Leasing land can bring huge advantages with tax incentives

Many farmers are still unsure of the rules despite increased attention, writes **Cathal Geoghegan** and **Anne Kinsella**

LAND leasing, in particular long-term leasing, has become an important topic of debate among the farming community in recent years.

In Budget 2015, land leasing options were made more attractive through a 50pc increase in the tax reliefs available on lease income. In Budget 2016 it was announced that the current reliefs would remain as per 2015.

With a switch in policy focus to land usage as opposed to traditional land ownership, this major policy measure has been put in place to stimulate greater activity in the long-term lease market.

However, despite the enhanced tax exemption thresholds and the increased attention leasing has received in the farming media, recent research has shown that many farmers are still unsure of the exact rules surrounding the leasing of land.

The uncertainty may be a reason why the supply of land available for long-term leasing remains relatively stable.

Basic Payment Scheme

In an Irish context, issues arising for farmers that leased out all of their land in 2013, and the subsequent implementation of the Basic Payment Scheme (BPS) with regard to new entitlement allocations illustrates how links between land access entitlements and subsidy payments in the past may influence farmer behaviour in the shorter and longer term.

Even the slightest ambiguity or uncertainty surrounding details and conditions needs to be quelled, otherwise such rumblings may be sufficient to dissuade some farmers from taking that vital first step.

The focus in committing to a lease should be firmly on the advantages and gains from leasing rather than on the possible pitfalls associated with leasing. Leasing is where land is leased out by a lessor (landowner) to a lessee (active farmer) for a minimum of five years.

In order to incentivise leasing, the land owner is exempt from income tax on lease rental income up to each exemption limit.

The lease must be in writing and stamped by the Revenue in order for the lessor to avail of the enhanced income tax incentives.

The lease term and the maximum tax exemption limits are as follows:

- 5 to 7 year lease equals up to €18,000 rental income per year;
- 7 to 10 year lease equals up to €22,500 rental income per year;
- 10 to 15 year lease is equal to €30,000 rental income per year,
- 15+ year lease is equal to €40,000 rental income per year.

The rental income eligible can include income from both land and entitlements. The tax reliefs do not apply to leases to a blood relative (wife/son/daughter/sibling) but are applicable on leases to a niece or nephew.

Conacre system

Although the rental income up to each threshold is income tax exempt, the universal social charge (USC) and PRSI still apply on this lease income.

Despite the attractive tax incentives described above, the level of leasing still remains at relatively low levels in Ireland, especially when compared to the rest of Europe.

The Irish rental market continues to be dominated by the conacre system, which only allows farmers to rent land for 11 months at a time.

However, in many ways the conacre system fails to meet the demands of modern farming. Land rented on conacre often tends to be of poorer quality than average as neither the landowner nor the renting farmer has an incentive to invest in land improvement over the short rental period.

Dairy expansion has resulted in increased demand for land and more long-term land leases. Consequently where land improvement investment is required to increase land productivity then long-term leases provide the key for farmers committing to longer term planning and investing.

The advantages of leasing over conacre are numerous. Firstly, conacre income is taxed the same as normal income whereas leasing income is free of income tax (up to the cut-off points listed above).

Secondly, leases are formal contracts, meaning that they form a secure source of income for the length of the lease. Thirdly, leases tend to attract a premium over conacre rental prices so those leasing out under a formal agreement tend to earn more per acre annually than if they were renting out conacre.

Finally, leases can be drawn up so that they satisfy the interests of both the lessor and the lessee. Lease agreements are flexible to the needs of both parties.

Clauses can be inserted so that one of the parties can leave the lease early if desired or the lease price can be a subject to review after a certain period of time.

Owing to the generous tax-free thresholds available, a lessor, by leasing out all or even some of their land, could farm less but indeed end up earning more.

> “DESPITE THE ATTRACTIVE TAX INCENTIVES, LEASING STILL REMAINS AT RELATIVELY LOW LEVELS

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The advantages of leasing over conacre are numerous, including the fact that leasing income is free of income tax up to a cut-off point

‘A farmer could farm less and earn more’

USING information from the 2014 Teagasc NFS, the potential incomes for farming and leasing for an average cattle finishing farm are compared. We assume the farm is 40 hectares (99 acres), which is the size of the average cattle finishing farm in the NFS.

We assume the farm has good land and so commands a lease price of €350/ha per year. We use the average family farm income for a cattle finisher in 2014 to determine the farmer's income.

According to the NFS, this amount is €332 per hectare, inclusive of direct payments. Based on the 40 hectare farm size, the farmer's farm income is calculated to be €13,280. We also assume that the farmer is married and under the age of 65 for taxation purposes. After tax, the farmer has a yearly income of €12,524 from farming.

Alternatively, the farmer decides to sign a seven-year lease, leasing out his land and his entitlements to a neighbouring farmer for the seven-year period. The farmer signs a private contract clause which ensures that the entitlements revert to him after the lease is finished. The lease price is €350/ha per year and the entitlements are leased at full value at €333 per entitlement. This results in a pre-tax lease income of €27,321 per year. After tax is taken into account, the farmer's net yearly income from leasing is €25,171.

In conclusion, using average figures for an Irish cattle finishing farm, one could earn €25,171 from leasing compared with €12,524 from farming.

CASE STUDY 2014

	Farm Income			Lease Income				
Cattle finisher	Farm Income *	Tax, PRSI	Net	Land	Entitlement	Tax, PRSI	Net	Difference**
	13,280	756	12,524	14,000	13,320	2,150	25,171	101%

*including Direct Payments

** Net Farm Income versus Net Lease Income

***A farmer would still have some overhead costs on land leased out such as interest charges on any outstanding loans