One obvious comparable model for this is the Rent-a-Room relief from Income Tax designed to encourage the offering of lodgings. If a farmer takes in a lodger that income can be relieved. This proposal would see that approach applied, within limits, to rent for his land.

As a relief from Income Tax it would not be available to companies, taxed under Corporation Tax and, as designed in Ireland and proposed here, it would only be for arms' length lettings, not to family members. In short, its goal is directly focussed on smaller owners who may be finding the present a challenge and the future a problem.

<sup>2</sup>[www.teagasc.ie/rural-economy/rural-economy/national-farm-survey/national-farm-survey-reports/](http://www.teagasc.ie/rural-economy/rural-economy/national-farm-survey/national-farm-survey-reports/)

<sup>3</sup>[www.revenue.ie/en/corporate/documents/statistics/farmers/farming-profile-2016.pdf](http://www.revenue.ie/en/corporate/documents/statistics/farmers/farming-profile-2016.pdf)

<sup>4</sup>Part B of [www.agriculture.gov.ie/media/migration/foodindustrydevelopmenttrademarkets/agri-foodandtheeconomy/agri-taxationreview/AgritaxationRevFinal120315.pdf](http://www.agriculture.gov.ie/media/migration/foodindustrydevelopmenttrademarkets/agri-foodandtheeconomy/agri-taxationreview/AgritaxationRevFinal120315.pdf)

## 3.8 The Farmhouse

While such owners might be encouraged to let by such tax relief so that they have a sustained income from a tenant of their land rather than the more precarious one from farming it themselves, many will still be concerned to protect their house from Inheritance Tax. Without relief, Inheritance Tax can drive the break-up of family farms where the value lies in the land and dwellings, rather than liquid assets. That can lead many to farm longer than may be appropriate.

Maintaining the availability of APR on a qualifying farmhouse so as to maintain family assets has thus been and is an instinctive reaction for many. That gives relief on the “agricultural value” of the house, which may now often be less than its market value. One tax case, *Antrobus*, set it at 70 per cent of market value, making 30 per cent taxable, now often used as a starting point for the assessment. Case law shows that to be accepted as a “farmhouse” it must not only be of a “character appropriate” to the relevant land but also be the dwelling from which the day-to-day farming is conducted. For an owner-occupier, it must have been used for agriculture throughout the final two years before death. With increasing challenges by HMRC, more houses are failing to qualify as farmhouses, often because the owner occupier became too frail and aged to be using the house as a farmhouse, indeed may have been away in care. Farming for as long as is possible may have been in vain if these tests are not met throughout in the last two years of life.

However, an alternative relief (the Residential Nil Rate Band Amount) is now available and is to be fully phased in by 2020. From April 2017, this relief is available on a house that the donor has lived in while owning it which is passed to a “lineal descendant” and where the net value of the whole estate is less than £2 million (with a margin of lesser relief just above that). By 2020, that relief will be worth £350,000 per married couple. That means that where this is suitable, it will be a more secure relief than APR on all houses and a more valuable one for houses worth up to £500,000.

The limitation on eligibility by the total net value of the estate may make this more suitable for smaller units, while it also may drive discussion about lifetime gifts of land down the family for larger units. Careful advice should be taken before acting on these matters.

## 3.9 Taxation Summary

The combination of the proposed Income Tax relief on rents and the current Residential Nil Rate Band Amount would create a different environment for those many private owners troubled about tax as it could:

- provide a secure income from rent that would, within limits, be tax free where the lease qualifies.
- relieve the owner of the need to keep farming in the hope of protecting the house from Inheritance Tax, often with the risk of the heirs finding that those endeavours failed.

However, while the change to Income Tax (and the new Inheritance Tax relief on a family house) may be an important pre-condition to reversing the collapse of the formal let sector, it is not a sufficient one in Scotland. At least two issues already covered need to be tackled in conjunction with it for the policy to be effective:

- building the confidence of owners so that they will commit themselves to leases of 5 years or more rather than holding back for fear of being caught in a less flexible position by other changes in policy.
- changing the support mechanisms so that there is less reward for the simple occupation of farmland. Of course, in many situations, the support will sustain and be reflected in the rental income and so flow to more confident owners in that way, but so long as the payment is available as a source of substantial income in its own right it militates against flexibility in occupation.

This tax-based approach, speaking directly to owners' concerns, seems to be more likely to release more land than either formal retirement schemes or arrangements for tenants to be paid to leave. There is little evidence of formal retirement schemes working, save as a manoeuvre within families, while only the largest tenancies can release enough value to pay for a new life.

### 3.10 Other Arrangements

Since the non-tenancy arrangements are matters of contract and not of specific legislation, there is much less on these to be considered.

The more important issues concern encouraging the parties to be clear about the business proposition between them. Namely, to understand the practicalities of what is being considered, how it might work, its implications for them as well as the business proposition and what might happen on its end. The answers may change over time; an owner in his 60s may be a more active participant than when reaching his 80s.

This might be best handled by a more developed discussion of the models that can be used with their principles and issues. Greater familiarity with these may encourage more use and better decisions. In that, it is stressed that standard agreements and templates are tools for adaptation (within their principles), not models to be followed unthinkingly.

These contractual arrangements generally require good professional advice drawing on the experience of what has and has not worked in other cases. Issues in that include:

- accurate description of the agreement, especially if the relationship is not intended to be employment, partnership or a tenancy.
- the treatment of any dwellings involved.
- *Law* – what is the farmer's relationship with the land? For example, it could be that, particularly in Scotland, a share farmer's access to the land might be seen as a tenancy in the event of that becoming an issue.
- *Tax* – effects on the tax status of the owner. For example, if the day to day farming of his land is no longer being handled from his house, then it may well not be a farmhouse for the purposes of Inheritance Tax. For a joint venture livestock operation, is the herd basis for Income Tax an issue? Having a company as a partner excludes the Annual Investment Allowance.
- *Subsidy* – who meets the tests to claim payments? How are agri-environment commitments to be handled?
- *Other Matters* – Who will be responsible for livestock movement recording or nitrate vulnerable zone records?

## 4. THE WAY AHEAD

A vibrant ecology of letting arrangements requires the positive participation of landowners; there would be no tenants if no one was willing to be a landlord.

Formal policy changes can be made that can encourage owners to become landlords or make their land available for others to farm.

Two approaches, in combination, could open opportunities for land to be won by those best able to use it to profitable effect:

1. Within tenancy law, a new simple principles-based code of law for new lettings that focus on seeing an agricultural tenancy as a business arrangement within a simpler and an intelligible framework can offer a positive vehicle for farming for the next generation.
2. Taxation changes can encourage the release of land, most obviously by a capped Income Tax relief for rent, akin to the existing Rent-a-Room relief, for arm's length lettings of 5 years or more by individuals. In conjunction with the new Residential Nil Rate Band Amount relief from Inheritance Tax (an alternative for many to hoping for the house to qualify for Agricultural Property Relief) this can offer a retirement package.

A post-Brexit Scottish agricultural policy should not focus on supporting farming as a means of land occupation, but have goals including assisting it as a business sector. Indeed, Brexit could offer the sense of a historic moment at which to make such a change with an emphasis on the priorities for the future.

However, it will not be enough just to change the law and “hard” policies. More is needed to build confidence so that a flexible let sector and wider agriculture can thrive.

### 4.1 The Positive Management of Change

Opening people's minds to a more positive view of letting and other arrangements calls for a number of “soft” policy approaches, generally non-legislative but in which government has a role.

Prime among those is building confidence among landowners and farmers that this is not an area pregnant with risk for them. Once they have let, the land is in the tenant's occupation for at least the agreed period of the lease, subject to any statutory provisions over termination.

Beyond that, and perhaps with some progress made on at least some of the changes reviewed in this paper:

- an open-minded approach to what positive change may be, rather than focussing on specific outcomes such as young new entrants. The success of contract farming in the combineable cropping world shows what can be achieved without policy where a good business answer is found. One task is to create the freedom for such development to happen with tenancies.
- a recognition that all these arrangements are about a mutual deal, usually a business deal, between parties. The arrangement should, with those legal, fiscal and other matters be the one that best provides the framework to do what suits them.
- shift away from outlooks that can see the landlord/tenant relationship as an adversarial, zero-sum game.
- promoting a positive attitude among all involved that this depends on good quality relationships with sympathy between the parties and positive approach by advisers. The approach should be to see that a good relationship for farming land should be mutually beneficial.
- a background framework of advice for all who may be interested. Much of this can be met professionally, by professional bodies and practices, but the basics of the real legal, fiscal and other aspects of the various options needs to be more clearly shared and understood.
- consideration of further development of current projects in Scotland along the lines of the Land Mobility model adopted first in the Republic of Ireland and now in Northern Ireland to promote and facilitate arrangements while recognising that much happens privately.

Such an approach could form one part of a larger promotion of agriculture and rural land use as a business sector of the economy, changing to seek opportunity and adopting innovation to earn its income. Facilitating that outcome and managing the change required in achieving it is a critical task. Not seizing the moment to promote lettings would be to handicap the sector at what may be the time of its greatest need. What could justify that?