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PART B

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PART B

Chancellor's (Lawson) Papers:

THE TAX TREATMENT OF FORESTRY

Disposal Directions: 25 Years

12/9/95.

45/B.rj.2185/037

SECRET AND PERSONAL

FROM: N MONCK

DATE: 1 December 1987

FINANCIAL SECRETARY

I agree with x.

cc Chancellor
Sir P Middleton
Mr Scholar
Mr Burgner
Mr Culpin
Mr Bonney
Mrs Burnhams

PS/IR
Mr Beighton, IR

FISCAL INCENTIVES FOR FORESTRY : PROPOSALS BY CPRE

In his letter of 19 November the Director of the Council for the Protection of Rural England (CPRE) asks for a meeting with the Chancellor to discuss the proposal that all private sector investment in forestry should be assessed for tax under schedule B. This is one of the recommendations in the enclosed report by PIEDA, some consultants who did some work on forestry for the NAO in 1986.

2. There is some overlap between these recommendations and proposals being considered inside Government:

(a) the effect of consistent schedule B treatment (instead of the existing possibility of switching between schedule D and schedule B) would be similar to that of exemption from income tax;

(b) the CPRE is dismissive about the traditional justifications for the exceptional incentives to forestry planting. Our own ideas about attaching environmental conditions to grants and/or refusing grants for environmentally damaging schemes would be in line with the direction of the CPRE proposals.

The CPRE or at least PIEDA do not seem to envisage compensating for the reduction in tax incentives by increasing grants, though they would no doubt like some twist in favour of environmental benefits.

X 3. If our own proposals continue to seem likely to go ahead and if one of you can spare the time, I think it would be worthwhile to see the CPRE who want bring a PIEDA representative. It would probably increase the chances that the CPRE would come out in support of any Government changes.

4. If there is a meeting, the Minister's main role would be, as usual, to listen and so little briefing would be needed. But it would be useful to make something of the practical problems of the proposal to apply schedule B consistently. The Inland Revenue have agreed to provide a note on this. When you have decided about a meeting, we will provide a draft reply to the CPRE.

NM

N MONCK

Council for the Protection of Rural England

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CAMPAIGN FOR THE COUNTRYSIDE
CPRE

Ref AP/AW

19 November 1987

HM TREASURY – MCU
RECD. 19 NOV 1987
ACTION Mrs Lomhams
cc IR
COPIES TO PS/FST
REF. No. 2023/87

Rt Hon Nigel Lawson MP,
Chancellor of the Exchequer,
HM Treasury,
Parliament Street,
London,
SW1P 3AG

Dear Chancellor,

Fiscal Incentives for Forestry: Proposals for Next Budget

There is growing public concern that the current regime of tax incentives for forestry planting represents a very serious misuse of public resources. While private planting of conifer forests is given remarkable and exceptionally favourable fiscal encouragement, the justifications for these incentives have either long been overtaken by events or been shown to be without foundation.

You will be aware that the inappropriate kinds of afforestation fuelled by these outmoded fiscal incentives are a source of anger and concern amongst conservationists, not only voluntary bodies like CPRE and the RSPB, but also statutory bodies including the Nature Conservancy Council and Countryside Commission. This is because current patterns of afforestation have damaged so many well-loved landscapes and wildlife habitats, and contributed to river pollution. The thrust of environmental policy is now towards encouraging the sensitive planting of native broadleaved trees and the proper management of the native woodlands we already have. The degree of destruction wrought by the recent hurricane underlined the importance of reinforcing this change of direction, part of which must be fiscal changes.

Because CPRE believed the time had come for fiscal change in forestry we commissioned the highly-respected consultants PIEDA (Planning, Economics and Development Consultants) to produce an authoritative analysis of the changes which are needed to bring public forestry policy into line both with other sectors of industry and with sound environmental objectives. PIEDA have a good working knowledge of forestry policy, having produced 'Forestry in Great Britain' (August 1986), an economic assessment for the National Audit Office, which influenced significantly the Auditor-General's own 'Review of Forestry Commission Objectives and Achievements'.

The PIEDA analysis leads to the specific proposals, contained in the attached report, which we hope you will consider implementing as a matter of urgency. Particularly relevant for the next budget is the recommendation that all private sector investment in forestry should be assessed for tax under Schedule B.

May we come and discuss these proposals with you, bringing PIEDA with us? We should be most grateful for such an opportunity at whatever time and place is convenient to you. We have not yet made the PIEDA submission publicly available, although we intend to do so at a later date.

I am sending a copy of this letter for information to the Secretary of State for the Environment and Scotland and to the Minister for Agriculture, Fisheries and Food.

Yours sincerely,

Andrew Purkis

Andrew Purkis
Director

COUNCIL FOR THE PROTECTION OF RURAL ENGLAND

FORESTRY POLICY:
PROPOSALS FOR REFORM

by

Pieda

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November 1987

CONTENTS

1.0 <u>REPORT SUMMARY</u>

<u>Introduction</u>

1.1 Investment in forestry by both the public and private sectors is sustained by a uniquely favourable regime established or permitted by government policy. This has persisted despite a series of official reports, starting with the 1922 Geddes Committee on National Expenditure and most recently the 1986 National Audit Office report, which have suggested that the financial return from new planting is low, and a growing concern that many of the non-financial benefits claimed for forestry do not bear close examination.

1.2 As a result of this favourable treatment, new planting is taking place in remote areas often unsuitable for forestry. Much of this planting is strongly opposed by a wide range of national and international environmental pressure groups as it poses a threat to unique habitats and landscapes.

1.3 The purpose of this paper is to describe the main features of the favourable treatment afforded to forestry, consider the financial returns from new planting and, then, the non-financial arguments which appear relevant, proposing specific adjustments to current policy which would produce results more in keeping with the objectives of current taxation policy and the national interest.

<u>Recommended Remedies</u>

1.4 **The Forestry Commission should be expected to meet the Test Discount Rate of 5% for new planting, except where it can demonstrate significant non-financial social benefit, for example increased employment in particularly vulnerable rural communities, environmental gain or recreational amenity.**

1.5 **As initially intended, all private sector investment in forestry should be assessed for tax under Schedule B. This will discourage wasteful public subsidy of planting where land cost is low and returns poor, but not planting in areas of reasonable economic returns.**

1.6 The grant system should be changed to encourage the planting and management of woodlands (particularly broadleaf woodlands) which offer clear and specific environmental and recreational benefits and which are not environmentally damaging.

1.7 Proposals for major new planting in all areas which are environmentally sensitive, by both the Forestry Commission and the private sector, should be subject to Environmental Impact Assessment in line with criteria established by parliament. These criteria should allow for consultation with and advice from the Nature Conservancy Council, the Countryside Commissions and the Council for the Protection of Rural England.

2.0 THE POLICY FRAMEWORK

2.1 Since 1979 successive administrations have worked toward a system of taxation based on the principle of fiscal neutrality, this meaning that the fiscal regime should not, in general, be used to influence the distribution of investment between different activities. There has also been a continuing attempt to ensure that assets in the public sector earn a 'market' rate of return - reflecting the opportunity cost of those resources.

2.2 The treatment of forestry stands in marked contrast to this general philosophy. On the one hand, the government has successfully shifted the balance of new planting from the public to the private sector, with new planting by the private sector accounting for upwards of 66% of activity in recent years. On the other, however, this achievement is unfortunately outweighed up by fact that, in both sectors, forestry receives uniquely favourable treatment as compared to other activities.

The Forestry Commission

2.3 While public sector investment is generally appraised against the need to meet a target rate of return of 5%, investment in forestry is appraised against a much less severe financial target. After the Phelp's Committee review of 1970-1972, the Commission's accounts were recast "to require in the future that the Forestry Enterprise aim at a target rate of return on the funds entrusted to them set at 3% in real terms" (Forestry Commission, 53rd Annual Report). As demonstrated in the recent report by the National Audit Office (and the accompanying report by PIEDA) even this low 'target' rate of return is not effective, as the accounting conventions used by the Commission have the effect of writing off all sunk costs every five years. Given the long maturation period of UK forests, this prevents any assessment from the Commission's accounts of the true return to new planting or restocking, these being the crucial investment decisions.

2.4 The likely rate of return is best assessed by the Commission's own planting models which, for the areas in which the bulk of its planting now takes place, typically show a rate of return which is less than 3%. As best can be judged, Commission estimates at the beginning of the 1982-87 quinquennium indicated a weighted average Internal Rate of Return (IRR) on new planting and restocking of 2.25%. New planting in the North of Scotland appears to yield an average financial return in the region of 1.25%.

The Private Sector

2.5 In recent years the private sector has become the most important source of new planting but the extent and geographical pattern of this planting is largely the result of quite exceptional tax treatment which is not afforded to other commercial activities.

2.6 In 1951 a tax loophole was identified when it was realised that an investor (normally a private individual) can undertake new planting, qualify for grants, and elect to be taxed under Schedule D, the normal business tax schedule, instead of under Schedule B, the tax regime specifically for forestry. Under Schedule D the plantation costs (excluding the cost of land and net of grants) can then be offset against income tax liability from other sources. Subsequently, the plantation can be sold or transferred to a Schedule B or tax exempt investor. Capital Gains Tax is not payable by the original investor on the increased value of growing trees at this sale. The second investor can thus obtain the plantation at a price below the true establishment cost (because of the tax relief and grant aid obtained by the private investor) and then hold the forest to maturity, without incurring CGT liability on the sale of trees at harvesting.

2.7 In consequence, investment in forestry obtains almost every conceivable tax 'break', combining grant assistance, income tax relief and Capital Gains Tax exemption. This system is certainly tax efficient from the point of view of individuals with a high marginal rate of income tax and is attractive to tax exempt institutions for whom the investment is profitable given a discounted acquisition price, but it is clear that it encourages investment in new planting where the social return is, by any reasonable definition, extremely low.

2.8 The system often encourages forestry plantation in areas which are not well suited to that activity. This arises because the cost of land cannot be offset against tax, so that the private sector investor is encouraged to plant areas where the price of land is low, offsetting the other costs of establishment against tax. By definition, such land is not well suited to commercial activity of any kind - hence, the present-day absurdity of large-scale planting increasingly taking place in remote and upland areas. Given soil conditions, remoteness and the harshness of the climate, these areas are manifestly badly suited for forestry. That such areas are now the centre of major new planting is comment enough on the perverse effects of the taxation regime within which private planting flourishes.

2.9 Neither can it be argued that the resultant form of land ownership is socially desirable. The current tax incentives do nothing to encourage low-income hill farmers and their counterparts to invest in forestry. Instead, it is evident that the typical investors are high marginal taxpayers, not resident in the region and fundamentally unconcerned with its welfare. In short they are 'absentee landlords', often in areas where such land ownership has been heavily criticised in the past. The driving force behind such investment is simply tax avoidance - it does not derive from the inherent returns to the investment or from wider considerations such as creating employment in rural areas, environmental gain or recreational benefit.

2.10 Investment in 'commercial' forestry thus often occurs where there is a major divergence between the social rate of return (that is, taking all grants, costs and pre-tax revenues into account for all parties, including the government) and the private rate of return (that is, taking into account only those costs and revenues accruing to private investors and private institutions, these including grants and tax relief). The existing fiscal regime thus has the effect of supporting fundamentally uneconomic investments, so causing a misallocation of resources.

2.11 The remainder of the paper, having outlined the current situation as it affects both public and private sector planting, argues that the resultant level and pattern of investment are inappropriate and suggests changes in the taxation regime which would treat forestry in a fashion similar to other forms of investment. These changes would produce a greater congruence between private and social rates of return.

3.0 NON-FINANCIAL CONSIDERATIONS

3.1 The continuation of planting assisted by uniquely favourable tax 'breaks' to the private sector and by accepting very low rates of return on public investment, requires very special justification. Historically, this has been provided by arguing that there are off-setting non-financial benefits, such as the desirability of creating employment in rural areas, potential recreational or environmental benefits, and balance of payments or strategic considerations. The general application of these arguments does not appear well founded in present circumstances.

Employment

3.2 Whereas in the 1950s and 1960s, unemployment tended to be above the national average in rural areas, this situation has, in more recent years, been reversed. Indeed, rural areas often have below average unemployment and more favourable employment trends, this applying to much of the Highlands and Islands of Scotland where most new planting presently occurs.

3.3 Moreover, new planting is not a particularly efficient way of dealing with present unemployment. First, most of the jobs created by new planting occur not immediately but in harvesting some 40 plus years after planting. Second, so far as can be assessed, the cost of job creation is extremely high, amounting to some £10,000 per employment year in the case of Forestry Commission planting in North Scotland, this being well above the cost of job creation in other sectors of the economy. Third, although it is often suggested that forestry provides better opportunities for increased employment than other sectors, it is the case that employment in forestry has tended to decline, while rural employment has increased.

3.4 In recent years, the creation of downstream employment in wood processing has been brought forward as another 'benefit' of forestry. Yet, it is evident that new planting is hardly relevant to the development of downstream processing, which is based on the harvesting of mature forests. In any event, the major wood processing developments have been heavily subsidised by the public sector. As noted in our report for the National Audit Office of December 1985 .... "In four recent, major projects, the share of costs accounted for by public sector grants varied between 18% and 33%, while the estimated grant cost per job was between £25,000 and £84,000, making no adjustment for job duration". It follows that the employment effects of wood processing do not, in general, constitute an additional benefit that can be offset against the poor returns from new planting. Further, as we again noted in our December 1985 report ".... examples suggest that any 'external' benefits accruing from expanded processing activity have been more than adequately compensated for by public sector support".

Recreation

3.5 Forests can provide important recreational benefits but they can also produce important disbenefits. Both benefits and disbenefits are specific, in the sense that they relate to the particular circumstances of individual forests and areas, rather than to all forests and all areas. Hence, mature woodlands which are more easily accessed from existing centres of population, are likely to offer the greatest possibility of recreational benefits, particularly at their perimeters where sites have been specifically prepared with recreation in mind. By way of contrast, new planting produces little in the way of additional recreational benefits for many years and, if in remote areas, may create important disbenefits to naturalists, walkers and climbers, birdwatchers and persons engaged in field sports. In addition, recreation is given relatively little encouragement in private sector forests.

3.6 As such benefits and disbenefits are specific they cannot be treated as a consideration which should be taken into account in assessing all planting. Rather they should be given an appropriate weight according to the specific circumstances in question. One generalisation is possible, however - that the geographical distribution of new planting is remote from major population centres and may therefore yield few recreational benefits, while such planting has increasingly been opposed by a wide range of interest groups.

Environment

3.7 It is often difficult to reach any final judgement on the balance of environmental considerations, and these too will tend to be specific to particular cases. However, there has, in recent years, been growing opposition to major commercial forestry schemes and the main conservation groups, including, significantly, those government agencies for whom care and protection of the environment is the primary statutory objective, are united in their concern over the environmental impact of much of present planting. This is due to a perceived adverse impact on the landscape and on a wide range of ecological factors, including the soil and water systems and the wildlife of an area. As evidence of this, the last few years have seen a number of reports critical of new planting by bodies such as the Council for the Protection of Rural England, the Royal Society for the Protection of Birds, the Nature Conservancy Council and the Countryside Commissions in both England and Wales and Scotland.

Balance of Payments

3.8 The naive argument that home grown timber is 'import-saving' is easily discounted because there is no evident benefit in greater self-sufficiency as such. The home production of timber is only beneficial to the economy if it can be demonstrated that the resources it employs could not have been used as productively elsewhere. This seems improbable, as it has already been demonstrated that the return to investment in new planting is very low.

3.9 Import saving can only be considered as a benefit to the economy 'in its own right', if the economy is faced with a chronic and persistent balance of payments deficit which, in turn, exerts an adverse impact on the domestic economy. In practice, there is no historical evidence that the UK has experienced such a situation or that autarky is a better corrective mechanism than the other policy instruments available. Finally, new planting undertaken today would have no impact on the balance of payments before 2025. There is no basis for believing that the economy will then face a persistent deficit situation and it would be sensible to take the view that future difficulties would be best resolved in the future when they could be better understood and assessed. In brief, there is no case for attaching an 'import saving premium' to new investment in forestry.

Strategic

3.10 Here, the argument clearly no longer holds in that the strategic resource is already in existence and is unaffected by new planting - the 2 million hectare target for a strategic reserve was passed by the late 1970's. Further, the Zuckerman Committee of 1957 on "Forestry, Agriculture and Marginal Land", concluded that the strategic argument was no longer valid in view of the likely nature of any future world conflict.

Conclusions

3.11 We conclude that the non-pecuniary arguments commonly adduced to 'justify' the low rates of return from new forestry planting have, as general arguments, little substance. Neither the strategic nor balance of payments arguments are relevant. As regards the environment, the balance of environmental opinion whilst not against the creation of new woodlands or forests per se, is clearly against much of the new planting which has actually occurred in recent years and such planting may also create more recreational disbenefits than benefits. Nor, given the present levels of unemployment in rural areas compared to urban areas, is there any case for applying any particular weight in favour of creating employment in rural communities. Moreover, the cost of job creation in forestry is very high and the major employment gains from new planting are far removed in time.

3.12 The major arguments put forward to justify the low financial returns obtained by the Forestry Commission and (pre-tax) by the private sector have remarkably little substance. There is no evident case for accepting the low rate of return for new investment obtained by the Forestry Commission, which in practice is even less than the 3% target to which it is meant to operate. Nor is there any compelling reason to suppose that private sector investment in forestry should be singled out for specifically favourable treatment. There is, therefore, a pressing need for a fundamental reconsideration of the policy framework within which the Forestry Commission and the private sector operates, and we turn to this below.

4.0 POLICY PROPOSALS

The Forestry Commission

4.1 If we suppose that there is a case for the Commission continuing as a Forest Enterprise as well as a Forest Authority, then the policy changes required are self-evident. As a general rule the Commission, in undertaking new planting, should be expected to achieve the financial targets set for the rest of the public sector i.e. it should meet the 5% Test Discount Rate.

4.2 Exceptions to this rule should occur only where the Commission can demonstrate the existence of substantial non-financial benefits in the area where planting is proposed. In effect these would be confined to the creation of employment in areas of high unemployment, environmental gain and recreational benefit. In view of this and in light of the European Commission's proposals that all major new planting be subject to Environmental Impact Assessment, we would recommend that all major investment in new planting be subject to an EIA and discuss the mechanisms by which this may be applied in the next section on Private Sector forestry.

4.3 The effect of these changes would be to reduce the level of planting by the Commission and to ensure that all social benefits and dis-benefits were thoroughly assessed. The present level and pattern of planting is the result of setting very low financial targets for the Commission. In the context of agricultural over-production in Europe there is a strong case for reconsidering the location of Commission planting which has been pushed 'up the hill' and 'further north' because of a wish to preserve agricultural land in its existing use.

Private Sector Forestry

4.4 The exceptional tax treatment afforded to investment in forestry is the major cause of the level and pattern of new planting by the private sector. It is from here than any reform must begin. We therefore consider below two other activities which receive favourable tax treatment, the Business Expansion Scheme and agriculture, and, from this, consider changes in the tax regime within which private forestry operates. We then go on to consider changes to the planning process through the requirement for Environmental Impact

4.5 The Business Expansion Scheme, whose intention is to encourage individuals to provide venture capital investment in the small business sector, allows such investors income tax relief and exemption from CGT. The BES obviously has some parallels with the fiscal treatment of forestry but is limited to sums not exceeding £40,000 per annum, whereas no similar limit applies with forestry.

4.6 Agriculture receives exceptional treatment with respect both to grant assistance and to indirect price support through the protection afforded by the Common Agricultural Policy. As far as tax treatment is concerned, farmers can set revenue expenditure against income from other sources if the farm makes a loss under Schedule D but this is limited to an initial six year period. Further, 'hobby farmers', that is those who previously chose to run farms at a loss to gain tax relief on income from other sources, are not permitted to offset such losses against income tax liability. No such process applies in forestry although it is evident that there are some 'hobby foresters' who are content to make a loss on their forest investment to allow tax relief on income from other sources, as well as 'hobby farmers'.

a) <u>Taxation Reform</u>

4.7 In practice, the conditions placed upon the Business Expansion Scheme and agriculture are not directly applicable to forestry. To limit relief to investments of £40,000 or less would exclude most large forestry developments, given the high establishment and maintenance costs associated with most new plantations. To restrict Schedule D relief to the first six years of the life of the plantation would merely cause Schedule D investors to sell on the plantation at the end of that period, within which the bulk of establishment costs would have already been incurred.

4.8 The critical difference between the tax treatment afforded to forestry and other activities, is the facility to switch between Schedule D and Schedule B taxation. It should be noted that such switching was not the initial intention of policy makers. In fact, Schedule B taxation was introduced to 'reward' investors who managed woodlands over a long period.

4.9 In order to assess whether changes to the taxation regime could be effected which better meet the goal of equalising private and social returns, we have considered three alternative tax and grant regimes which we consider represent a more neutral form of taxation treatment for forestry, while maintaining an incentive to invest in economically viable or environmentally beneficial circumstances. These are:

- **Regime (1)** all investors to be assessed on the basis of Schedule B plus present grants
- **Regime (2)** removal of CGT exemption from Schedule D investors plus present grants; and
- **Regime (3)** varying the level of grants for differing types of planting under the present tax regime.

We have assumed the retention of a grant system since our prime concern is with the tax treatment issue. In practice, the impact of the tax treatment on returns is for greater than that of grants.

4.10 It is not possible to provide a comprehensive analysis of the impact of such changes on the entire spectrum of new planting. However, it is possible to provide indicative estimates of the order of magnitude of the changes on important examples of new planting. This is done by conducting sensitivity analysis on a number of forest investment models, data on expenditure and income throughout the life of the forest being gathered from a variety of sources. The results produced by these models are estimates but while the precise figures are subject to margins of error, the results are considered to indicate correctly the magnitude and direction of change in returns under different assumptions. It should also be noted that the planting models employed do not deal with extreme cases, in that planting is clearly occurring in circumstances where the divergence between private and social returns is far greater than in the analyses applied here.

b) <u>Conifers</u>

4.11 The models used to test alternative tax treatments are based on information published by the:

- Nature Conservancy Council;
- Royal Society for the Protection of Birds; and
- Forest Economic Advisory Services.

4.12 The data from these sources (the details of which are in Appendix A) have been used in a model developed by PIEDA to calculate the internal rate of return (IRR) and net present value (NPV) of investment in forestry over the life of a plantation. These indicators have been calculated for:

- a Schedule D investor;
- a Schedule B investor; and
- the nation (i.e. the social return)

4.13 In determining the optimum tax treatment, it has been considered that the return to the Schedule D and Schedule B investors should more closely match the social return than at present. The returns to Schedule D and B investors are therefore considered under the present tax system and under schemes (1)-(3) in para 4.9 above, this being shown in Table A.1.

4.14 In Table A.1 the social return is compared to the private rates of return to the private investor and tax exempt institution (or Schedule B investor) under the present regime. It should be noted that in order to discriminate between the returns achieved by the two private investors it is necessary to assume a target rate of return for the tax-exempt institution in order to calculate the market price at which the sale of the growing trees is conducted. This has been taken as 4% for illustrative purposes, the same assumption being carried through all calculations. It should be noted that the application of a different target rate of return does influence the anticipated return for the Schedule D private investor but does not change the basic principles involved.

4.15 The results demonstrate that the social rate of return is repeatedly below the private return under the present tax regime and had a wider range of models been available, more extreme cases would certainly have been revealed. It is clear that of the alternative regimes applied, Regimes 1 and 2 are preferred to Regime 3 in that they produce a greater convergence of private and social returns. Our preference on these grounds is for Regime 1. Regime 1 does involve the retention of a 'special' tax regime for forestry but it is not one which appears to confer unique benefits. Moreover, the system has the benefit of administrative simplicity for a very long-term investment where, for example, computation of CGT liability would pose many difficulties.

4.16 It is therefore recommended that <u>all</u> investors in woodland be assessed under Schedule B, as was intended prior to the identification of the tax loop-hole. Schedule D election, normally open to all businesses, would not be permitted. We consider that this would discourage planting in areas of low social return, for example in the uplands of Scotland, forcing investment to take place 'down the hill' in areas where the economic returns are higher. This is particularly appropriate to the emerging surplus of agricultural land.

4.17 Further, we consider that the planting grant system be maintained for conifers in addition to Schedule B relief. The grants, however, may be made more flexible to 'reward' new planting where it is of high social benefit (eg. where it is of recreational or environmental benefit). For replanting, grants should also be available but <u>only</u> in cases where high social benefit could be clearly demonstrated.

c) <u>Broadleaf</u>

4.18 Due to the unpredictable nature of costs and revenues related to broadleaf plantations resulting from disease, loss of trees and wide variations in management costs, it is inappropriate to base recommendations upon standard models. It should also be emphasised that the case for encouraging the planting and management of broadleaf woodlands frequently has little to do with commercial considerations. Instead, its immediate justification must be recreational and environmental and effective encouragement can only be through a system of grants which recognises these characteristics.

4.19 Grants for broadleaf planting currently run at a higher level than for conifers and payment is made in three tranches. If it were considered desirable to encourage further the planting and management of broadleaf woodlands, whish is particularly appropriate given the recent widespread windthrow damage in Southern England, then consideration should be given to a system of maintenance grants extending over a period of, say, 20 years or longer given the length of rotation for broadleaf trees. This would be particularly relevant to farmers who may be encouraged to plant broadleaf trees on existing agricultural land as is targeted under the proposed Farm Woodlands Scheme. Grants for restocking or replanting broadleaf trees could also be extended to cover management and maintenance costs over a similar period to that for new planting.

4.20 It should be noted that mature broadleaf plantations currently under the management of bodies such as local county naturalist trusts, the Nature Conservancy Council or Royal Society for the Protection of Birds would not be threatened by the fiscal changes proposed. Schedule D relief is at its most relevant only during the establishment phase of the plantation. As mature woodland is past this phase, it is most likely to be assessed under Schedule B and is therefore unaffected by the tax reforms proposed.

d) <u>Environmental Impact Assessment</u>

4.21 It our recommendation that major Forestry Commission new planting should be subject to an EIA before proceeding. We would propose similar treatment of private planting. This is consistent with the recommendation of the European Commission that all "projects which are likely to have significant effects on the environment" be subject to an EIA.

4.22 We do no consider it necessary for all new planting or any replanting to be subject to an EIA, as this would result in an overly bureaucratic and lengthy process. The government should, instead, draw up guidelines to determine those new planting proposals which will require to be assessed prior to planting permission being granted.

4.23 The findings of the EIA would be presented to the Secretaries of State in Scotland and Wales or the Minister of Agriculture and Fisheries in England. The Nature Conservancy Council and the two Countryside Commissions should have a statutory requirement to advise the government and comment upon the EIA prior to the granting of planting permission.

APPENDIX A

1. The models have been derived using data from the:

- Nature Conservancy Council;
- Royal Society for the Protection of Birds; and
- Forest Economic Advisory Service

2. Throughout the analysis, certain assumptions remain constant, namely:

- land price remains constant throughout the life of the plantation;

- all Schedule D investors pay 60% marginal rate of income tax;

- all Schedule D investors secure a special bank loan to buy the land, paying only interest throughout the term of the loan and repaying the capital sum on sale of the land. Tax relief at the marginal income tax rate is allowable on interest payments;

- all tax relief is applied one year in arrears;

- the price paid for the growing trees by the Schedule B investor/tax exempt institution is equal to the net present value of the income stream of the forest from the year of sale to the year of harvesting, discounted to the year of sale at 4%;

- thinning does not occur; and

- replanting or other activities post-harvesting have been ignored.

3. Schedule D Tax Relief is calculated as follows:

- 60% of establishment (i.e. planting, ploughing etc) and all maintenance costs net of land cost and grants received

- 60% of interest payments on land loan

- 4% for a maximum of 25 years on capital expenditure (i.e. roads and fences).

Schedule D and Schedule B investors are exempt from capital gains tax.

4. The results of the various manipulations of the model under alternative fiscal and grant regimes are shown below in Table 1. The 'private investor' is assumed to be that person who establishes the plantation for sale pre-maturity, and the 'institution' the investor who then buys the plantation and maintains it until harvesting.

5. Where the return to the investor is negative, investment would not occur.

Table A.1

Model Results

Data Source	RSPB	Forest Economic Advisory Service	NCC
Per hectare:			
Land Cost	£120	£750	£144
Establishment Cost	£600	£350	£412
Capital Cost	£160	£300	£264
Year of Sale from Private Investor to Institution	10	10	15
Species	Sitka Spruce	Sitka Spruce	Sitka Spruce
Rotation Length	40yrs	50yrs	48yrs
Hazard/Yield Class	HC4 YC12	YC16	HC4
Sale Price Trees at Rotation	£3,500	£10,000	£7,200
Social Return	2.5%	3%	4%

Return to Investors (Internal Rate of Return)	Private Investor (Schedule D)	Tax-Exempt Institution (Schedule B)	Private Investor	Tax-Exempt Institution	Private Investor	Tax-Exempt Institution
Present Regime	7%	4%	5%	4%	13%	4%
Regime 1	negative	4%	negative	4%	5%	4%
Regime 2	4%	4%	4%	4%	10%	4%
Regime 3	5%	4%	3%	4%	8%	4%

NOTE OF 2/12 DISC'N

SECRET

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER
REC. 03 DEC 1987 √3/12
ACTION MR MONCK
COPIES TO CST FST SIR P MIDDLETON MR ANSON MR BURGNER MR SCHOLAR MR BONNEY MR M HUGHES MR BEIGHTON - I.R.

From the Private Secretary

3 December 1987

Dear Jonathan,

TAXATION OF FORESTRY

The Prime Minister held a meeting on 2 December to discuss the taxation of forestry, on the basis of the Chancellor of the Exchequer's minute of 4 November. Those present were the Lord President of the Council, the Chancellor of the Exchequer, the Secretary of State for the Environment, the Minister of Agriculture, the Secretary of State for Scotland, the Parliamentary Under-Secretary of State, Welsh Office, and Mr Richard Wilson and Mr George Monger, Cabinet Office.

The Chancellor of the Exchequer said that the present income tax treatment of forestry was indefensible. It was inconsistent with the Government's general policy of tax reform. It encouraged the wrong people to plant the wrong trees in the wrong places. It actually cost the Exchequer £10 million a year more than if forestry was not taxed at all. He had come to the conclusion that complete exemption from income tax was the best and simplest course, subject to transitional arrangements for four years. In view of the Government's commitment to encouraging forestry, he proposed that the £10 million a year thus saved should be used to increase grants. The increase in grants would take effect at once so there would be a net cost while the tax change was phased in over the transitional period. The increase could be targetted to get greater environmental benefit.

In discussion, it was generally agreed that the Chancellor's proposals were right in principle. The Secretary of State for Scotland and the Minister of Agriculture argued, however, that the Government had recently reaffirmed its policy of promoting forestry and had increased the target annual rate of planting. It would therefore be important to ensure that the change did not lead to a substantial reduction in planting. The Secretary of State for the Environment on the other hand felt that there would be environmental gains if the planting target was not in fact reached. The meeting recognised that there was some doubt about the effect of replacing the present tax incentives by higher grant incentives, since they appealed to different types of investor. No decision about the new grant structure should

NORGROVE TO JMGT 3 DEC

SECRET

therefore be taken until a proper judgement could be made about its effect. Consultation in advance with the Forestry Commission about a Budget matter would not be appropriate, and the best course might therefore be to announce the tax change in the Budget but to leave open the new grant structure until after consultation with the interests affected. It was also argued that the inheritance tax régime applying to forestry could affect the incentive to plant, and the Chancellor undertook, without commitment, to look at it in the light of the discussion.

Summing up, the Prime Minister said that the Group agreed with the tax change proposed by the Chancellor, and noted that he would wish to announce it in the Budget. They also agreed that the savings of £10 million a year should be used to increase grants and this too could be announced in the Budget. But the details of the new grants should be left open pending urgent consultation after the Budget with those affected as to how the increase in grants could best contribute to the Government's objectives. Meanwhile, there should be no further consultation. If there were a leak before the Budget, the Group noted that the Chancellor would wish to answer a Written Question announcing his plans and that the changes would as necessary apply as from the date of the Answer.

As agreed at the meeting, I am not copying this record beyond the Treasury.

Yours,

David

D R NORGROVE

Jonathan Taylor, Esq.
H.M. Treasury

36/50

psl/32A

SECRET

Mr Allan pup

The Revenue will be dealing with this in a submission this week

AM 7/12

MR MONCK

FROM: A C S ALLAN

DATE: 7 December 1987

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Burgner
Mr Scholar
Mr Bonney
Mr M Hughes
Mr Beighton - IR

TAXATION OF FORESTRY

You will have seen David Norgrove's letter of 3 December recording the discussion at the Prime Minister's meeting.

2. One of the points the Chancellor undertook to look at was the IHT regime for forestry. One possibility the Chancellor would like to see explored is to exempt forestry from IHT providing it had been held for a certain minimum number of years (which might be seven, or could be longer). He suspects this would have a negligible effect on IHT yield. It would encourage long-term investments in forestry but provide no advantage to those who were just interested in exploiting the tax regime.

ACSA

A C S ALLAN

45/B.rj.2186/015

SECRET AND PERSONAL

FROM: N MONCK

DATE: 14 December 1987

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Burgner
Mr Scholar
Mr Bonney

Mr Beighton - IR

Ch/ (a) or (b) (para 10)? [illegible] 14/12

I am prepared to [illegible] go for (b) route / Have seen & approved the [illegible] but [illegible] of a [illegible]. [illegible]

MONCK TO CX 14 DEC

FORESTRY

The purpose of this minute is to seek your views on the handling of the grant side of the forestry package.

2. At the Prime Minister's meeting on 3 December you successfully got agreement to your proposed tax changes and to £10 million of additional public expenditure on forestry grants. You would announce both in the Budget. Details of the new grants would not be settled until there had been urgent consultations with forestry interests after the Budget.

3. The meeting also decided that there should be no further consultation within the Government before the Budget. This means that:

(a) we will not be ready to issue consultative proposals about new grants on Budget day, as we had earlier expected; and

(b) the internal consultations with the Scots, the Welsh, MAFF, DOE, and the Forestry Commission, about a draft consultative document will take place after the Budget. The departments are bound to be influenced by the reactions of forestry interests.

4. (a) would look a bit incompetent and could damage the presentation of the forestry package. (b) would also be risky. It is uncertain how forestry interests will react to the forestry propoals in the context of the Budget as a whole. But if external reactions are hostile, as they well may be, they are likely to be at their strongest at the very time we are carrying out internal consultations with other departments. Consultations with so many departments on the basis of

a somewhat fragile upper limit of £10 million a year may be tricky anyway. But it would be worse to undertake them in the clamour of external lobbying. There will be plenty of scope for argument about the absolute and relative incentives compared with other activities needed to achieve the recently announced planting targets. There would be some risk in such a scenario that we could not get internal agreement to a consultative document based on £10 million of extra public expenditure and a stronger one that even if we succeeded in that, we would not be able to hold it after external consultation.

5. We would be in a much stronger position if we were able to issue specific proposals compatible with the £10 million figure and agreed with other Ministers on Budget day. We ought to be able to achieve that on the basis of the Prime Minister's meeting if we were able to consult internally before the Budget. But we could of course only do so if you were willing to get the ban on internal consultation before the Budget reversed.

6. We have considered what would be involved in such internal consultations at official level. Discussions with the Forestry Commission could be confined to a very small group, some of whom will already have seen the paper and given advice on it to Mr Rifkind. It should not be necessary to go beyond the Director General (Mr Francis), the Chief Economist and the Commissioner for Finance. We would want our existing contacts from MAFF and DOE to be part of a group as a counterweight to the Forestry Commission. The Scottish and Welsh Offices would need to be represented, preferably by the individual official who advised Mr Rifkind and Mr Walker on your paper before the Prime Minister's meeting.

7. If the ban on internal consultation is maintained, the Treasury and Revenue would of course have a draft consultative paper ready to show to other departments on Budget day. But we would still be a very long way at that point from reaching interdepartmental agreement and would face the presentational and public expenditure risks in para 4.

The Current Review of Forestry Grants

8. Coincidentally the Commission are about to send us proposals for changes in the present grant rates as a result of their latest review. We understand that the Commission have concluded in consultation with Timber Growers UK that no general increase in grant rates is necessary to take account of cost increases since the last review in 1985. But they wish to introduce an additional incentive for planting on better quality agricultural land within their existing PES provision with effect from 1 April 1988. They hope to make the announcement sooner. Some Treasury questioning of the underlying assumptions will no doubt be expected;

so requests for additional work on grant rates should not create speculation within the Commission. But a three month delay in responding to a proposal of this sort would be difficult to explain. We will face an awkward choice between allowing the Commission's proposals to be announced and subsequently overtaken by the Budget statement, and using bureaucratic means to delay any announcement with the risk that this will provoke speculation. This choice might be marginally easier to handle if we could take senior Commission officials into our confidence. But this point is not decisive for the issue discussed in this minute.

Conclusion

9. There is a choice of evils here. Going for internal consultation before the Budget would involve some increased risk of a leak. But the extra risk should not be large, given the recent exchanges, which have not so far led to a leak. And we are ready with a contingent statement, which you have seen, if a leak occurred. Against that risk, we should have a good prospect of agreeing a consultative document which could be issued on Budget day. It might well not win general assent externally. But we should have lined up all the relevant departments and have a specific and agreed battle line to defend. We could hope then to respond to external pressures by varying the pattern of grant increases or the environmental conditions attached to them rather than by varying the sum. Our strong preference would be for the latter course.

10. The issue for decision is whether you prefer:

(a) to stick to the ban on internal consultations and take the associated risks on presentation and public expenditure; or

(b) to get the ban reversed and go for publishing consultative proposals on Budget day.

N MONCK

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

SECRET AND PERSONAL

Ch/
Agree with IR recommendations at paras 28 + 29 (i.e. hold extension of woodlands relief in reserve)?

FROM: J MARSHALL
16 December 1987

CHANCELLOR OF THE EXCHEQUER

Agreed.
N.

FORESTRY: CAPITAL TAXES

Purpose of this note

1. At the Prime Minister's meeting on 2 December agreement was reached that it was right in principle to replace the present income tax regime for commercial woodlands with exemption. We have taken this as authority to instruct Counsel on the existing package as far as it concerns the tax treatment of the income. Work is in hand on this basis. It was however suggested at the meeting that the existing inheritance tax regime could affect the incentive to plant. You undertook, without commitment, to look at this in the light of the discussion. This note examines the case for and against a change in the IHT rules. It concludes that there is no convincing case for any change but identifies a possible extension of an existing relief which Ministers could hold in reserve in case they came under pressure to make a gesture on the IHT front.

2. The note also seeks your agreement to some small technical amendments to the CGT rules consequential on the income tax exemption.

---

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin

PS/IR
Mr Painter
Mr Isaac
Mr Beighton
Mr Pitts
Mr Marshall

3. For completeness, the annex to this note examines whether there are any other grounds for changing the capital taxes rules - CGT as well as IHT - as they apply to woodlands in the light of the decision to exempt the income. The conclusion is that no other change is called for.

4. The note has been agreed in draft with Mr Beighton. It takes account of the views of Mr Scholar and Mr Monck.

Details

TAX TREATMENT OF THE INCOME

5. Under the proposals as they stand, profits from the occupation of woodlands will be removed from the scope of income tax and corporation tax. This will also involve withdrawing entitlement to capital allowances since the income to which the capital expenditure relates will no longer be taxable.

6. Subject to the transitional provisions,

- expenditure on woodlands will not be allowed as a deduction against any other income;

- the proceeds from the sale or felling of the timber will not be charged to income tax or corporation tax;

- expenditure on buildings and other capital items connected with woodlands will no longer qualify for capital allowances.

CAPITAL TAXES

Inheritance Tax

7. It was suggested at the Prime Minister's meeting that the less well off might not in practice take advantage of the

increased planting incentive they would get through grants, while planting by the better off might be reduced as their incentive fell. It was suggested that the planting dip from the mid 1970s had been as a result of tax changes or the threat of the introduction of a wealth tax.

8. You agreed to explore the possibility of exempting woodlands from IHT, subject to a minimum holding period. Mr Allen's note of 7 December suggests seven years, or even longer and asks whether this would have a negligible effect on IHT yield. The objective would be to encourage long term investments in forestry but to provide no advantage to those who were just interested in exploiting the tax regime.

<u>1970s Dip</u>

9. Levels of private planting and restocking in the period since 1945 are shown in the Table below. The figures are for grant paid in each financial year shown. They reflect planting occurring up to 18 months before the year. Thus the sharp drop which occurred in 1975/76 largely reflected planting which would have taken place in 1974/75. Other signs of a decline in activity were apparent earlier. Applications to dedicate new land to forestry (and hence qualify for a grant) fell in 1970/71 compared with the level in the late 1960s, and the Timber Growers' Organisation noted a drop in private planting in 1972/73.

Table

Private planting and restocking for which grant paid

Thousands of hectares

Annual Averages		Annual figures (y/e March 31st)			
1946/50	3.7	1970/71	23.0	1980/81	12.0
1951/55	5.3	1971/72	24.5	1981/82	16.1
1956/60	12.0	1972/73	24.9	1982/83	15.7
1961/65	13.0	1973/74	24.1	1983/84	20.1
1966/70	13.9	1974/75	21.9	1984/85	19.1
		1975/76	12.8	1985/86	23.3
		1976/77	9.8		
		1977/78	8.7		
		1978/79	11.1		
		1979/80	11.7		

10. The general decline in activity in the 1970s was noted in the Airey Report (February 1977) which examined the factors underlying this fall. The Report concluded that:

i. the fall in dedications of new land in 1970/71 arose because hill farming was then doing relatively well, making forestry seem less attractive. Uncertainty aroused by the announcement of a review of forestry policy in December 1970 added to this;

ii. a dramatic fall in private planting took place in 1974. An important element in this was a change in the grant system. Entry to all existing grant schemes was suspended in June 1972. A replacement scheme was not announced until October 1973, although a temporary scheme was available from April 1973. The details of the new scheme were announced in July 1974 and they came into force in October of the same year. The Report notes that there was an immediate suspension of many new large scale projects as a result of the June 1972 termination of new grants;

iii. the economic climate beginning with the rise in oil prices in late 1973 had a major influence on reduced planting levels;

iv. the announcement of capital transfer tax and wealth tax in August 1974 occurred too late to have a significant impact on planting levels as early as 1974 but the announcement was likely to have added to a weakening in confidence.

11. We doubt if the present situation is comparable with that in the 1970s. Then there was the threat of a wealth tax and of a replacement of estate duty. Now we have an ongoing inheritance tax with no expectation of any increase in its levels by the present Government. And even in the 1970s, it seems clear that although the threat of tax changes may well have added to the dip in new planting, it was not the cause.

12. In any case, we question whether the likely effect on planting of the proposals will in fact be as bad as feared in the premiss for reviewing IHT. Mr Monck's working group concluded that, given the change in the form of the planting incentive and particularly the differential effect on high and low taxpayers, it was not possible to be certain how the level of planting would be affected. But the report also said that, with £m10 more for grants, it should be possible to devise a system of grants which could provide incentives only slightly below present levels for higher rate taxpayers (and which for other than higher rate taxpayers would provide higher incentives) compared with the present tax regime. To the extent that higher rates are reduced in the Budget the attraction of tax shelters (as opposed to grants) to individuals currently paying tax at top marginal rates is likely to be reduced. Moreover, the rationale of the new regime is to encourage investment in forestry by means of grants, not through the tax regime.

13. For the reasons discussed in the last two paragraphs, we doubt the need for any change to the IHT exemption, but in the following paragraphs we examine the case for and against.

Timber

Present Treatment

Woodlands Relief

14. There is already a special provision (woodlands relief) which allows the deferment of the tax charge on death, but not for lifetime transfers, provided certain conditions are met eg a 5 year minimum period of ownership. If an election is made, the value of the timber, but not the land, may be left out of account until its subsequent disposal by sale, death or lifetime transfer (other than between spouses). If the legatee dies before any such disposal, that death cancels any deferred charge relating to the first death and a fresh deferment claim can be made by the next legatee. When IHT finally becomes payable it is based on the value of the timber at the date of the disposal, not the date of the previous death, and is charged as the top slice of the estate of that deceased person.

15. The relief goes back to estate duty in the early years of this century. It was introduced in recognition of the economic and strategic importance of timber having regard to its unique characteristics - the long-term nature of the crop and the fact that little or no income is produced until the trees are mature. It ensures that tax need not be paid before the timber is ripe for felling. The effect is that there need only be one tax charge throughout the life cycle of woodlands, regardless of the number of estates through which ownership of the timber has passed.

Possible Changes

Total exemption from IHT

16. If timber were to be removed from IHT altogether it would be necessary, as you pointed out, to provide for a

minimum period of ownership, to prevent for example deathbed acquisitions. The requirement should be no less strict than the present condition for woodlands relief ie a minimum period of 5 years if the timber is acquired by purchase or exchange.

17. The exemption of woodlands from income tax recognizes the fact that there is no very satisfactory basis for taxing an activity where the greater part of the income arises 50 or more years after the greater part of the expenditure is incurred. No similar argument however could be put forward in relation to IHT however. In so far as there are special features, eg that one does not want people to cut down immature trees so as to find cash to pay the tax, the present rules cater for this. Exemption could act as an incentive, although the benefit in many cases would be pretty long term. But it would also be seen as a means whereby the better off families could over time minimise their tax. And exemption would leave Ministers much more open to claims for similar treatment from the heritage, agricultural landowners' and family businesses' lobbies, particularly as the declared objective of the last two is to secure complete exemption for their interests.

18. If nevertheless you wanted to introduce a positive incentive to encourage long term investment in forestry, an alternative which would expose Ministers less to these difficulties would be to make the existing woodlands relief more generous. Under this option there would be an IHT regime for timber (subject to the protective period) whereby any tax payable on transfer on death, or within 7 years of death or into a discretionary trust would be postponed until such time as the timber (standing or felled) was sold or exchanged. So even where more than one chargeable event occurred prior to such disposal, the tax subsequently payable would be payable only once. It would be charged on the value of the timber at the time of disposal. It would be calculated by reference to the chargeable event in the preceding 30 years which would give the greater yield. This is an anti-avoidance device, borrowed from the heritage regime, designed to prevent

manipulation immediately prior to the disposal of the timber. This variant offers two advantages over the existing regime. First, it extends the relief to lifetime transfers and discretionary trusts. Second, entitlement to the relief is no longer foregone when a subsequent lifetime transfer either to an individual or into a discretionary trust occurs prior to the disposal of the timber.

Cost

19. The cost of either variant - total exemption or a more generous woodlands relief - is not likely to exceed £m3 in a full year. Although not a significant amount in relation to the overall IHT yield (1987/88 Budget forecast £bn1.1) it is large in relation to the extra £m10 to be made available in grants. As such it might be represented as giving an undue tax advantage to the better off.

20. As between the two variants, we think it would be easier to hold the line with the woodlands relief extension since this is based on the special characteristic of timber while ensuring that the tax charge is triggered when the timber is sold or exchanged.

Land

Present Treatment

21. The normal rules apply to land on which trees are planted. And woodlands run on commercial lines attract the usual IHT relief for business property (value reduced by 30 or 50 per cent and payment by ten interest free annual instalments) The purpose of the relief is to ease the impact of IHT on businesses. And in this respect land does not attract any more favourable IHT treatment than the assets of any other businesses.

Possible Changes

Total exemption from IHT

22. Presumably, if you decide not to exempt the timber, there could be no question of exempting the land. But if you decide to exempt the timber then it might be suggested that the land should also be exempt. If land were to be removed from IHT altogether much the same considerations arise as noted above in relation to the complete exemption of timber. But the extension of the treatment to land would be more difficult to justify by reference to any special characteristics of the asset. Whereas trees have special characteristics which are already recognized in woodlands relief, the land on which they grow is land like any other land. This difference is reflected in the existing arrangements which restrict woodlands relief to timber but give business property relief to commercial woodland. Exemption, even with a minimum holding period of 7 years or more, would trigger renewed demands from small businesses and the unquoted companies group for 100 per cent business property relief for their enterprises. Exemption of woodlands as opposed to other land would be open to objections on grounds also of distorting commercial decisions eg in relation to development.

23. An alternative to total exemption might be to extend woodlands relief to land. But that too would risk distorting commercial decisions in relation to land usage. Woodlands relief recognizes the special nature of trees as a slowly growing asset: there seems no justification for extending the relief to land.

Cost

24. The cost of exempting land from IHT is likely to be £m2 in a full year. This would be in addition to the £m3 cost of exempting timber. And, as noted above, it would be in addition to the incentive for planting contained in the new grants regime.

CGT

25. It will however probably be necessary to make two minor technical amendments to the CGT legislation, to remove the existing reference to the income tax treatment of commercial woodlands. No more than a quarter of a page, at most.

SUMMARY

IHT

26. The 1970s dip in planting took place for reasons unconnected with the tax treatment, although tax may have played a part in its duration. The special characteristics of trees as slowly growing assets are already recognized in the existing IHT rules. The provision of an additional £m10 in grants should give sufficient scope, especially if higher rates are reduced in next year's Budget, to devise a grants system which would continue to attract taxpayers at higher rate(s). There is no disincentive to planting. So the question is whether Ministers wish to go further and introduce a positive incentive via IHT for planting. But that would go against the thrust of the package as a whole which is intended to replace tax incentives with a grants regime that can be more precisely targetted.

27. Moreover, exemption of the land, even with a minimum holding provision, would be difficult to justify by comparison with other types of land and other assets, especially business assets. Exemption of the timber would pose similar problems.

If nevertheless you wished to give a positive IHT incentive to planting, an extension of woodlands relief for timber as suggested in paragraph 18 might give some encouragement to maintain planting at comparatively small Exchequer cost (£m3), without exposing a flank. It might however be seen as merely cosmetic.

Recommendations

IHT

28. If Ministers decided to make some gesture, the extension of woodlands relief (paragraph 18) seems the only feasible measure which does not risk provoking claims for similar exemption for many other classes of assets. But it is not clear that it would impress potential investors. We do not recommend it. You may however wish to keep it in reserve in case pressure builds up for something to be done on the IHT front.

CGT

29. Subject to the views of Parliamentary Counsel, we may need to make small consequential amendments to the capital gains tax provisions (paragraph 25).

Points for decision

30. We should be glad to know if you agree with the recommendations at paragraphs 28 and 29.

JM

J MARSHALL

ANNEX

This annex considers whether there is a case for withdrawing or changing

A. any of the IHT reliefs currently given to woodlands
B. any of the special CGT rules

A - IHT

ABOLISH WOODLANDS RELIEF FOR TIMBER AND WITHDRAW BUSINESS RELIEF FROM WOODLANDS?

1. The main note considers the case for exemption. The alternative argument is that, if the income tax exemption is being given, and IHT rates are coming down, should not these reliefs be withdrawn? Part of the thrust of the Budget is to simplify the system and get rid of distorting reliefs where practicable.

WOODLANDS RELIEF

2. In recent years, taxpayers have tended to claim business relief only even in cases where, in addition, woodlands relief on timber is also available. This may in part be because of the rule that where woodlands relief is claimed tax is payable by reference to the value at the date of disposal. This decline in the relative importance of woodlands relief is likely to continue as IHT encourages lifetime transfers of assets, whether woodlands or whatever.

3. This might suggest that if the opportunity were taken in next year's legislation to abolish woodlands relief, its withdrawal might not be controversial. But that could not be guaranteed. First, death is not always anticipated: there are likely to continue to be cases where, in the absence of

transfers of woodlands before death, legatees will continue to want to be able to elect for the relief. Second, its removal would almost certainly be criticised by those representative bodies (Timber Growers UK, Country Landowners Association, Landowners Group) who have argued that the existing relief is too narrowly drawn and should be extended to the land. They would probably claim that the evidence of decline in the use of the existing woodlands relief supported their contention.

BUSINESS RELIEF

4. There does not appear to be a convincing case for removing business relief from commercial woodlands. The purpose of business relief is to ease the impact of IHT on businesses. Commercial woodlands do not attract any more favourable treatment in this respect than other businesses. Not surprisingly, there is no evidence of abuse of these normal rules in the case of commercial woodlands. To withdraw it would be seen as going further than taking action to correct a current income tax avoidance device since it would disadvantage commercial woodlands for IHT purposes by comparison with other businesses.

B Capital Gains Tax

Land

5. No special rules apply to the land on which the timber grows; disposals are subject to capital gains tax in the usual way. For example, in the case of commercial woodlands, rollover relief is available on the reinvested proceeds of the sale of the land on the same basis as other businesses disposing of qualifying business assets.

Trees

6. Trees (whether standing or felled) which form part of woodlands (whether commercial or not) are effectively exempt from capital gains tax on sale or disposal. The same applies

to saleable underwood (ie thinnings).

7. There are three reasons for the current exemption:

- the yield is subject to income tax;

- anti-avoidance;

- simplicity.

8. Under the new income tax regime the first of these falls away. But this does not affect the second reason for the exemption, which is to block a loophole that would otherwise permit the artificial creation of tax losses for capital gains tax purposes. There are more arcane possibilities for avoidance involving connected persons and trusts in which a forest owner has an interest. But the most straightforward - and very simple - avoidance arises from the fact that the profit on felled commercial timber is income, not capital gains, while the cost of the purchase of a growing woodland will often all or almost all be capital. Suppose for example an individual buys a woodland for £20,000 of which £5,000 is attributable to the growing trees. A few years later he fells the now mature trees and sells them for £15,000. Simultaneously he sells the bare land for £15,000. He has made a commercial profit of £10,000 (£15,000 + £15,000 - £20,000). But all of that commercial profit is attributable to the felled timber, and is outside the capital gains net. And under the new regime it will be exempt from income tax. For capital gains tax however he has a loss of £5,000 (£20,000-£15,000) which he can set against other capital gains. Similar results would arise if the growing timber was not felled but was sold separately from the land: the profit on the timber would again normally be income. The CGT legislation therefore provides that in calculating losses or gains on the disposal of the woodlands so much of the consideration as is attributable to the timber is not to be included in the computation.

9. The exemption of the growing timber from capital gains tax is currently represented as one of the tax privileges enjoyed by forestry and its continued exemption could be criticised as an inducement to investment in commercial woodlands. The main answer to this would be that in acting on the income tax side Ministers had already removed the incentive which was distorting commercial decisions. Under the new regime the real rates of return (including grants) are expected to amount, at most, to seven and a half per cent - and not for forty years. This takes account of CGT exemption and does not look like a very convincing inducement to set against the creation of loss making opportunities which removing CGT exemption would entail. And in any event, given the time it takes for trees to reach maturity, in practice death would often remove much of the eventual gain.

Simplicity

10. In addition, as the Council for the Protection of Rural England recognize in their recent Budget representations, bringing timber from commercial woodlands into the effective scope of capital gains tax would complicate the tax structure. There would be valuation problems relating to the purchase price and any subsequent expenditure. Records of expenditure on the trees would have to be kept over many years - in the case of broadleaf this could be for over a century. Even if such records were kept, there would be disputes as to whether items of expenditure incurred were revenue (in which case under the new income tax regime they would not attract relief) or capital (in which case they could be set against any gain on disposal). There would also be sizeable complications where, over the long growing period, woodlands moved in and out of commercial status. Special rules would be required to deal with such situations.

Change the CGT Treatment of the Land?

11. If the growing timber needs to remain outside the CGT net, the question arises whether the land on which it grows should

be treated the same way or whether it should remain, as now, subject to CGT. Although at first sight it may seem paradoxical the answer seems to be that it should stay subject to the tax. As noted above in relation to IHT, the underlying land is just like any land, and can acquire development value, be turned over to housing or general agriculture, etc. It is only the timber (and the extra value it gives) that is special. Exempting the land from CGT would give rise to much the same sort of problems as for IHT. It would create a tax shelter and thereby distort commercial decisions on land usage (eg by planting trees on it, one could get exemption for any subsequent development gain). It would be necessary to attempt to define woodlands much more tightly than at present; and special provisions would be necessary to cater for changes in land usage. Exempting timber but not land reflects the fact that it is only the timber that is special.

12. Retaining the capital gains tax exemption for timber once the income tax charge is abolished can be defended because:

- the Government will have acted to end the current income tax shelter;

- it is necessary to retain the CGT exemption on anti-avoidance grounds: it would be strange to open a loophole at the same time as another was being closed;

- ending the exemption would involve complex provisions and the maintenance of detailed records over long periods by owners of woodlands and their advisers.

SECRET and PERSONAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: J J HEYWOOD
DATE: 21 December 1987

Ch/ I sent you Mr Marshall's minute separately today.

21/12

PS/CHANCELLOR

cc PS/Chief Secretary
Sir P Middleton
Mr Monck
Mr Scholar
Mr Culpin
Mr Marshall IR
PS/IR

FORESTRY: CAPITAL TAXES

The Financial Secretary has seen Mr Marshall's minute of 16 December.

2. The Financial Secretary thinks that there is no need at all to lighten the IHT regime for forestry.

JEREMY HEYWOOD
Private Secretary

SECRET and PERSONAL

mjd 2/450n

SECRET AND PERSONAL

pmp

FROM: J M G TAYLOR

DATE: 24 December 1987

MR J MARSHALL - IR

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Scholar
Mr Culpin

Mr Painter
Mr Isaac
PS/IR

FORESTRY: CAPITAL TAXES

The Chancellor has seen your submission of 16 December, and PS/FST's minute of 21 December. He agrees with your recommendations at paragraphs 28 and 29 (ie to hold the extension of woodlands relief in reserve and, if appropriate, to make small consequential ammendments to the capital gains tax provisions).

JT

J M G TAYLOR

FORESTRY
IHT

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

SECRET AND PERSONAL

FROM: J MARSHALL
12 January 1988

MR TAYLOR

FORESTRY: CAPITAL TAXES

1. Your minute of 24 December.

2. We understand that the Chancellor intends to raise with the Prime Minister the possibility of a limited inter-departmental consultation prior to the Budget on the structure of a revised grant regime (Mr Monck's minute of 14 December).

3. As far as we know, the Chancellor did not undertake to report back to Ministerial colleagues on the outcome of his review of the inheritance tax regime for forestry. Nor does David Norgrove's letter of 3 December ask him to do so.

---

cc Financial Secretary
Mr Scholar
Mr Monck
Mr Culpin

PS/IR
Mr Painter
Mr Isaac
Mr Beighton
Mr Pitts
Mr Marshall

4. The Chancellor may however wish to take the opportunity of his discussion with the Prime Minister to say that he has concluded that there is no case for a further relaxation in the IHT regime. Forestry already benefits from the normal business relief provisions. In addition there are special provisions (woodlands relief) which take account of the long life cycle of growing timber.

JM

J MARSHALL

Ch.

Forestry: Consultations

You will remember that you agreed that I should speak to No 10 to get them to soften their line on consultations.

2. Mr Norgrove fully understood why we wanted to do this, but asked that you should mention this to the PM at your next bilateral. Mr Monck has provided a speaking note, immediately behind.

JT

12/1

PS. You may also like to mention to the PM that you have concluded not to relax further the IHT regime on forestry (pps. on separate string, behind)

FORESTRY CONSULTATIONS

45/B.rj.2187/0

SECRET AND PERSONAL

FROM: N MONCK

DATE: 12 January 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar

Mr Beighton, IR

MONCK TO CX 12 JAN

FORESTRY

The Prime Minister's meeting (recorded in Mr Norgrove's letter of 3 December) decided that there should be no further consultation within the Government about increasing forestry grants before the Budget. I understand you have accepted the arguments in my minute of 14 December for re-opening that decision with the aim of issuing consultative proposals about new grants on Budget day.

2. We have since seen some revised cost figures from the Forestry Commission which suggest that the value of the present income tax treatment could be something over £15 million rather than the £10 million figure we have used so far. The Prime Minister's meeting

> "agreed that the savings of £10 million a year should be used to increase grants".

We shall stick to that decision in the inter-departmental discussions. In any case the value of the present tax treatment would fall if higher rates are reduced in the Budget. That could be seen as an argument for postponing the inter-departmental discussions until after the Budget. But I still strongly prefer to issue definite grant proposals at the same time as the Budget.

Points to make to the Prime Minister

3. I suggest you make the following points:

(a) on reflection, I think it would be preferable to issue specific consultative proposals about new grants on Budget day, the same day as the new tax treatment of forestry is announced;

(b) to do that we need to carry out limited consultations within the Government in order to agree on the best way of spending £10 million a year. I thought I should mention this point to you;

(c) it should be possible to restrict the consultations to a very few officials, most of whom will already have been involved in briefing their Ministers for the discussion on 2 December;

(d) as you asked, I have ready a contingency statement that could be used if, despite restricting the circle, there were to be a leak.

NM

N MONCK

SECRET

CH/EXCHEQUER
REC. 14 JAN 1988
ACTION MR MONCK
COPIES TO CST FST
SIR P MIDDLETON
MR ANSON
MR SCHOLAR
MR BEIGHTON I.R.

PMP

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

13 January 1988

GRAY TO ALLAN 13 JAN

Dear Alex,

FORESTRY

At his meeting with the Prime Minister today the Chancellor sought her views on the possibility of strictly limited consultation with key officials before the Budget about the new grant regime. He felt this was necessary in order to have a co-ordinated set of announcements in the Budget. The Prime Minister agreed to such consultations as long as they were conducted on a very tight basis.

Yours,

Paul.

PAUL GRAY

Alex Allan, Esq.,
H. M. Treasury

SECRET

CABINET FOLDER

SECRET

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

Ch/ I suppose this is just about OK, provided that the disclosure to Sir D Montgomery is on strict conditions of secrecy?
AF 2/2

Alex Allan Esq
Principal Private Secretary
Chancellor of the Exchequer's Office
HM Treasury
Parliament Street
LONDON
SW1P 3HE

CH/EXCHEQUER
REC. 02 FEB 1988
ACTION Mr MONCK,
COPIES TO CST, FST, Sir P. MIDDLETON, Mr ANSON, Mr SCHOLAR, Mr BEIGHTON - IR.

2 February 1988

Urgent advice reqd on to the disclosure to Sir D Montgomery. I will speak to Mr MacGregor in margins of Cab: PSS Reminded.

Dear Alex,

GOVERNMENT SUPPORT FOR FORESTRY

I understand from the Director General of the Forestry Commission that an official group is considering the preparation of proposals for changes in the forestry grant schemes following the Ministerial discussions which took place towards the end of last year. I have spoken to Jonathan Taylor about the substance of the issues involved, which my Secretary of State discussed with Mr MacGregor and the Chancellor in the margins of Cabinet on 28 January.

The purpose of this letter however is simply to seek the Chancellor's consent for the Director General of the Forestry Commission to inform Sir David Montgomery, the Chairman of the Forestry Commission, on a secret and personal basis, of the proposals as they are now being developed within the official Working Group. My Secretary of State would wish him to be involved on that basis in the light of his overall responsibilities for the Forestry Commission and the grant making powers of the Commissioners. Given that his Director General is involved, it would be unreasonable if he were not also to be informed.

May I take it that the Chancellor will be content with this given that disclosure to Sir David would be made under strict conditions of secrecy?

I am copying this note to Shirley Stagg and to John Shortridge.

Yours sincerely,

David Crawley

DAVID CRAWLEY
Private Secretary

SECRET

HMP03306

45/B.rj.2188/006

CABINET FOLDER

BUDGET CONFIDENTIAL

for 4/2 to 9/2

FROM: N MONCK
DATE: 2 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Burgner
Mr Bonney
Mr Donovan

Mr Beighton, IR

MONCK TO CX 2 FEB

Ch/ You may like to have a word with Mr Rifkind + Mr Macgregor in the margins of Cabinet. 2/2

I will. pl put in with papers, please

FORESTRY

This note comments on the points which I understand Mr Rifkind, accompanied by Mr MacGregor, made to you after Cabinet last Thursday.

2. I have spoken to officials in the Forestry Commission and MAFF about Mr Rifkind's approach. It seems to have been prompted partly by nervousness in the Forestry Commission about taking part in my group without having seen the record of the No 10 meeting on 2 December which, as you may remember, was shown only to us. There was thus no written starting point for the Commission which had been agreed by their Ministers. But the approach also reflects underlying issues which are real enough and familiar from earlier papers.

3. The first point was that you had agreed to an additional £10 million a year in public expenditure rather than some lower sum within that. That is right and I did not conceal it at the first meeting of the group on 22 January, though I stressed that the agreed £10 million was a limit. My MAFF opposite number tells me that (without talking to me) he has reassured Mr MacGregor on this point since your conversation.

4. Mr Rifkind's other points are linked - that the package will entail some reduction in traditional conifer planting and that we will be seeking the approval of extreme environmentalists in consultations about the grant proposals to accompany the change in tax regime.

5. It is of course true that the No 10 meeting decided that grant proposals should be subject to consultation about the structure. So far as I know this was not

our idea: I had supposed that Mr Rifkind had asked for it to give himself some room for manoeuvre if forestry interests protest strongly. If there is a chance, now that we are having internal consultations before the Budget, of putting out our new grant levels as firm decisions, that would presumably be preferable from the point of view of Treasury Ministers. It may be worth raising this later on with your colleagues when we know more about the chances of reaching agreement in my group. The Forestry Commission themselves would prefer that.

6. The difficult underlying issue is the compatibility of the package with the higher "aim" for planting (33,000 hectares). Mr Jopling announced this along with ALURE measures in February last year, but he said nothing about new policy instruments to achieve the aim.

7. This was not a firm target. But it could be, or be presented, as harder to achieve under the new package for various reasons:

(a) the £10 million a year estimate for the revenue cost of the present tax regime is too low so that the total Exchequer subsidy would be reduced after the Budget;

(b) even if the total size of the Exchequer subsidy is unchanged, the area planted will tend to be reduced if subsidies are redistributed

(i) away from higher rate to basic rate taxpayers; and

(ii) away from conifers to broadleaved trees eligible for higher grants per hectare in order to achieve environmental benefits.

None of these are new points - indeed (b)(i) and (ii) were in the original report. But they are key issues for my group. The Forestry Commission is already arguing that £10 million a year of extra public expenditure would produce private planting of about 18,000 hectares, well below expected 1988/89 levels, and well below the aim of about 33,000 hectares.

8. So far as (b)(ii) is concerned, I have taken the line that although it is certainly not the aim to satisfy the extreme environmentalists, Ministers do want to claim, as one of the plus points of the package, that it will yield greater environmental benefits and to have this recognised by the moderates (eg in the Countryside Commission and the Nature Conservancy). It is not clear how much of a switch of expenditure, as opposed to changes in procedure, eg tightening the conditions attached to grants, will be needed to achieve this. My approach will in effect be to go for a package with the minimum switch of expenditure which DOE advise us the moderate environtmentalists are likely to acknowledge publicly.

9. On the other points in para 7 we are of course saying that any (b)(i) effect cannot be reliably quantified and that the sum of £10 million was collectively agreed. But the No 10 record is not absolutely firm that it is only the structure and not the cost of grant increases which is subject to consultation after the Budget and the Scots are claiming that Mr Rifkind is not committed to this figure.

Possible Outcomes

10. I assume that your preferred outcome would be to get agreement to present a £10 million package on the basis that, given all the uncertainties, it is not expected to produced significantly different total planting levels from the old regime. The attractions of the new regime would be less benefit for higher rate taxpayers, greater transparency, and a better environment.

11. It seems probable that the Forestry Commission and Mr Rifkind (and perhaps Mr MacGregor too) will not sign up to this. The Commission are arguing that there is a choice between explicitly reducing the published Jopling planting aim and raising extra grant expenditure by nearly £20 million. We are currently resisting and testing their argument. But we may find that we have to produce a paper which would describe a £10 million package and the way it could be presented, and record the Commission's and no doubt Scottish arguments for higher public expenditure. Whatever happens, it is preferable to have started the process of sorting out these arguments before the Budget.

Conclusion

12. To sum up, the points made by Mr Rifkind were in part wrong but others reflect underlying issues. A series of meetings on these is now going on and I shall report to you later this month. If we cannot produce an agreed outcome on the lines of para 10, a meeting of Ministers or a series of bilaterals may then be necessary.

R. Jackson

pp **N MONCK**

Jonathan

SECRET AND PERSONAL

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

CH/EXCHEQUER
REC. 11 FEB 1988
ACTION Mr MONCK
COPIES TO CST, FST, Sir P. MIDDLETON, Mr ANSON, Mr SCHOLAR, Mr BEIGHTON – IR

✓ 11/2 PPS. pl.

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3HE

10 February 1988

Dear Nigel,

RIFKIND 10/2

FORESTRY TAX REGIME

John MacGregor and I mentioned to you last week our concern about the way that the official discussions on forestry tax and grant incentives appeared to be developing. In particular, it seemed to us that collective Ministerial agreement was being assumed on certain key points which had not been agreed at our meeting on 2 December.

You acknowledged our concern. However, I gather that the line taken by your officials at the most recent official meeting on 2 February continued to assume that there had been Ministerial agreement (a) that the maximum resources for any new forestry grant scheme should be limited to £10m and (b) that a new scheme should give greater weight to environmental objectives, encouraging in particular smaller scale planting, particularly of broadleaves at the expense of large scale planting of conifers.

It does therefore seem to John, Peter and I that we should clarify what was agreed at the meeting on 2 December. In our view, the point on which we reached general agreement was that the existing tax regime was objectionable in principle and should be scrapped. Consideration of a grant regime to replace it was to be based on a detailed assessment of what would be required to maintain the Government's existing objectives for the extent and balance of forestry planting. We agreed that the objective should be to contain the cost of the new grant scheme within the amount that will be saved from changing the present tax regime. There was certainly no agreement that new environmental objectives radically altering the Government's planting objectives should be introduced.

The task of the official committee is therefore, in our view, to prepare for collective consideration a new grant scheme for encouraging forestry which will aim to achieve the planting objectives we announced only a few months before and will not attempt to change to any material extent the location, nature or extent of new planting, whether for environmental or any other reasons. It will of course be open to the official committee to spell out what the financial and other consequences of proceeding on this basis are.

We would be glad if you could confirm that this is how the committee should be proceeding.

I am copying this letter to John MacGregor and Peter Walker.

Yours ever,

Malcolm

MALCOLM RIFKIND

45/B.rj.2188/010

SECRET AND PERSONAL

FROM: N MONCK

DATE: 11 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Burgner
Mr Bonney
Mr Donovan
Mr M Hughes

Mr Beighton, IR

Ch/ Content?

AT 11/2

FORESTRY TAX REGIME

Mr Rifkind wrote to you on 10 February on behalf /behind of all the forestry Ministers. He makes two points about what was agreed at the meeting at No 10 on 2 December and hence about the work of officials now going on. First, he is trying to argue that there was no agreement that the maximum extra public expenditure on forestry grants should be limited to £10 million a year, though he does accept that there was agreement on the objective of containing the cost within the Revenue savings from changing the tax regime. Secondly, he says that there was no agreement that new environmental objectives radically altering the Government's aim for new forestry planting should be introduced.

2. I attach a draft reply which should be copied to Mr Ridley, along with Mr Rifkind's own letter. It would be helpful if a letter on these lines could go off as soon as possible in advance of the next meeting of the official group next Wednesday. As well as dealing with Mr Rifkind's points, the draft takes the opportunity to get away from the idea of a consultative document and move towards an early firm announcement.

NM

N MONCK

DRAFT LETTER FOR THE CHANCELLOR TO SEND TO MR RIFKIND

Thank you for your letter of 10 February (which I have copied to Nicholas Ridley).

2. You raised two questions about what we agreed at the No 10 meeting on 2 December and about the official work which is now going on.

3. First you questioned whether there had been Ministerial agreement that the maximum resources (ie additional public expenditure) for any new forestry grant scheme should be limited to £10 million, though I am glad that you recognise our agreement to contain the extra cost within the amount that will be saved from changing the present method of support. As you know, £10 million is the published figure for the cost of the current tax treatment; and it was accepted as an upper estimate of the tax costs of the private forestry programme in the ALURE context a year ago. I do not recall any dispute on 2 December about my offer to spend £10 million on raising grants and the record, which I know you have not seen, says there was agreement "that the savings of £10 million a year should be used to increase grants and this too could be announced ...". Your officials have, however, now put forward alternative figures, which mine have not accepted and I think we should now wait to see where our officials get to.

4. Secondly, you say there was "certainly no agreement to new environmental objectives radically altering" the Government's planting aim announced a year ago. I agree that radical change is not at issue. But I do think

and I am sure Nicholas Ridley agrees - that we want the package and its presentation to be publicly recognised as an improvement by moderate and realistic environmental interests. I know you will want to stress continuity in order to minimise the risks for aggregate planting but if there is too much stress on that, the environmental support, which I judge we need politically, will not be forthcoming. It is a question of getting the balance right. I attach great importance to the work officials have in hand on this.

5. I understand that Forestry Commission officials would like the new grants to be introduced not later than a month after the announcement of the change of regime. I would be attracted by avoiding a period of external consultation which is likely to be of little value though it will offer plenty of scope for lobbying. Now that I have agreed to your request that the Chairman of the Forestry Commission can be consulted before the main announcement, I hope we can get the new grants formally agreed and announced very rapidly after it.

6. I am sending copies of this letter to John MacGregor, Peter Walker and to Nicholas Ridley.

[N L]

42/2.BTW.1234/27

SECRET and PERSONAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 11 February 1988

Ch/ Draft reply behind. AS 11/2

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Scholar
Mr Beighton IR

PSF ask Mr Monck to beef up re environmental para of the draft letter. The 'environmental' improvements are an important selling point, tho' I agree that CST won't want to concede any pressure about it. NL

FORESTRY TAX REGIME

I have seen Malcolm Rifkind's letter of 10 February. - behind

2. I think we would be missing a major trick if we did not simultaneously remove an objectionable tax shelter and do something to stop this environmental disaster. Those dreadful monotonous conifers are made even more offensive by the fact that they represent the sheltered income of highly-paid pop stars. Good stuff!

3. The Forestry Package has two <u>equally important</u> objectives:

(i) Tax reform;

(ii) Increasing the attraction of broadleaved trees relative to conifers.

4. If we cannot maintain (within the agreed £10 million cost ceiling) the recently announced aim of planting 33,000 hectares per annum, without jettisoning objective (ii), then I think we should reduce the planting aim.

5. Indeed, I had always hoped that one result of this package would turn out to be that fewer trees in total would be planted!

NL

NORMAN LAMONT

SECRET and PERSONAL

001/3293
PHS/37/2

SECRET AND PERSONAL

FROM: **FINANCIAL SECRETARY**
DATE: **12 February 1988**

CHANCELLOR

cc:
Chief Secretary
Sir Peter Middleton
Mr Monck
Mr Bonney
Mr Burgner
Mr Marshall - IR
PS/IR

CH/

I agree with Prof Mackay. But the tax policy we have agreed will bring the existing element to a full stop (since its essentially the shelter of other income) & the minimal grants (unfortunately) necessary as a result of our 'Alness' pledge. N.

FORESTRY

I do think that we are not being tough enough even now on the forestry issue.

The Council for the Protection of Rural England came in to see me today. Professor Mackay of whisky fame was there and in my view gave a devastating critique of forestry policy. I pressed him hard on the "aid to rural economies" argument for forestry. He made these points:-

(a) We are talking about incremental employment from increased planting - it will be miniscule.

(b) Afforestation sometimes destroys rural jobs (e.g. hill farmers).

(c) Employment in forestry is declining but employment is increasing in rural areas.

(d) The cost per job is high. The Highland and Islands Development Corporation is a cheaper way of creating jobs in remote areas.

(e) Some of the areas have tourist potential which is greater without forestry.

(g) As for the "imports" argument, we import about 90 per cent of our wood and always will. Covering the whole country in forests would make little difference but would be an environmental disaster.

(h) As Scotland becomes more afforested forestry will spread more and more to England (Yorkshire and Derbyshire). There will be an outcry against this.

He referred to the Island of Mull which was being covered in trees by the Genesis Pop Group and the wild life driven out.

I asked him how Scottish public opinion saw the issue.He thought there were misconceptions about forestry and its importance to the rural economy. That was undeniable. But opinion was moving against forestry fast. I believe this is so.

I cannot think why Malcolm Rifkind is so bent on destroying vast areas of Sutherland such as the "Flow Country".

Of course, we need more trees replacing former agriculture land. But there is no economic or social case whatsoever for the forestry policies being pursued in Scotland.

The CPRE have produced two in-depth studies of the case against foresty policy. There is plenty of ammunition!

g.n.

NORMAN LAMONT

45/B.rj.2188/011

SECRET AND PERSONAL

FROM: N MONCK
DATE: 12 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Burgner
Mr Bonney
Mr Donovan
Mr M Hughes

Mr Beighton, IR

Ch.
'X' below. After consulting Mr Monck, I told the Scottish Office as a courtesy that these pps. should go to Mr Ridley, too. Mr Rifkind apparently said "no, they are deliberately going only to forestry Ministers". He will, ∴, probably explode if we copy them to Mr Ridley now. Wd. you like to spk. to him first? JS

FORESTRY TAX REGIME

I attach a revised draft letter. The environmental paragraph is beefed up, as you asked, in the light of the Financial Secretary's minute. But my impression is that this subject is highly charged and fissilc. The fact that Mr Rifkind's Office is - absurdly - resisting having his letter copied to Mr Ridley is one indication of that. Whatever the merits of the case, I assume you do not want to have a time-consuming and possibly serious row at this juncture with the three forestry Ministers. Their position is irritatingly strong because of:

(a) the agreed announcement of the new planting aim a year ago as part of the ALURE package designed to mitigate the CAP reform; and

(b) the lack of any endorsement of a switch to better environmental benefits in the record of the Prime Minister's summing up.

I suggest that the revised draft is as far as you should go, as well as insisting on bringing Mr Ridley into the correspondence.

NM

N MONCK

Thanks.
Draft OK. Explain that I feel I have to copy to Mr R, since he was @ the PM's mtg on 2/12 @ wh. all this was agreed.
NL.

45/B.rj.2188/009

SECRET AND PERSONAL

Be type for Ch sig

~~DRAFT~~ LETTER FOR THE CHANCELLOR TO SEND TO MR RIFKIND

Thank you for your letter of 10 February.

2. You raised two questions about what we agreed at the No 10 meeting on 2 December and about the official work which is now going on.

3. First you questioned whether there had been Ministerial agreement that the maximum resources (ie additional public expenditure) for any new forestry grant scheme should be limited to £10 million, though I am glad that you recognise our agreement to contain the extra cost within the amount that will be saved from changing the present method of support. As you know, £10 million is the published figure for the cost of the current tax treatment; and it was accepted as an upper estimate of the tax costs of the private forestry programme in the ALURE context a year ago. I do not recall any dispute on 2 December about my offer to spend £10 million on raising grants and the record, which I know you have not seen, says there was agreement "that the savings of £10 million a year should be used to increase grants and this too could be announced ...". Your officials have, however, put forward alternative figures, which mine have not accepted and I think we should now wait to see where our officials get to.

4. Secondly, you say there was "certainly no agreement to new environmental objectives radically altering" the Government's planting aim announced a year ago. I agree that radical change is not at issue. But given the amount of criticism of the effects of existing policy and its

rationale, I am sure that it is politically essential for any package to be publicly recognised as an improvement by moderate and realistic environmental interests. I understand you will want to stress continuity in order to minimise the risks for aggregate planting but if there is too much stress on that, the support from moderate environtmentalists will not be forthcoming. You and other forestry Ministers have an interest in securing that too since it will otherwise be increasingly difficult politically to sustain the case for continuing anything like the present degree of Exchequer support. It is a question of getting the balance right. Nicholas Ridley clearly needs to take part in this, and I am therefore copying this as well as your own letter to him.

5. I understand that Forestry Commission officials would like the new grants to be introduced not later than a month after the announcement of the change of regime. I would be attracted by avoiding a period of external consultation which is likely to be of little value though it will offer plenty of scope for lobbying. Now that I have agreed to your request that the Chairman of the Forestry Commission can be consulted before the main announcement, I hope we can get the new grants formally agreed and announced very rapidly after it.

6. I am sending copies of this letter to John MacGregor, Peter Walker and to Nicholas Ridley.

[N L]

BANANAS NOT TREES?

42/2.BTW.1234/45

SECRET and PERSONAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY
DATE: 15 February 1988

CHANCELLOR

Players.

cc Chief Secretary
Sir P Middleton
Mr Monck
Mr Burgner
Mr Marshall IR

BANANAS NOT TREES?

No doubt you noticed that concern about Forestry policy has continued to mount in the media. I attach a copy of the article in yesterday's Observer Magazine.

2. Prince Charles is due to make a speech in the House of Lords on this on Wednesday. I also noticed that Hector Munro said that he was opposed to current forestry policy in Scotland. So opinion is perhaps beginning to change.

3. It does seem very wrong that the Forestry Commission should not be bound to make the same rate of return as nationalised industries. Perhaps what we ought to do is to dust down our plans for privatising the Forestry Commission.

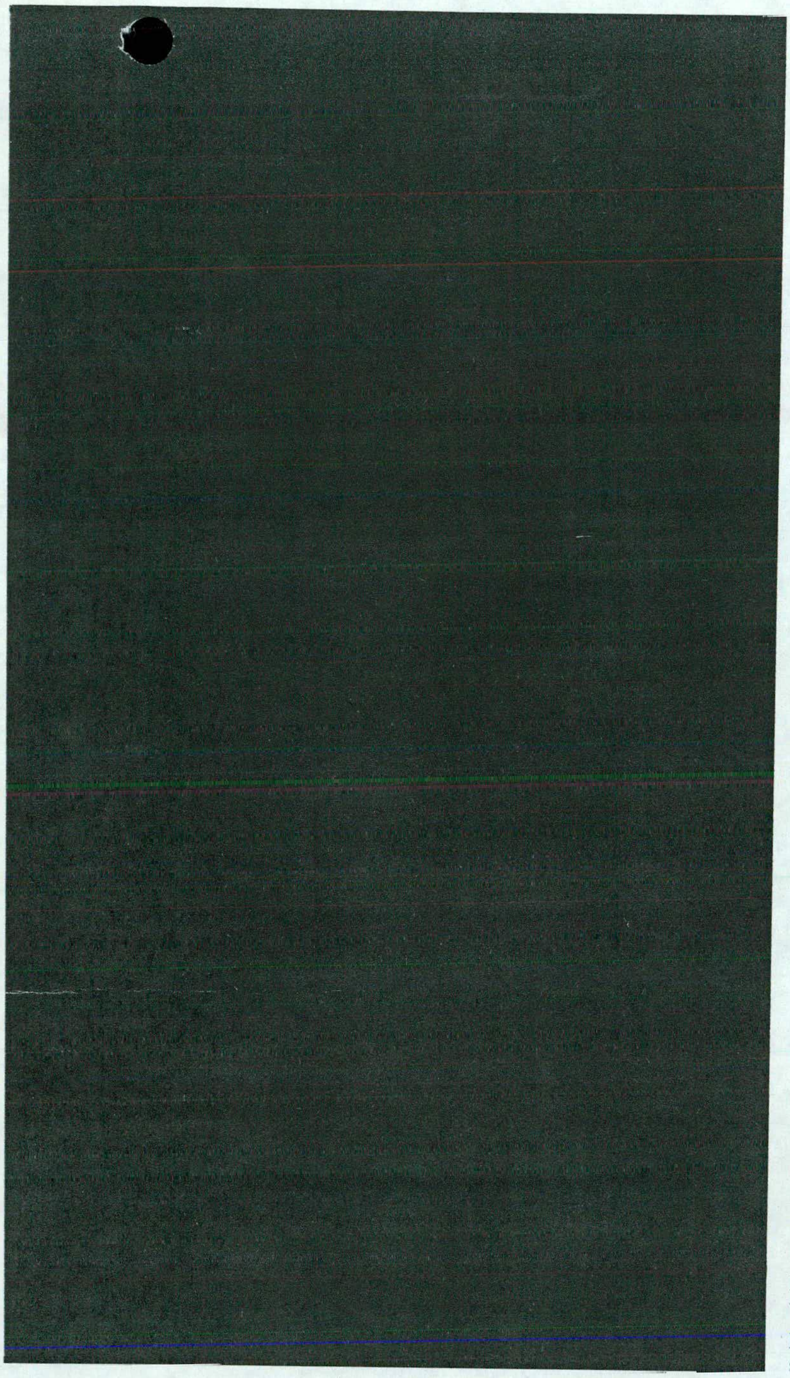
4. On a more satirical note, you may have spotted 'a modest proposal' from a leading conservationist to free ourselves from our invidious dependence on banana imports: set up a Banana Commission and get the taxpayer to foot 70% of the costs!

NL

NORMAN LAMONT

ENC

SECRET and PERSONAL



POP STARS, JUDGES, SPORTS CELEBRITIES, LEADING BUSINESSMEN and scores of Britain's wealthiest people are each year being given grants and tax relief amounting to tens of millions of pounds by the Government to destroy ne of the most magnificent areas of country.

They are taking advantage of a tax ak, twice censured by special liamentary investigations, which vides little benefit to the economy l is wrecking one of the most cious wildlife areas on earth.

After months of investigation *The Observer* is able to reveal a list of names. They include Cliff Richard, Genesis, the Thompson Twins and Charles Hodges (Chas, of Chas and Dave). Nick Faldo, the British Open champion, benefits richly, as does Alex 'Hurricane' Higgins and his wife Lyn. So, too, do Terry Wogan and Hammond Innes. Sir Frank Layfield, chairman of the Sizewell Inquiry, is one of a consortium utilising the tax break, while Baron Ackner, one of the Law Lords, has made tens of thousands of pounds with its aid.

Two leading conservationists – Dr Jean Balfour, for 10 years chairman of the Scottish Countryside Commission, and Timothy Colman, an ex-president of the Norfolk Naturalists' Trust – are major beneficiaries of the practice, even though it is condemned by most of Britain's leading conservationist bodies. Both are former leading lights of the Government's Nature Conservancy Council, which has been leading the battle to save the most vulnerable wildlife areas against the effects of the tax breaks.

One of the biggest recipients of this deluge of public money is Shirley Porter, leader of the Tory group on the Westminster City Council and a fierce critic of ill-considered public spending.

All these – and many more – have discovered that money truly can grow on trees. It is all perfectly legal, highly lucrative – and has helped to ensure that Britain is perhaps the only country in the world where environmentalists campaign *against* the planting of trees. Through grants and tax relief, the Government pays the wealthy up to three-quarters of the cost of establishing over bare landscape plantations of conifers – mainly sitka spruce – which obliterate its character and drive out important communities of wildlife.

The incentives are so weighted that it is not worth the while of ordinary, local farmers to plant the small woodlands that would improve their holdings, provide shelter for livestock, and win the approval of environmentalists. Instead they attract high earners who are planting 50,000 acres of blanket forests a year – a new generation of absentee landowners, some of whom may never have visited their plantations or even know where they are.

If it were not for this fiscal alchemy, which transforms bleak moors and rough hill grazing into highly desirable properties, far fewer of the vast forests would be planted – virtually none on poor ground. As it is, the incentives are so generous that increasingly they are driving forestry on to land which is particularly unsuitable for it but which is of unique value ecologically.

The latest – and most serious – incursion is into the Flow Country of Caithness and Sutherland, in the extreme north of Scotland. A haunting, open expanse of peat and pools, moss and rare flowers – home to a great assembly of scarce birds – it is the only area of its kind left in Europe. It is recognised by the international scientific community as being one of the world's outstanding ecosystems, as important as the Brazilian rainforest or Africa's Serengeti.

It is protected under no fewer than four international treaties, all of which Britain has signed. Nevertheless, it is disappearing astonishingly fast. William Wilkinson, chairman of the Nature Conservancy Council, calls it 'the most important single conservation issue of at least the last 30 years'.

Already one sixth of the Flow Country has been planted, and destroyed for ever – mostly in the past six years. Alex and Lyn Higgins, between them, have taken 1,140 acres of it. Timothy Colman, of the mustard family, has 790 acres, while Terry Wogan has two plantations totalling 1,251 acres. Lady Porter has planted two forestry estates together covering no less than 1,762 acres; while in 1981 she bought another 1,272 acres of land for

Some areas of Caithness and Sutherland have proved that they don't make good conifer coun

just over £30,000 – only to sell it on to a forestry company for double the price.

The incentives

The Government extols such private forestry. Less than 10 years ago the Forestry Commission, a Government department, planted almost 70 per cent of Britain's trees. But in 1981 ministers announced that private investors were to be given priority. Now private investors account for 80 per cent of all new planting – and of more than 90 per cent in the Flow Country.

The complicated system of grants and tax breaks has created a cash-generating machine funded largely by public money. That machine is primed by the Forestry Commission itself. If you plant conifers, the Commission will give you a grant of £100 for every acre. You also get free advice and help. But the machine starts running at speed only when it is fed with the rich fuel of tax relief.

Provided that you take the elementary precaution of opting for the right tax schedule (Schedule D), you can claim against tax just about all your expenditure in setting up and running your plantation. The only thing that is not tax-free is the cost of the land; but many investors take out special forestry loans to pay for the land, with interest-only payments – and the interest, too, can be offset against tax.

The more tax you pay, the bigger the incentive. A Scottish crofter pays so little that it is not worth his while to go in for tax-break forestry. But for people paying the top rate of 60 per cent it is very attractive.

So when, for example, Sir Austin Bide, honorary president of Glaxo Holdings, bought 532 acres of land at Stennieswater in the Scottish Borders for £158,000 last March, he was making a very sound investment indeed. cost of creating a forest on Sir Au plot is likely to be about £215,000 on paper, he will pay a total of £37 for the land and its development. E return hc will get a grant of £5 from the Forestry Commission (assuming he pays the top rate o £129,000 in tax relief – a total cost public purse of £182,000. So, on or another, about half of his fo investment will be at the cost c public.

Generous though this seems, investors do even better. Nick Fald example, stands to get back in t and grants 65 per cent of the)00 spent on establishing a forest is 365 acres of Easter Ross. ırly Timothy Colman should › 70 per cent of his costs in the Country. And Lady Porter, that ;e of wasteful public spending, will :n better out of the public purse. ıing again that she pays the top ıf tax, she should receive a cool)00 in tax relief and grants – just ıan 70 per cent of her investment – ı grateful nation for planting trees ; unique area.

the cost of the land is the only diture that cannot be set against ıere is a great incentive to go for ıeapest – and thus the poorest – But it is precisely this land which, th the Flow Country, is usually ;ically the most precious.

e money machine has further yet n, and many more goodies to v. For the trees, as they grow, are preciating asset and can be sold for ıt deal. Last summer Cliff Richard 2,677 acres of forest in Powys, ;, for close to £1 million. This, of e, is on top of the £660,000 he is ated to have received in grants and reaks. And he won't have had to apital gains tax on the trees, for sale, too, is tax-free.

1969, Baron Ackner bought 100 at Garwald Cairn in Eskdalemuir £2,054. After planting it with yers' help, he sold it to another e investor in 1983 for £66,000 – a per cent increase.

Jean Balfour has made a still more acular killing. In 1983, the year she retired as chairman of the ish Countryside Commission, she the Corlae Woodlands in :udbrightshire (part of an estate she bought with her husband for)00 and then planted) to the on fund of the W.H. Smith group. price was £761,000.

the people who planted the forests to hold on to them until they were l, the taxman would get them in the for under Schedule D they would to pay tax on the profit from the :r. This they generally avoid. ad, they sell the plantations, usually about 10 years, when the trees – a dense, dark, prickly thicket – are ı up to about £2,700 an acre. It is ıated that some end up with a n of up to 33.5 per cent a year on original investment – which means :he investment has almost doubled lue in two years. It is a remarkable ıf turning otherwise taxable income :ax-free capital.

ıe forests are bought by another group of speculators – who are entitled to yet another series of presents from the Chancellor. These investors – individuals and institutions such as pension funds and life assurance companies – buy £25-£40 million worth of plantations every year. They aim to keep the forests until they are ready for felling, and then sell the timber for a large profit. Again they avoid tax. The individuals opt for a different tax schedule (Schedule B), which means that they pay no tax on their timber sales. The institutions such as pension funds do not even have to do that; their profits are tax-free anyway.

Nobody knows how much all this costs the taxpayer, not even, it appears, the Treasury. But some rough estimates can be made. One way or another, the Forestry Commission appears to provide about £16 million a year to private investors. The tax relief to planters probably adds up to another £20 million every year. Then there is the tax saved by those who sell the timber.

Last summer Parliament's financial watchdog, the House of Commons Committee of Public Accounts, said it was 'concerned at the lack of up-to-date and reliable information' on the cost of the tax breaks.

It is also extraordinarily hard to find out who is getting the public money. There is no national register of forest owners and the Forestry Commission does not disclose the names of the people who buy its land, or the price they pay for it, without their permission, even to Parliament.

The only way that taxpayers can identify the beneficiaries of their largesse is to spend long, laborious days combing obscure public documents in the little-known Register of Sasines for Scotland and the Scottish Record Office. Even then the exercise can be carried out only for Scotland; there are no equivalent documents for England and Wales. *The Observer* spent months tracking down the details in this way.

Who benefits?

Besides the investors, two other groups are also doing extremely well out of the bonanza – the forestry companies and the people who sell the companies land.

There are four main forestry companies: the Economic Forestry Group, Fountain Forestry, Tillhill Forestry and the Scottish Woodland Owners (Commercial) Ltd. Between them they scout Britain from Cornwall to Caithness for places to plant trees, and have become adept at buying large chunks of likely-looking land, parcelling them up into 'forestry lots', and persuading wealthy tax-avoiders to buy them.

In practice, almost all the land is in Scotland, and almost all the investors come from England. For example, searches in the Scottish registers by the Royal Society for the Protection of Birds revealed that by December 1986, Fountain Forestry had bought more than 92,000 acres of the main Flow Country at an average of about £80 an acre. It had sold about a third of it (at four times the price) to 76 investors, 72 of them with English addresses.

'AT THAT time you were charged 86 per cent tax on earned income and 98 per cent on unearned. So it was worth while to get into trees. Basically I sold out to help house the children'


Baron Ackner

The forestry companies will also plant the saplings for the investors, manage the growing trees, arrange the sale of the forests to the second generation of speculators, and eventually fell the timber – all for a fee. But Stephen Tompkins, who sold land for the Economic Forestry Group until he became disillusioned and left for a job in conservation, says: 'New planting is the lifeblood of the afforestation companies and they are strident and ruthless advocates of planting all possible land.'

The companies find no shortage of sellers. Land sold for forestry can fetch at least six times as much as it is worth for grazing sheep. In 1985 the Islay Estate Company, which belongs to the family of Government minister Peter Morrison and Tory MP Charles Morrison, sold 1,600 acres of rough land in the north-east corner of Islay to the Economic Forestry Group for £265,000. The company promptly parcelled the land up into forestry lots and sold them – two to racehorse owner Terry Marsden.

In 1977 crofter Magnus Macdonald exercised his right to buy his croft on the Isle of Skye for 15 times his annual rent – a total of £1,855. After holding on to it for the statutory five years, he sold it for forestry to the family of racing-car designer Keith Duckworth for a cool £300,000.

The Al Fayed brothers, owners of Harrods, are also cashing in on the private forestry boom. Over the past four years, through the Ross Estates Company Ltd – one of their tangle of estates firms – they have sold more than 6,000 acres to Fountain Forestry. They have received almost £712,000 for the land, which is mostly in and around Easter Ross and south-east Sutherland.

Some of the Al Fayeds' land in Scotland is under crofting tenure and so cannot be sold without the consent of the crofters who work it. However, like a few other landlords, the Al Fayed brothers have managed to persuade the crofters to sell off 'common grazings' as forestry land and split the profit.

The vast amount of public money that fuels all this has twice been condemned by parliamentary inquiries. Back in 1980, when the private forestry boom was just accelerating, a report by the Public Accounts Committee called for early legislation to 'terminate the manipulation' of the system. Nothing was done. In 1986 an investigation by Parliament's National Audit Office concluded that the incentives for private planting could not be justified.

Naturally the foresters disagree. A newly formed lobby, the Forestry Industry Committee of Great Britain, calls the handouts 'an effective and worthwhile use of public sector resources' and, in the past, Timber Growers UK, which represents private forestry, has implied that the incentives should be even bigger. Fountain Forestry's marketing director, Barry Gamble, maintains: 'Forestry is one of the most unselfish investments you can make. You are investing for future generations.'

▶ 3

Kerr, Baron Ackner and many others have invested – is widely hailed as a 'showcase' and has won environmental awards. But it does irrevocably change the character of the landscape and its wildlife.

Just as Wordsworth inveighed against a plantation in the Lake District as 'a vegetable manufactory', so many modern country lovers have come to hate the dense green that now blankets once open countryside. The Forestry Commission has improved the landscaping of its plantations over recent decades, but private planting often still ignores aesthetics.

'LADY PORTER has been advised that it is much better for the environment of northern Scotland that trees should be planted than that it should be left as open moorland'

Lady Porter, via her secretary

The forests attract their own wildlife, as the industry never tires of repeating, but this is inevitably different from the life of the open country it replaces. The Royal Society for the Protection of Birds says: 'Broadly speaking, afforestation replaces the threatened and vulnerable with the commonplace and adaptable.' The Government's Countryside Commission and Nature Conservancy Council concur.

Much afforestation also leads to soil erosion, disrupts the flow of streams and rivers, loads them with silt, and increases the devastating effects of acid rain. In places these effects have led to dramatic declines in the salmon and trout that attract many visitors to the country's uplands. Though in years gone by the Forestry Commission has done a great deal to stimulate tourism and recreation in its forests, it has done little to provide facilities in the past decade. Private forestry has done even less.

The future

Outside the forestry industry – among conservationists and farmers, Government bodies and local councils – new ideas are emerging which still envisage forestry playing an important part in national life.

New forestry could be licensed, to make sure it takes place in areas where it will yield an adequate return, and grants and tax breaks could be tied to the licences. It could be encouraged on better, more productive land, away from ecologically important areas. It could be made to blend in with farming, with farm-scale woodlands which would improve the productivity of smallholdings. Incentives could be geared to supplement local incomes. And many more native broadleaved species of tree could be grown. All this is a million miles away from the forestry which obliterates hill farms, sweeps on to fragile wildlife areas, causes foreign conifers to proliferate in dense alien plantations, and enriches the wealthy absentee landowner.

The Government has begun, almost imperceptibly, to move in this direction, with a farm woodland scheme launched last year. But it has shied away from the wholesale reform that is needed.

Before the election Nicholas Ridley, the Environment Secretary, pressed in a secret Cabinet committee, chaired by the Prime Minister, for a 'fundamental review' of 'Government assistance to forestry', according to the minutes seen by *The Observer*. He won important support. But the committee decided not to proceed; the review was shelved.

Why? Did the Cabinet take fright at the idea, just before the election, of revealing the extent of the tax benefits? Did they fear their own wealthy supporters would rebel? Or were they, perhaps, wary of offending such truly powerful figures as Terry Wogan? Nigel Lawson now has proposals before him to reform the tax system in next month's budget. Will he be braver? *m*

Unfortunately, the evidence strongly suggests [illegible]at only the wealthy specul[illegible] the landowners who sell for forestry and the companies themselves really benefit. The national economy gains little or nothing, and irreplaceable environmental riches are destroyed.

Paradoxically for such a personal gold mine, forestry seems to be an economic black hole. Since 1946, some £2,058 million of taxpayers' money has been spent to produce a forestry estate worth only £1,452 million (all figures at 1984-5 prices). Even now, forestry cannot hope to reach the normal targets set for public investment.

Normally, public money is not invested unless it can achieve a rate of return of at least 5 per cent a year. The industry itself admits that 'very little forestry indeed' can hope to realise this. In 1972 the Forestry Commission was given a special dispensation and set a target of only 3 per cent. Since then it has been struggling to meet even this, failing altogether between 1977 and 1982.

The Commission's new planting is, on average, expected to achieve only 2.25 per cent a year – and its planting in the north of Scotland, nearly half the work planned for the next three years, is expected to yield only 1.25 per cent. In areas such as the Flow Country, where trees will almost certainly have to be felled early before they are blown down by the local gales, returns could be only 0.5 per cent a year (a *tenth* of the Government's normal target).

Private forestry can expect to achieve much the same rates of return, yet the Government continues to pour out subsidies to new plantations, whether their prospects are good, bad or appalling.

Ancient history

There has to be a reason why the Government so blatantly ignores its own economic philosophy. There is. It is to make sure we win the First World War.

Britain's forestry policy was established when the nation found its mines short of timber for pit props in wartime. Thirty years ago ministers belatedly realised that nuclear weapons had made this unnecessary, and the 'strategic' objective was jettisoned. But the policy did not change, and the amount of land under trees has since doubled. Meanwhile, the public have been treated to a series of new justifications to persuade it to part with its money.

One is import-saving. Britain imports over 90 per cent of its timber and forest products at an annual cost, according to the industry, of more than £4,500 million. Therefore, the argument runs, we must grow much more at home, and the public subsidies 'represent good value for money'. This, too, ignores fundamental economic principles. There is no point in pouring public money into producing something at home that can be bought more cheaply overseas. The cash saved by buying from abroad could be put to better use elsewhere in the economy.

Sir Gordon Downey, Parliament's Comptroller and Auditor General, says drily that the import-saving argument 'could be applied to any industry in the country'. Conservationist Stephen Tompkins puts it more colourfully. 'Britain,' he points out, 'is 100 per cent dependent on imports for bananas. If the taxpayer met 70 per cent of the costs, we would be able to grow bananas here. We could even have a Banana Commission. But whether it would be in the national interest is another matter.'

So the industry falls back on another argument, that forestry creates jobs in remote rural areas. To a certain extent this is true, but the record is not particularly impressive.

The numbers of jobs in forestry have actually fallen as new labour-saving techniques have been introduced. For instance, between 1971 and 1985 the number of jobs in the Scottish Borders declined, though the area under trees increased.

Though forestry does provide more jobs than the farming it replaces, the work is much more irregular. A small amount of work is created during planting, but there is very little to do for the 20 to 40 years while the trees are growing, until the main burst of employment at harvesting. This boom-and-bust cycle is likely to disrupt fragile, local communities. If workers are brought in from outside to help during the busiest periods, then the communities will benefit little.

Furthermore, forestry jobs are expensive to create, and the money could be better used in generating other work, according to expert investigations. The National Audit Office estimates, conservatively, that they cost twice as much as agricultural jobs in the north of Scotland.

Meanwhile severe damage is done to the environment, which in turn may damage tourism, one of the greatest sources of employment of all. Not all forestry has as dire results as in the Flow Country. The Eskdalemuir afforestation in the Borders – in which Sir Austin Bide, Sir Frank Layfield, Lord Justice Kerr, Baron Ackner and many others have invested – is widely hailed as a 'showcase' and has won environmental awards. But it does irrevocably change the character of the landscape and its wildlife.

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BUDGET SECRET - TASK FORCE LIST

FROM: N MONCK
DATE: 22 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Burgner
Mr Culpin
Mr Hudson
Mr Call

Mr Beighton) IR
Mr Marshall)

I wd like a [illegible] mtg with Mr Monck (FST [illegible]) on [illegible] 18, [illegible] attached paper, together with my own proposals [illegible] circulate [illegible] with colleagues (no officials) [illegible] by an informal [illegible] with [illegible] I agree with [illegible] para 12: I wd prefer a [illegible] announcement of grants [illegible] after the Budget. NL.

Ch. Points for (immediate) decision in para 18 22/2 FE

PS. I [illegible] also [illegible]

FORESTRY

I attach a paper on the agreed and disagreed points on forestry. It has been broadly agreed with the forestry and agriculture departments, at the cost of some repetitious drafting by them, and with Environment. There are still some gaps and some amendment will be needed, but as time is short I am submitting the paper in this form now. You will need an early meeting with the other Ministers and the paper is designed as an agreed basis for resolving the disagreements.

2. The size, cost and structure of the grant increases are the main outstanding points for decisions. The key issue is whether the grant increase matches the estimated <u>average</u> value of the present tax regime (about £350 per hectare), as opposed to the value to the 60 per cent taxpayer (£500). I think that would be very hard for you to defend. But forestry Ministers will claim that anything less will not deliver the planting aim. They are milking this for all it is worth or more. There are second order decisions on the scope and length of the transitional tax arrangements. We and the Revenue think you can make concessions on the transitional arrangements. But there is limited room for manoeuvre on grants.

3. If you have a meeting, you will need to decide whether to circulate the paper with a substantive covering note setting out your own provision or without that. Later paragraphs contain advice on the options, but first I should mention some points the paper is silent on.

Important points not in the paper

4. The paper naturally says nothing about change in **higher rates** of tax and, despite all the press stories, the forestry departments have not so far raised this, eg the likely complaints about the reduced value of tax relief under the transitional tax arrangements (see para 27 to 31 of the paper) by people who planted or are committed to incur costs before the tax change. More important, they assume that there will be something of a rush to take advantage of the tax transition (despite their support for making the grant increase match the value of tax relief for a 60 per cent taxpayer). This makes them overvalue their proposals on the scope and length of the transition, which is convenient in negotiating terms. On the other hand forestry Ministers may not realise how generous the grant levels they are backing and you have offered are. The Inland Revenue estimate that the average marginal tax rate for foresters will be reduced from 42 per cent now to 33 per cent after the Budget. Although tempting, this point would not cut much ice with forestry Ministers because it does not help with the planting aim.

5. The paper does not quote **year by year public expenditure** costs of the different grant increases over the 1988 PES period. This is partly because it is less misleading to make comparisons of different levels of subsidy on a long run "steady state" basis (see para 18 of the paper) than at an early stage of the build up. The extra public expenditure of the Forestry Commission proposal does not reach £10 million until 1992/1993 though it is of course on a rising trend towards the steady state increase of £18 million a year. Forestry Ministers will argue that this should be acceptable to you, although you originally proposed a grant increase of about £350, not £500.

6. We will brief you with some good arguments in favour of a grant increase of £350 per hectare. But I cannot pretend that any of us really knows whether or not it would eventually deliver the 1987 planting aim, after any pause that the change of regime may cause. (The same goes for the possibility of capital losses on existing woodland triggered by loss of tax relief on costs, eg by those who will for various reasons not be eligible for increased grants.) And there is one point that the Forestry Commission could have made more of - **the treatment of land costs,** which can be important for the estimates underlying the paper. We have followed the Forestry Commission approach of assuming that land is sold for the same real price as its initial cost. The private sector and consultants seem to use a different approach, allowing for the cost of borrowing which would produce higher costs, higher tax relief and hence point to higher grants. But following the Forestry Commission in this seems defensible. We have no reliable data on the importance of borrowing costs for forestry, but the available evidence

from the Revenue and other sources suggests they are not very significant. Moreover, we have not allowed for continuation of the downward trend in forestry costs after 1987/88; the switch to grants from tax relief will tend to reduce or delay expenditure in future; and land prices are likely to fall. Nevertheless we thought it right to mention this.

7. The paper does not deal with the problem on the **Farm Woodlands Scheme (FWS).** It has just emerged that MAFF dislike the effect of the new regime on the FWS which has been assumed to offer existing forestry grant levels. A separate note on this will follow quickly. The effective choices will be between doing nothing, which we are arguing for, and a smaller grant increase, which MAFF favour.

Objectives

8. Your objectives will presumably be to refuse to increase grants by an amount equal or close to the current value of the tax regime to the top rate taxpayer, and to get the lowest negotiable public expenditure cost and grant increase (except that you might be prepared to pay a little more if that would buy a better environmental outcome).

Level and structure of grants; and the transitional tax treatment

9. Tables 3-4 in paras 19 and 20 of the paper set out some options on grant levels, with figures for the long term steady state costs. You will see that, with new (higher) level of planting costs, a flat rate grant increase of about £350 per hectare (close to your original figure in November) corresponds to the value of the present tax regime on the Inland Revenue's estimate of the current average marginal tax rate. To the extent you go higher, you would probably be making the new regime more costly than now (though there is some margin of uncertainty round the Revenue estimate) and of course even more generous in relation to post-Budget tax rates.

10. You could argue strongly for £350 on these grounds; plus the very rapid rise of new planting with the present levels of subsidy, and the small difference in the rate of return made by the lower grant. Anything higher would be hard to present to everyone except the forestry interests and would conflict with the objective of keeping the public expenditure cost within the (pre-Budget) tax savings (see Mr Rifkind's letter of 10 February). It would also conflict with treating the public expenditure increases as tightly linked to tax changes and hence quite different from the NHS.

11. You could then move to the structure (paragraphs 24-26 of the paper), saying that level and structure/environmental benefits need to be taken together. If

they move on the latter you might move the grant increase to £375. This would still be presentable as maintaining the present average level of incentives or subsidies. You could also offer to give way on the two points on the tax transition - allowing the pipeline applicants to qualify and adding one year to the length of the transition (keeping another in reserve for possible use after the announcement).

i.e. transitional arrangements for maintenance

12. Admitting the pipeline cases would be in line with what is proposed for Budget Starter 150 (paragraphs 20 to 22 of Mr Stewart's note of 17 February) - although in the forestry case it is not proposed to put a time limit on the period for approval of the applications. The Revenue stress the urgency of settling this point: in the meantime Parliamentary Counsel has been asked to draft on a contingency basis.

Environment

13. Para 5 and Annex A to the paper sets out how the environmental benefits can be presented. Mr Ridley is content with this but would also like to get some shift in the grant structure, in addition to the existing differential.

Announcement and presentation

14. Paras 7-9 deal with this. We have got as far as we can at official level. The Forestry Commission agree to aim for publication of the new grants with conditions and guidelines in the week after the Budget. Despite your agreement that the Chairman of the Commission should be consulted now, the Commission still want some freedom for other part-time Commissioners to fine tune the grants as well as the associated conditions and guidelines. The case for this does not seem compelling and you may want to press for even earlier announcement. In any case you will want agreement that a general description of the basis for the new grants and of the environmental benefits should be in the Budget speech. This might have the following elements:

(a) tax system will be simpler and no longer misused but there will be transitional tax arrangements;

(b) the overall [ie average] generosity of the new grants will be similar to the present remarkably generous regime. So existing forestry aims can be maintained;

(c) new regime will not discriminate in favour of top rate taxpayers;

(d) it will be better for the environment.

15. The hiatus between Budget speech and announcement of the new grants could be awkward, especially as Mr Walker has agreed to speak at the annual EFG lunch on the Thursday of Budget week. He will have to clear his speech and to include at least an agreed passage in it.

16. Both the Inland Revenue and the Forestry Commission will need to issue press notices on Budget Day after clearing the texts with each other (as well as us).

17. At some stage you will have to settle whether to let forestry Ministers take the strong line that the Government commitment to the planting aim is undiminished, that it believes the new regime will deliver the aim, and that if it does not a review of grant levels will be needed. We want to fudge it as suggested above. We would accept that grants will need to be reviewed but with no presumption that grants must be set at the level needed to deliver the planting aim.

Conclusion

18. You may want to discuss this. At this stage the questions you need to address are:

(a) if you agree to a meeting with colleagues (possibly preceded by bilaterals with Mr Ridley and perhaps Mr MacGregor), do you want to circulate your own proposals or would it be preferable simply to circulate the attached paper?

(b) do you intend to take the line in paras 9 to 12 above on the level and structure of grants and the transition;

(c) are you content with the proposal that the Forestry Commission should publish the new grants in the week after the Budget (with a fall back to the following Tuesday) or do you want the announcement earlier?

19. We will let you have a note on the Farm Woodlands Scheme as soon as possible.

20. I am sorry about the length of this minute and the paper: disagreement, complexity and the number of departments involved are among the causes.

NM

N MONCK

SUPPORT FOR FORESTRY

Note by Officials

At a meeting on 2 December at No 10 the Chancellor's proposal that forestry should be removed from the scope of both Income and Corporation Tax was agreed: costs would not be allowed against taxable income and income would not be taxed. In view of the Government's aim of encouraging new planting, he proposed that the £10 million a year that would eventually be saved should be used to increase grants; and that the increase could be targetted to get greater environmental benefit. It was agreed that the decision to increase grants could be announced in the Budget.

2. Forestry Ministers have since questioned whether they accepted that the maximum resources for any new forestry grant scheme should be limited to £10 million, though they accept that, subject to an assessment of what is needed to maintain the planting aim, the objective should be to contain the cost of the new grant scheme within the savings from the tax change. They have also questioned the extent of agreement on any changes for environmental reasons.

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4. Afforestation by the private sector, which collapsed in the mid-1970s from 20,000 hectares a year to only 7,000 hectares a year, has recovered since the 1980 statement of forestry policy gave the private sector the assurance it needed of the Government's support for expansion: planting reached 19,400 hectares in 1986/87 and an estimated 22,000 hectares in the current year. At this rate of increase the planting targets would have been achieved five years hence. But

The Forestry Commission budget for 1988/89 provides for a further increase to 28,600 hectares (see chart A), though this assumes an unchanged subsidy regime. Private sector planting and harvesting now provides 4,000 jobs, injects over £40 million a year into the upland economy and is expanding the economic potential of areas with few alternatives to sheep farming. Afforestation is mainly undertaken by investors drawing on tax relief to plant sizeable areas of sotfwoods that are most in demand. The recent large investments in paper mills, saw mills and board factories in Scotland, Wales and Northern England have demonstrated to investors that home grown wood can be sold against competition from imports into very large domestic markets. The main processing companies are all expanding their capacity to absorb the growing output from the country's forests.

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5. Departments have agreed that the text in Annex A can be used as a source for briefing or more formal statements. In part this makes use of existing policy or of changes that would have happened anyway. But there are also genuine new points:

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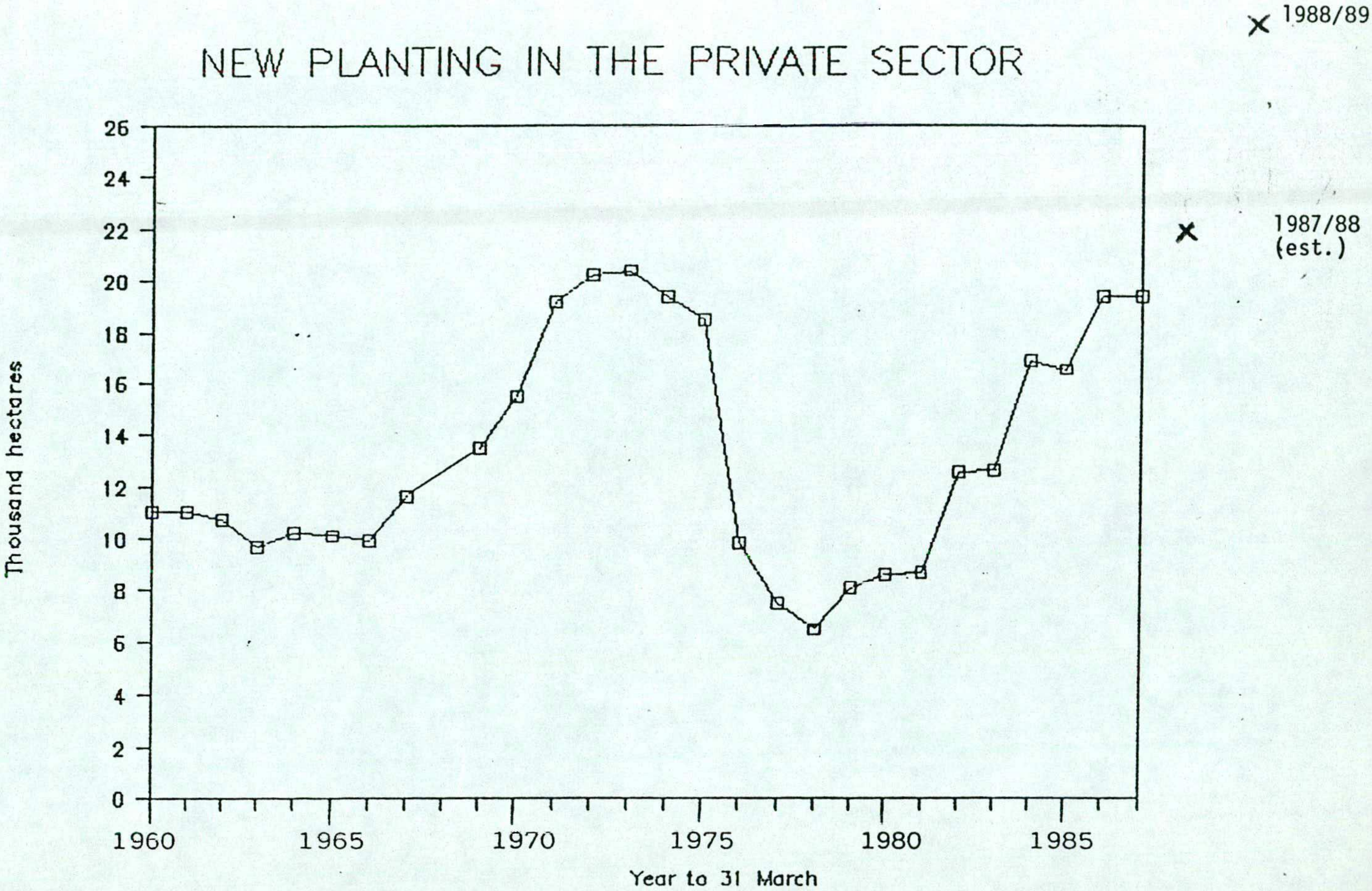
6. All this will be helpful, though it will not deal with possible objections (see paragraph 31) about the absence of tax relief after the end of the transitional period for maintenance expenditure in all woodlands, especially broadleaved, or about the separate subject of restoring woodlands after the storm damage in south east England.



The 1988/89 x is a Forestry Commission forecast
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Announcement of New Grant Scheme

7. Officials are agreed that any hiatus between the announcements of the tax changes and of the details of the new grants will be awkward and should be minimised. The grants are statutorily the responsibility of the Forestry Commissioners, including six part-timers other than the Chairman. The part-timers will need to be consulted after the Budget and will expect to play some part in settling the details of the scheme by having some flexibility for fine tuning the grant rates and guidelines, though the earlier involvement of the Chairman should speed this process. The agreed aim is that the Forestry Commissioners should publish the new grants and the conditions and guidelines for them together during the week after the Budget. If that were to prove impossible, the fallback would be publication not later than Tuesday, 29 March, before the Parliamentary recess begins, probably on Thursday, 31 March.

8. In order to achieve this, the Forestry Commission will prepare drafts of the conditions and guidelines in time for clearance by Ministers before the Budget subject to the fine tuning mentioned above.

9. To cover the period of hiatus, briefing notes will be prepared and agreed, which will among other things draw on Annex A. These will be needed not only to answer points raised in the Budget Debates, but also for such occasions as the annual lunch of the Economic Forestry Group (chaired by Lord Rees) on Thursday 17 March. The Secretary of State for Wales has agreed to be guest speaker, and the leaders of all sections of the forestry industry, as well as a number of Ministers, are traditionally present.

SECRET AND PERSONAL

II UNRESOLVED ISSUES AND OTHER POINTS

Grant Levels

10. This is a difficult issue for two reasons. First, there are a number of factual uncertainties about the size of tax losses associated with forestry which under the existing regime can be offset against other income. The figures used in this paper are based on average costs in forestry for the private sector derived from academic surveys commissioned by the Forestry Commission. It should be noted that some income survey data available to the Inland Revenue based on a small sample suggest that the forestry savings may overstate the tax cost of the present regime. The uncertainties apply both to the level of forestry costs and to their trend over time. Chart B on the following page illustrates the different approaches to the trend of costs over time. In recent years there has been on average a fairly sharp downward trend in costs. But the Forestry Commission do not believe that the 4 per cent annual reduction in real costs can be safely projected forward because the new requirement for planting broadleaves in upland forests and the more stringent environmental and landscaping conditions have raised costs.

11. Another important factual uncertainty is the average marginal tax rate to be assumed. There is no reliable data on the present shares of higher rate taxpayers, lower rate taxpayers and tax exempt funds in new planting. In December 1986 Forestry Commission suggested that it was reasonable to assume 60 per cent of planting was carried out by top rate taxpayers, 20 per cent by tax exempt institutions and 20 per cent by investors in small woodlands for whom the tax cost was half that for top rate taxpayers. This would imply an average marginal tax rate of 42 per cent. The Forestry Commission now suggest that 75 per cent of investment is by higher rate taxpayers. This is not inconsistent with a 42 per cent average marginal tax rate if, as seems likely, top rate taxpayers tend to hold the investment for a shorter time period. There will also be a number of higher rate taxpayers investing in forestry with marginal rates below 60 per cent; discretionary trusts, for example often invest in forestry (these have marginal tax rates of 45 per cent). All in all the Inland Revenue consider that 42 per cent is a reasonable estimate of the average marginal tax rate. The Forestry Commission have argued that a figure nearer 50 per cent would be more appropriate.

12. Secondly, departments differ in the weight they attach to different aims in deciding the new grant levels. The **forestry and agriculture departments** have emphasised that forestry Ministers attach considerable importance to achieving

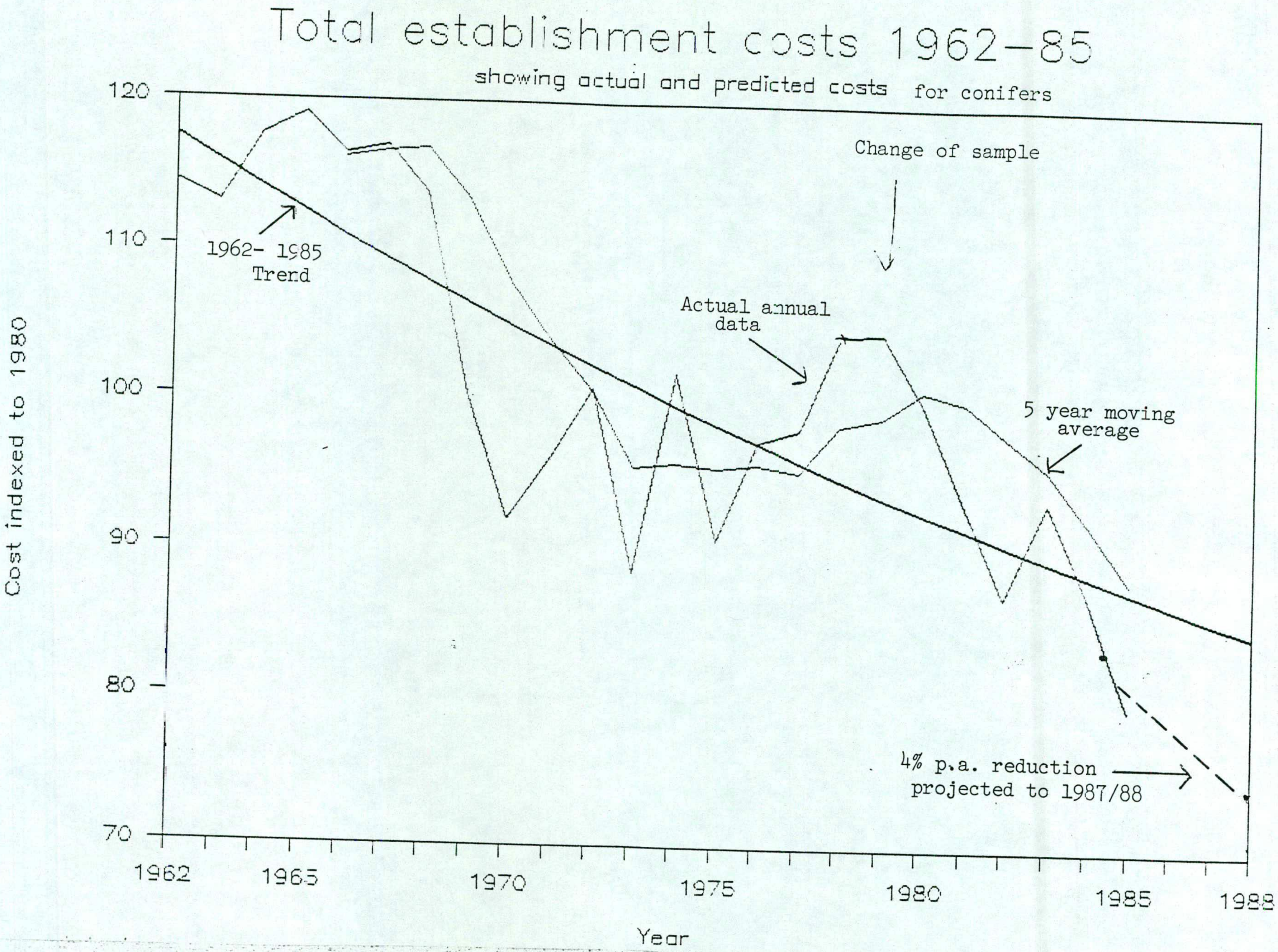
Total establishment costs 1962–85
showing actual and predicted costs for conifers
Change of sample
1962- 1985
Trend
Actual annual
data
5 year moving
average
4% p.a. reduction
projected to 1987/88
Cost indexed to 1980
120
110
100
90
80
70
1962
1965
1970
1975
1980
1985
1988
Year

CHART B

the planting aim of 33,000 hectares a year (29,000 private sector) of new woodlands, which was announced in February 1987 in the context of the ALURE measures. They consider that the progress towards this (detailed in para 4 above) will be jeopardised by the change in the mechanism of subsidy unless the incentives under the new regime can be presented as equivalent to the old incentives.

13. Given that confidence is maintained, forestry officials consider that planting under the new scheme should begin to build up after a delay of two or three years as happened with previous schemes. If, in the longer term, the rate of planting looked likely to overshoot the aim, the Forestry Commission's monitoring system would give warning in advance and the grants could be scaled down. They see no practical or political difficulty in that.

14. Forestry and agriculture officials consider that unless the grant level for conifer planting is set at a level which is broadly similar to the present grant and tax regime, that part of the programme which contributes some 90 per cent of all planting (ie large scale conifer planting), and is in the main carried out by high income earners, will be put at serious risk. Any reduction in the new grant for conifers below that level would, in the view of these departments, be certain to lead to loss of confidence and a real risk of a collapse because there would be little prospect of sustaining their interest of the majority of current planters nor of compensating for this by an influx of new interest by lower rate taxpayers or exempt funds. A serious decline in planting might however be avoided if the industry is persuaded that the Government remains committed to expansion. The level of the grants, particularly for planting conifers on an economic scale, is the tangible evidence of the Government's commitment. To maintain confidence forestry Ministers must be able to claim that the new grants offer as great a stimulus as the present regime. Their adequacy will be judged from the published survey of cost, which are known within the forestry industry and on which the Forestry Commission's proposals are based.

15. The **Department of the Environment** wants to ensure that the new regime delivers greater environmental benefits and would like the pattern of grants to be influenced by that aim. The **Treasury** has doubts about the value for money of the present level and pattern of support and, like the DOE, wants to ensure that the environmental benefits of the new package are recognised publicly by moderate environmental interests. It considers that the grant level for conifers should not be based on the current value of the present tax regime to a 60 per cent taxpayer and should, at most, be no higher than the present average value. The current steep rise in planting levels and the projection for 1988-89 which is close to the planting aim suggests that the present overall level of subsidies is more than adequate.

16. The Chancellor's paper of 4 November was based on forestry cost figures provided by the Commission in 1987, when the tax cost of raising the forestry planting aim was under discussion in the ALURE context. The discounted cost for a conifer plantation of over 10 hectares was then put by the Commission at £920. This excluded road building and management costs which the Commission now think should be included. After discussions of a range of figures, the Forestry Commission and the Treasury have compromised on a higher figure of the order of £1,510 for 1987/88. This allows for some continuation of the downward trend in costs up to that year but grant figures based on this compromise and the rate of return figures in table 4 effectively assume that no further reduction takes place in the future. However any cost reduction in future would be taken into account together with progress towards the planting aim and other factors when the grants are reviewed.

17. The Forestry Commission considers that the new grants should be equivalent to the value of the present tax regime to individuals with a 60 per cent marginal rate of tax who, they consider carry out 75 per cent of the planting. Forestry Ministers do not wish to see any material change in the location, nature and extent of new planting. This means a flat rate increase of £500 per hectare. The proposed and present rates are shown in table 1:

Table 1 — **Grants** — **£/hectare**

	Conifers		Broadleaved		
Hectares	**Present**	**Proposed by+ Forestry Com.**	**Present (FGS)**	**BWGS****	**Proposed by+ Forestry Com.**
0.25 - 0.9	630	1130	(890)	1200	1700
1.0 - 2.9	505	1000	(735)	1000	1500
3.0 - 9.9	420	920	(630)	800	1300
10 and over	240	740	(470)	600	1100

+ payable 70% in year 1, 20% in year 5, and 10% in year 10

** Forestry Grant Scheme (FGS) pays lower grants for broadleaved in mixed plantation.
Broadleaved Woodland Grant Scheme (BWGS) grants are paid for pure broadleaved

18. Grants at this level would raise the total Exchequer subsidy per hectare and hence the total cost for any given level of forestry planting, though there would be an opportunity to cut back during the period in which planting built up. This is because, as para 11 explains, the present average marginal tax rate is lower

than the top rate. Table 2 illustrates this by comparing the total long term annual cost in a "steady state" (ie on the assumption that the 1987 planting aim* has been steadily achieved for 10 years) under the present regime and under the new regime with grants at the level proposed by the Forestry Commission. The cost of the new supplement for planting on improved land (see Annex A, para 4) is included in the total.

Table 2

Steady State Total Annual Cost : £m

	Present Regime	**Regime Proposed by Forestry Commission**
Public expenditure grants	13	31
Tax cost (with average marginal tax rate at 42% and 50%)	11½-15	-
Total	24½-28	31

19. Table 3 illustrates a range of possibilities for the new grants, showing increases in grant and the corresponding steady state cost.

Table 3

Grant Increases and Annual Costs

	Increase in grant for 10ha of conifers	**Steady state total annual cost : £m**
Grant increase equivalent to tax relief with marginal rate+ of		
- 27p (basic rate)	£230	20
- 42p (Inland Revenue estimate of average marginal rate)	£350	25
- 45p (2nd higher rate and discretionary trust rate)	£375	26
- 50p (3rd higher rate and Forestry Commission view of average marginal rate)	£415	27
- 60p (top rate and Forestry Commission proposal)	£500	31

+ 1987/88 rates

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* The costing assumes, on Forestry Commission advice, that achievement of the private sector's contribution of 29,000 hectares to the national new planting aim of 33,000 hectares would in practice be accompanied by 5,000 hectares of replanting. So grants would be payable on 34,000 hectares planted or replanted by the private sector.

20. The rates of return under the new regime are compared with the present regime in table 4. It shows changes in both directions, though the diffences are not large:

Table 4

Estimated Real Rate of Return

	Present Regime	New Regime: with increase in grants per hectare of £230	£350	£375	£415	£500
27p taxpayer	3.8					
42p taxpayer	4.1					
45p taxpayer	4.2	3.8%	4.1%	4.2%	4.3%	4.4%
50p taxpayer	4.3					
60p taxpayer	4.4					

21. Ministers will wish to settle the grant increases from the options in table 3 in the light of the arguments in this section and tables 3-4, as well as the structural options (future increases for broadleaved or tapering conifer grants slightly for larger areas as suggested in the Chancellor's paper of 4 November) considered below.

22. The Treasury sees no case for any increase in the overall cost per hectare of present subsidies, ie at most an increaseof £350 per hectare; and would favour some reduction, especially if there is no change in the structure of grants. Any increase would be inconsistent with the collectively agreed objective of keeping the cost of the new grants within tax savings.

23. The Forestry Commission and agriculture departments are strongly of the view that any reduction in the value of grants, most particularly as they affect higher rate taxpayers, would have serious and eventually more costly effects in implementing the Government's aim. The Forestry Commission point out that the new unified scheme would deliver greater environmental effects through more small scale and broadleaved planting. This accounts for £2 million of the increase in costs. The Commission estimate that the supplement of planting on arable and improved grassland will produce savings in CAP support of some £2 million. The Treasury considers this measure is needed to validate the savings which have already been credited to the IBAP programme, and does not produce new savings. As planting will build up over several years, the annual additional public expenditure cost on the Commission's assumption about planting levels under the new grant scheme will not exceed even the lower estimate of the long term tax saving until 1994/95; but the additional annual cost will be on a rising trend for some years thereafter.

Structural options

24. At present the Forestry Commission's proposed grant scale in table 1 of paragraph 17 provides equal increases (of £500 per hectare) to planting grants for conifers under the FGS and to the grants for broadleaved under the BWGS in all size bands. The Forestry Commission believe that the availability under the new scheme of the higher broadleaved grant, based on the higher BWGS level, for all broadleaved planting will be sufficient, on the basis of recent trends, to raise the share of broadleaves in total planting from 10 per cent to 20 per cent. However since existing grants for conifers are smaller, the proportional increase in grant rates for them is larger. Forestry Ministers are agreed that no radical change should be made to the pattern of grants at this time; any further increase in grant rates for small scale or broadleaved planting at the expense of large scale conifer planting would result in a cut back of planting of softwoods for which there is an assured market. Ministers may nevertheless want to consider whether there would be benefit on environmental grounds in making changes to the grant structure, so as to give somewhat greater incentives for planting broadleaves where the size of individual plantations is normally much smaller (the great majority below 10 hectares). However there is no evidence that even higher grants for broadleaves are needed.

25. Another structural option, which could be considered either on its own or as a way of recouping the extra cost of increased incentives for broadleaf planting, would be to reduce the grants scale for conifers at the top end, eg for 40 hectares and above (the limit for the Farm Woodlands Scheme). Because so much new planting currently takes the form of large areas of conifer, the reduction in the increase for this size band would not need to be large to produce a worthwhile saving - for example a reduction in the grant from £740 per hectare to £700 for conifer applications for 40 hectares and above. The effect on the rate of return would be very small.

26. There is also a question on the timing of grant payments. Some further delay in the second or third payments (see footnote to table 1 in para 17) may need to be considered to prevent cumulative grants from exceeding cumulative costs at any point, since this could offer opportunities for fraud.

Transitional relief: scope and length

(a) Scope

27. Schedule B (under which the occupation of commercial woodlands is taxed) would be abolished with effect from the beginning of 1988/89. But Schedule D (which enables expenditure on commercial woodlands to be relieved against other income)

would continue to apply to occupiers of commercial woodlands until 5 April 1992, the end of a 4 year transitional period.

28. The transitional provisions are intended to cover not only those who are already occupiers of commercial woodlands but also those who before Budget Day are committed to becoming occupiers. Officials are agreed that those who have had applications and plans approved before Budget Day - even though the applicant may not yet be committed to the work prescribed and should be admitted in line with similar treatment accorded in the past. This would be on the footing that where such persons planted trees during the transitional period on the basis of such approvals they would only get the existing rates of grant plus tax relief. If they withdrew their applications and submitted fresh ones under the new scheme to get the benefit of the new grants they would be debarred from tax relief.

29. The Commission have urged that transitional tax relief should also be available to those who have submitted applications and plans before Budget Day which are still being processed. This might be criticised as being exceptional (unless, for example, there is written evidence of prior commitment). But the Commission

(a) attach importance to maintaining the momentum of planting in the change over - they reckon applications relating to some 25,000 hectares might be involved; and

(b) are concerned that the Government will otherwise be criticised for not approving applications on which the applicant has incurred expenses on plans and consultation.

A decision is needed on whether pipeline applications should qualify for the transitional provisions.

30. The Commission have just suggested that it would be a great help to owners in the South East faced with the heavy cost of clearance after the storm damage last October if clearance costs could qualify for the transitional tax provisions and if the period of transition were longer than 4 years. There has not been time to examine the practicality of this proposal. The Treasury notes that this is not seen as an alternative to the special grant which has been proposed to deal with storm damage.

(b) Length of transitional period

31. The Forestry Commission would like a longer transitional period than the 4 years proposed in the Treasury paper. Their preference is for a 6 year transition but

failing that 5 years. They argue that this would lead to less bunching of applications in 1988/89 and 1989/90 which they believe would be preferable on expenditure and on forestry management grounds. It would help owners faced with the heavy cost of clearance following the storm damage last October. It would also generally make for a smoother transition from one support basis to another. It may however increase the amount of new planting carried out under existing arrangments and hence the cost over the transitional period as a whole.

Maintenance Costs

32. The Forestry Commission have pointed to a criticism they expect to be made of the new regime. A present tax relief can be claimed for costs related to maintenance work as well as the initial planting costs for as long as the occupier is taxed under Schedule D. Landowners who would have continued with Schedule D for more than the assumed period of 10 years (as may happen in particular with owners of long-rotation broadleaved woodlands) will therefore under the new regime lose an element of tax relief on maintenance costs (averaging £30/ha per year) without any compensation, unless they are also engaged in felling and replanting. However it is not known how many owners are in this position and those who are will not lose the benefit of tax relief until the end of the transitional period. The problem would be alleviated to the extent that owners can be encouraged to adopt a pattern of management which involves some felling and replanting each year. It might be possible to alleviate the problem somewhat in the future by further extending the period over which planting grants are paid for broadleaves (currently 10 years for broadleaves compared with 5 years for conifers). But the Forestry Commission consider that this would reduce the value of the grant for planting at the same time as owners were being deprived of assistance with maintenance and lead to double criticism.

33. Farm Woodland Scheme - to follow

Questions for Decision

33. Decisions are needed on the following points:

(a) size and cost of grant increases: which of the options in table 3, para 19 should apply?

(b) structure of grants: should the grant increases be flat rate (as in table 1)? Or should there be a larger increase for broadleaved trees, or a smaller increase for larger conifer plantations, or both? Should the cost of any larger increase for broadleaved be additional to the cost of the answer to (a) or contained within it? Should the later grant payments be further delayed?

(c) **transitional tax provisions:** should the transitional availability of Schedule D be available for people who have submitted applications before 15 March which have not been approved? Should the transition last longer than 4 years, ie beyond April 1992?

[(d) FWS]

34. In addition, Ministers will want to note the agreed points on the presentation of environmental benefits (para 5 and Annex A); the timetable of the announcement of the new grants and the arrangements for briefing to cover the period of hiatus (paras 7-9).

23 February 1988

ANNEX A

ENVIRONMENTAL ASPECTS*

Environmental bodies have for some time expressed concern that large-scale forestry schemes might go ahead on an increasing scale with the benefit of tax relief but without being subject to the careful scrutiny and consultation procedures that would have been undertaken by the Forestry Commission if application had been made for planting grant. Now that government financial assistance for planting will be provided in the form of grant, that risk will disappear, because it is most unlikely that any sizeable scheme will go ahead unless the Forestry Commission has approved it for grant purposes. In considering applications relating to broadleaved woodland, the Commission will continue to observe the management guidelines published in 1985 after consultation; and guidelines on similar lines will be introduced for other types of woodland as part of the new scheme.

2. The existing Forestry Grant Scheme and the separate Broadleaved Woodland Grant Scheme will be replaced by a single scheme with objectives which, as recently recommended by the Countryside Commissions, explicitly recognise the multi-purpose nature of forestry, including enhancement of the landscape, creation of new wildlife habitats, and (in the long term) provision for recreation and sporting uses.

3. The new unified scheme will embody a substantial differential in grant rates in favour of planting of broadleaves which was introduced with the Broadleaved Woodland Grant Scheme. This incentive has resulted in substantial increases in new planting of broadleaves. This differential will continue to apply, to the one native conifer species, the Scots pine, when this is planted in its traditional habitats in Scotland. As already planned, the Forestry Commission will review the broadleaves policy at the end of this year, in the light of experience in the years since the Broadleaved Scheme was introduced in 1985. For both conifers and broadleaves, significantly higher rates of grant continue to be available for smaller areas of planting.

4. A new supplement will be introduced for planting on land which is at present arable or improved grassland (defined as grass reseeded within the last 10 years), and will provide an incentive for a greater proportion of afforestation to take place on better quality land outside the uplands, as a number of environmental bodies have advocated.

* This text has been agreed inter-departmentally as a source for briefing.

5. In order to implement the European Community Directive on Environmental Impact Assessment by July of this year, the Government have proposed that anyone putting forward a proposal for afforestation on a significant scale in an area which is subject to national designation on ecological grounds should normally be required to prepare an environmental assessment before the proposal is considered. It is proposed that the Forestry Commission should also exceptionally be able to require an environmental assessment outside designated areas where a proposal involves particularly sensitive and complex ecological factors. The final arrangments for implementing the Directive will be decided in the light of the comments submitted on these proposals.

6. In the case of contentious applications for grant, which are referred to the Forestry Commission's Regional Advisory Committees, the procedures have recently been modified to allow members of the public to make a greater input. Where objections to applications are maintained, cases will continue to be referred to Ministers before any grant is approved.

45/B.rj.2189/011

SECRET AND PERSONAL

Be type 'X' as final letter from me to David Crawley, Esq (PS S/S Scotland, + private address)

FROM: N MONCK
DATE: 26 February 1988

Ch./ This arrived too late to circulate on Friday. Content for me to write as drafted? 26/2

MR TAYLOR

cc Mr Burgner
Mr Bonney

Content.

FORESTRY

OFFICIALS' REPORT ON FORESTRY

I attach the final version of the officials' report for you to send round as a basis for the meeting the Chancellor is holding on Wednesday, 2 March. I suggest a covering private secretary letter to Mr Rifkind's office on the following lines:

X

1. "I attach a report by officials which will serve as a basis for the Chancellor's meeting at 10 am on Wednesday, 2 March.

2. The Chancellor proposes that the meeting should work through the questions for decision in the last but one paragraph of the report. He may then wish to raise aspects of the timing and content of the announcement.

MONCK 26/2

3. I am sending copies of this letter and the report to ~~the [private secretaries of the Secretary of State for Wales, the Secretary of State for the Environment and the Minister of Agriculture]~~ Jon Shortridge (Welsh Office) Deborah Lamb (Environment) and Shirley Stagg (MAFF)."

2. I have included the last ~~paragraph~~ sentence or 2 of the draft letter so that the Chancellor can raise such things as: the timing of the grant announcement (possibly foreshadowed by the Financial Secretary on the day after the Budget), the content and clearance of Mr Walker's speech, and perhaps the need to ensure that the Forestry Commission booklet is sufficiently "green" in tone.

5. The Chancellor asked this morning what tax motive could explain forestry activities by the exempt funds. The Revenue and we have no good answer to that question. We assume that pension funds do it partly because of the good match of long term assets with long term liabilities, as well as for diversification.

NM

N MONCK

SUPPORT FOR FORESTRY

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At a meeting on 2 December at No 10 the Chancellor's proposal that forestry should be removed from the scope of both Income and Corporation Tax was agreed: costs would not be allowed against taxable income and income would not be taxed. In view of the Government's aim of encouraging new planting, he proposed that the £10 million a year that would eventually be saved should be used to increase grants; and that the increase could be targetted to get greater environmental benefit. It was agreed that the decision to increase grants could be announced in the Budget.

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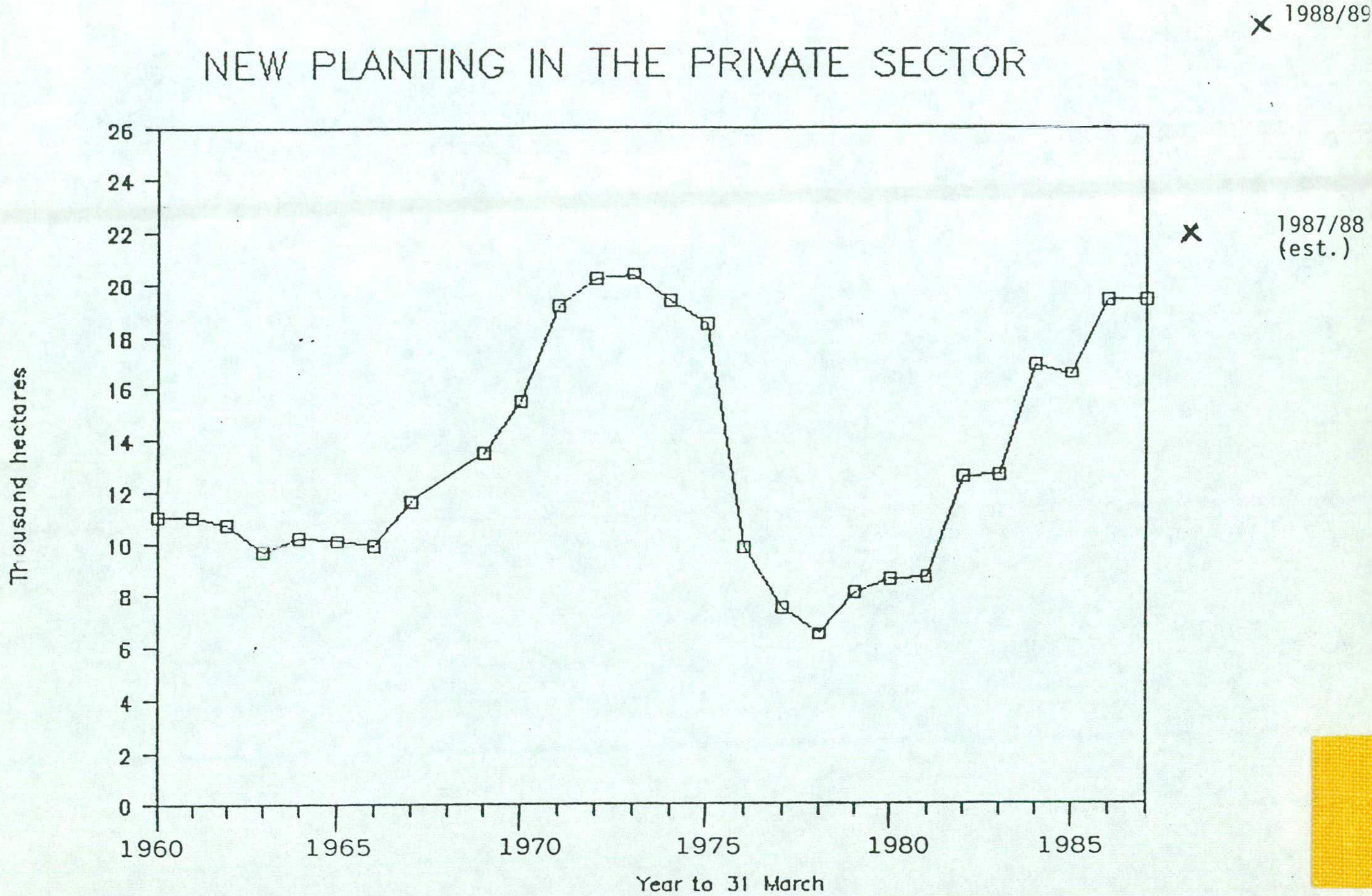

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assuming an unchanged subsidy regime

CHART A

Announcement of New Grant Scheme

7. Officials are agreed that any hiatus between the announcements of the tax changes and of the details of the new grants will be awkward and should be minimised. The grants are statutorily the responsibility of the Forestry Commissioners, including six part-timers other than the Chairman. The part-timers will need to be consulted after the Budget and will expect to play some part in settling the details of the scheme by having some flexibility for fine tuning the grant rates and guidelines, though the earlier involvement of the Chairman should speed this process. The agreed aim is that the Forestry Commissioners should publish the new grants and the conditions and guidelines for them together during the week after the Budget. If that were to prove impossible, the fallback would be publication not later than Tuesday, 29 March, before the Parliamentary recess begins, probably on Thursday, 31 March.

8. In order to achieve this, the Forestry Commission will prepare drafts of the conditions and guidelines in time for clearance by Ministers before the Budget subject to the fine tuning mentioned above.

9. To cover the period of hiatus, briefing notes will be prepared and agreed, which will among other things draw on Annex A. These will be needed not only to answer points raised in the Budget Debates, but also for such occasions as the annual lunch of the Economic Forestry Group (chaired by Lord Rees) on Thursday 17 March. The Secretary of State for Wales has agreed to be guest speaker, and the leaders of all sections of the forestry industry, as well as a number of Ministers, are traditionally present.

II UNRESOLVED ISSUES AND OTHER POINTS

Grant Levels

10. This is a difficult issue for two reasons. First, there are a number of factual uncertainties about the size of tax losses associated with forestry which under the existing regime can be offset against other income. The figures used in this paper are based on average costs in forestry for the private sector derived from independent surveys commissioned by the Forestry Commission. It should be noted that some income survey data available to the Inland Revenue based on a small sample suggest that the forestry savings may overstate the tax cost of the present regime. The uncertainties apply both to the level of forestry costs and to their trend over time. Chart B on the following page illustrates the different approaches to the trend of costs over time. In recent years there has been on average a fairly sharp downward trend in costs. But the Forestry Commission do not believe that the 4 per cent annual reduction in real costs can be safely projected forward because the new requirement for planting broadleaves in upland forests and the more stringent environmental and landscaping conditions have raised costs.

11. Another important factual uncertainty is the average marginal tax rate to be assumed. There is no reliable data on the present shares of higher rate taxpayers, lower rate taxpayers and tax exempt funds in new planting. In December 1986 Forestry Commission suggested that it was reasonable to assume 60 per cent of planting was carried out by top rate taxpayers, 20 per cent by tax exempt institutions and 20 per cent by investors in small woodlands for whom the tax cost was half that for top rate taxpayers. This would imply an average marginal tax rate of 42 per cent. The Forestry Commission consider that 75 per cent of investment is by higher rate taxpayers. This is not inconsistent with a 42 per cent average marginal tax rate if, as seems likely, top rate taxpayers tend to hold the investment for a shorter time period. There will also be a number of higher rate taxpayers investing in forestry with marginal rates below 60 per cent; discretionary trusts, for example often invest in forestry (these have marginal tax rates of 45 per cent). All in all the Inland Revenue consider that 42 per cent is a reasonable estimate of the average marginal tax rate. The Forestry Commission consider that a figure nearer 50 per cent would be more appropriate.

12. Secondly, departments differ in the weight they attach to different aims in deciding the new grant levels. The **forestry and agriculture departments** have emphasised that forestry Ministers attach considerable importance to achieving the planting aim of 33,000 hectares a year (29,000 private sector) of new woodlands,

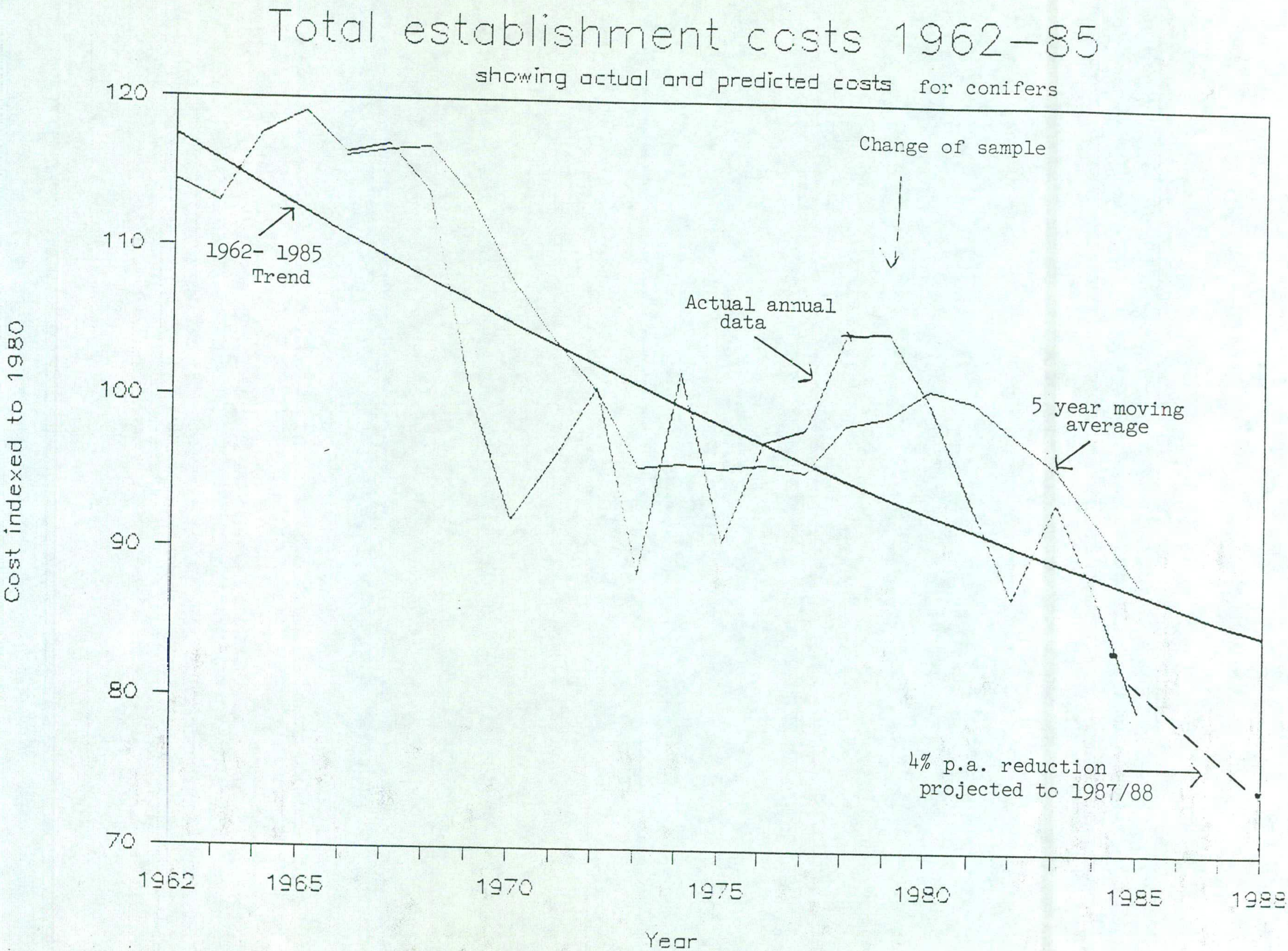

CHART B

CHART B

which was announced in February 1987 in the context of the ALURE measures. They consider that the progress towards this (detailed in para 4 above) will be jeopardised by the change in the mechanism of subsidy unless the incentives under the new regime are equivalent to the old incentives.

13. Given that confidence is maintained, forestry officials consider that planting under the new scheme should begin to build up after a delay of two or three years as happened with previous schemes. If, in the longer term, the rate of planting looked likely to overshoot the aim, the Forestry Commission's monitoring system would give warning in advance and the grants could be scaled down. They see no practical or political difficulty in that.

14. Forestry and agriculture officials consider that unless the grant level for conifer planting is set at a level which is broadly similar to the present grant and tax regime, that part of the programme which contributes some 90 per cent of all planting (ie large scale conifer planting), and is in the main carried out by high income earners, will be put at serious risk. Any reduction in the new grant for conifers below that level would, in the view of these departments, be certain to lead to loss of confidence and a real risk of a collapse because there would be little prospect of sustaining their interest of the majority of current planters nor of compensating for this by an influx of new interest by lower rate taxpayers or exempt funds. A serious decline in planting might however be avoided if the industry is persuaded that the Government remains committed to expansion. The level of the grants, particularly for planting conifers on an economic scale, is the only tangible evidence of this. To maintain confidence forestry Ministers must be able to claim that the new grants offer as great a stimulus as the present regime. Their adequacy will be judged from the published survey of cost, which are known within the forestry industry and on which the Forestry Commission's proposals are based.

15. The **Department of the Environment** wants to ensure that the new regime delivers greater environmental benefits and would like the pattern of grants to be influenced by that aim. The **Treasury** has doubts about the value for money of the present level and pattern of support and, like the DOE, wants to ensure that the environmental benefits of the new package are recognised publicly by moderate environmental interests. It considers that the grant level for conifers should not be based on the current value of the present tax regime to a 60 per cent taxpayer and should, at most, be no higher than the present average value. The current steep rise in planting levels and the projection for 1988-89 which is close to the planting aim suggests that the present overall level of subsidies is more than adequate.

16. The Chancellor's paper of 4 November was based on forestry cost figures provided by the Commission in 1987, when the tax cost of raising the forestry planting aim was under discussion in the ALURE context. The discounted cost for a conifer plantation of over 10 hectares was then put by the Commission at £920. This excluded road building and management costs which the Commission now think should be included. After discussions of a range of figures, the Forestry Commission and the Treasury have compromised on a higher figure of the order of £1,510 for 1987/88. This allows for some continuation of the downward trend in costs up to that year but grant figures based on this compromise and the rate of return figures in table 4 effectively assume that no further reduction takes place in the future. However any cost reduction in future would be taken into account together with progress towards the planting aim and other factors when the grants are reviewed.

17. The Forestry Commission considers that the new grants should be equivalent to the value of the present tax regime to individuals with a 60 per cent marginal rate of tax who, they consider carry out 75 per cent of the planting. Forestry Ministers do not wish to see any material change in the location, nature and extent of new planting. This means a flat rate increase of £500 per hectare. The proposed and present rates are shown in table 1:

Table 1

Include implied supplement

Grants
£/hectare

	Conifers			**Broadleaved**		
Hectares	**Present**		**Proposed by+ Forestry Com.**	**Present** (FGS)	**BWGS****	**Proposed by+ Forestry Com.**
0.25 - 0.9	630	980	1130	(890)	1200	1700
1.0 - 2.9	505	850	1000	(735)	1000	1500
3.0 - 9.9	420	770	920	(630)	800	1300
10 and over	240	670	740	(470)	600	1100

+ payable 70% in year 1, 20% in year 5, and 10% in year 10

** Forestry Grant Scheme (FGS) pays lower grants for broadleaved in mixed plantation.
Broadleaved Woodland Grant Scheme (BWGS) grants are paid for pure broadleaved

18. Grants at this level would raise the total Exchequer subsidy per hectare and hence the total cost for any given level of forestry planting, though there would be an opportunity to cut back during the period in which planting built up. This is because, as para 11 explains, the present <u>average</u> marginal tax rate is lower than the top rate. Table 2 illustrates this by comparing the total long term

annual cost in a "steady state" (ie on the assumption that the 1987 planting aim* has been steadily achieved for 10 years) under the present regime and under the new regime with grants at the level proposed by the Forestry Commission. The cost of the new supplement for planting on improved land (see Annex A, para 4) is included in the total.

Table 2

Steady State Total Annual Cost : £m

	Present Regime	**New Regime with grant increase proposed by Forestry Commission**
Public expenditure grants	13	31
Tax cost (with average marginal tax rate at 42% and 50%)	12-15	-
Total	25-28	31

19. Table 3 illustrates a range of possibilities for the new grants, showing increases in grant and the corresponding steady state cost.

Table 3

Grant Increases and Annual Costs

	Increase in grant for 10ha of conifers	**Steady state total annual cost : £m**
Grant increase equivalent to tax relief with marginal rate+ of		
- 27p (basic rate)	£230	22
- 42p (Inland Revenue estimate of average marginal rate)	£350	26
- 45p (2nd higher rate and discretionary trust rate)	£375	27
- 50p (3rd higher rate and Forestry Commission view of average marginal rate)	£415	28
- 60p (top rate and Forestry Commission proposal)	£500	31

+ 1987/88 rates

* The costing assumes, on Forestry Commission advice, that achievement of the private sector's contribution of 29,000 hectares to the national new planting aim of 33,000 hectares would in practice be accompanied by 5,000 hectares of replanting. So grants would be payable on 34,000 hectares planted or replanted by the private sector.

+ £415 equiv to 50 p rate relief

£ 460 " " 54 p "

Revised figures in Table 4
2nd March 1988

19A. Table 3A below shows the maximum area of new planting by the private sector which could be financed on various assumptions about the addition to grant rates and extra steady state public expenditure provision. It does not represent a forecast of actual planting under the grant rates suggested. The Government's current planting aim implies new planting by the private sector of 29,000 hectares a year.

Table 3A

Additional steady state expenditure	Maximum new planting by private sector which could be financed: 000's ha		
	Additional grant		
£ million	£230	£350	£500
8	28	23	18
10	31	25	20
12	34	28	22
14	38	31	25
16	41	33	27
18	44	36	29

20. The rates of return with different grant increases under the new regime are compared with the returns under the present regime in table 4. It shows changes in both directions, though the diffences are not large:

Table 4

Estimated Real Rate of Return

	Present Regime	New Regime: with increase in grants per hectare of £230	£350	£375	£415	£500
27p taxpayer	4.0					
42p taxpayer	4.2					
45p taxpayer	4.2	4.0%	4.2%	4.2%	4.3%	4.4%
50p taxpayer	4.3					
60p taxpayer	4.4					

21. Ministers will wish to settle the grant increases from the options in table 3 in the light of the arguments in this section and tables 3-4, as well as the structural options (future increases for broadleaved or tapering conifer grants slightly for larger areas as suggested in the Chancellor's paper of 4 November) considered below.

22. The Treasury sees no case for any increase in the overall cost per hectare of present subsidies, ie at most an increase of £350 per hectare; and would favour some reduction, especially if there is no change in the structure of grants. Any increase would be inconsistent with the collectively agreed objective of keeping the cost of the new grants within tax savings.

23. The Forestry Commission and agriculture departments are strongly of the view that any reduction in the value of grants, most particularly as they affect higher rate taxpayers, would have serious and eventually more costly effects in implementing the Government's aim. The Forestry Commission point out that the new unified scheme would deliver greater environmental effects through more small scale and broadleaved planting. This accounts for £2 million of the increase in costs. The Commission estimate that the supplement of planting on arable and improved grassland will produce savings in CAP support of some £2 million. The Treasury considers this measure is needed to validate the savings which have already been credited to the IBAP programme, and does not produce new savings. As planting will build up over several years, the annual additional public expenditure cost on the Commission's assumption about planting levels under the new grant scheme will not exceed even the lower estimate of the long term tax saving until 1994/95; but the additional annual cost will be on a rising trend for some years thereafter.

Structural options

24. At present the Forestry Commission's proposed grant scale in table 1 of paragraph 17 provides equal increases (of £500 per hectare) to planting grants for conifers under the FGS and to the grants for broadleaved under the BWGS in all size bands. The Forestry Commission believe that the availability under the new scheme of the higher broadleaved grant, based on the higher BWGS level, for all broadleaved planting will be sufficient, on the basis of recent trends, to raise the share of broadleaves in total planting from 10 per cent to 20 per cent. However since existing grants for conifers are smaller, the proportional increase in grant rates for them is larger. Forestry Ministers are agreed that no radical change should be made to the pattern of grants at this time; any further increase in grant rates for small scale or broadleaved planting at the expense of large scale conifer planting would result in a cut back of planting of softwoods for which there is an assured market. Ministers may nevertheless want to consider whether there would be benefit on environmental grounds in making changes to the grant structure, so as to give somewhat greater incentives for planting broadleaves where the size of individual plantations is normally much smaller (the great majority below 10 hectares). However there is no evidence that even higher grants for broadleaves are needed.

25. Another structural option, which could be considered either on its own or as a way of recouping the extra cost of increased incentives for broadleaf planting, would be to reduce the grants scale for conifers at the top end, eg for 40 hectares and above (the limit for the Farm Woodlands Scheme). Because so much new planting currently takes the form of large areas of conifer, the reduction in the increase for this size band would not need to be large to produce a worthwhile saving - for example a reduction in the grant from £740 per hectare to £700 for conifer applications for 40 hectares and above although there is no cost evidence for choosing this specific point. The effect on the rate of return would be very small.

26. There is also a question on the timing of grant payments. A slower build up of payments (see footnote to table 1 in para 17) may need to be considered to prevent cumulative grants from exceeding cumulative costs at any point, since this could offer opportunities for fraud.

Transitional relief: scope and length

(a) Scope

27. Schedule B (under which the occupation of commercial woodlands is taxed) would be abolished with effect from the beginning of 1988/89. But Schedule D (which enables expenditure on commercial woodlands to be relieved against other income) would continue to apply to occupiers of commercial woodlands until 5 April 1992, the end of a 4 year transitional period.

28. The transitional provisions are intended to cover not only those who are already occupiers of commercial woodlands but also those who before Budget Day are committed to becoming occupiers. Officials are agreed that those who have had applications and plans approved before Budget Day - even though the applicant may not yet be committed to the work prescribed and should be admitted in line with similar treatment accorded in the past. This would be on the footing that where such persons planted trees during the transitional period on the basis of such approvals they would only get the existing rates of grant plus tax relief. If they withdrew their applications and submitted fresh ones under the new scheme to get the benefit of the new grants they would be debarred from tax relief.

29. The Commission have urged that transitional tax relief should also be available to those who have submitted applications and plans before Budget Day which are still being processed. This might be criticised as being exceptional (unless, for example, there is written evidence of prior commitment). But the Commission

(a) attach importance to maintaining the momentum of planting in the change over - they reckon applications relating to some 25,000 hectares might be involved; and

(b) are concerned that the Government will otherwise be criticised for not approving applications on which the applicant has incurred expenses on plans and consultation.

A decision is needed on whether pipeline applications should qualify for the transitional provisions.

30. The Commission have just suggested that it would be a great help to owners in the South East faced with the heavy cost of clearance after the storm damage last October if clearance costs could qualify for the transitional tax provisions and if the period of transition were longer than 4 years. There has not been time to examine the practicality of this proposal. The Treasury notes that this is not seen as an alternative to the special grant which has been proposed to deal with storm damage.

(b) Length of transitional period

31. The Forestry Commission would like a longer transitional period than the 4 years proposed in the Treasury paper. Their preference is for a 6 year transition but failing that 5 years. They argue that this would lead to less bunching of applications in 1988/89 and 1989/90 which they believe would be preferable on expenditure and on forestry management grounds. It would help owners faced with the heavy cost of clearance following the storm damage last October. It would also generally make for a smoother transition from one support basis to another. It may however increase the amount of new planting carried out under existing arrangments and hence the cost over the transitional period as a whole.

Maintenance Costs

32. The Forestry Commission have pointed to a criticism they expect to be made of the new regime. A present tax relief can be claimed for costs related to maintenance work as well as the initial planting costs for as long as the occupier is taxed under Schedule D. Landowners who would have continued with Schedule D for more than the assumed period of 10 years (as may happen in particular with owners of long-rotation broadleaved woodlands) will therefore under the new regime lose an element of tax relief on maintenance costs (averaging £30/ha per year) without any compensation, unless they are also engaged in felling and replanting. However it is not known how many owners are in this position and those who are

will not lose the benefit of tax relief until the end of the transitional period. The problem would be alleviated to the extent that owners can be encouraged to adopt a pattern of management which involves some felling and replanting each year, although the Forestry Commission consider that this is unlikely to happen on any scale. It might be possible to alleviate the problem somewhat in the future by further extending the period over which planting grants are paid for broadleaves (currently 10 years for broadleaves compared with 5 years for conifers). But the Forestry Commission consider that this would reduce the value of the grant for planting at the same time as owners were being deprived of assistance with maintenance and lead to double criticism.

Farm Woodlands Scheme

33. The Farm Woodlands Scheme to be introduced under the Farmland and Rural Development Bill will provide for annual payments to be made by the agricultural departments to compensate for agricultural income foregone in conjunction with planting grants to farmers who plant trees on land which was previously in agricultural use. The level of annual payments proposed which has already been announced was calculated on the basis of current forestry grants and on the assumption that most farmers do not benefit significantly from the current forestry tax reliefs, although they are eligible to offset planting costs against profits arising on the remainder of their business. It is proposed that planting grants under the existing forestry schemes (FGS and BWGS) should continue to be available for participants in the Farm Woodlands Scheme. Planting costs incurred under the Farm Woodlands Scheme would no longer be eligible for tax relief under the new tax arrangements, income from farm woodlands which are planted on a commercial basis will in future be exempt from tax as will any planting grants but, as already announced, the annual income payments to farmers participating in the scheme will be taxed as income. Trees will continue to be effectively exempt from CGT.

34. This will lead to some worsening of the terms of the FWS. Annex B considers a number of possible options for dealing with this. The agriculture departments favour giving the same flat rate increase in planting grants of £500 per hectare as to traditional forestry (Option 5). The Treasury favour Option 6 which would involve no change to the present grant rates.

Questions for Decision

35. Decisions are needed on the following points:

(a) **size and cost of grant increases:** which of the options in table 3, para 19 should apply?

(b) **structure of grants:** should the grant increases be flat rate (as in table 1)? Or should there be a larger increase for broadleaved trees, or a smaller increase for larger conifer plantations, or both? Should the cost of any larger increase for broadleaved be additional to the cost of the answer to (a) or contained within it? Should the later grant payments be further delayed?

(c) **Farm Woodlands Scheme:** what changes, if any, are needed to the level of planting grants currently available?

(d) **transitional tax provisions:** should the transitional availability of Schedule D be available for people who have submitted applications before 15 March which have not been approved? Should the transition last longer than 4 years, ie beyond April 1992?

36. In addition, Ministers will want to note the agreed points on the presentation of environmental benefits (para 5 and Annex A); the timetable of the announcement of the new grants and the arrangements for briefing to cover the period of hiatus (paras 7-9).

26 February 1988

ANNEX A

ENVIRONMENTAL ASPECTS*

Environmental bodies have for some time expressed concern that large-scale forestry schemes might go ahead on an increasing scale with the benefit of tax relief but without being subject to the careful scrutiny and consultation procedures that would have been undertaken by the Forestry Commission if application had been made for planting grant. Now that government financial assistance for planting will be provided in the form of grant, that risk will disappear, because it is most unlikely that any sizeable scheme will go ahead unless the Forestry Commission has approved it for grant purposes. In considering applications relating to broadleaved woodland, the Commission will continue to observe the management guidelines published in 1985 after consultation; and guidelines on similar lines will be introduced for other types of woodland as part of the new scheme.

2. The existing Forestry Grant Scheme and the separate Broadleaved Woodland Grant Scheme will be replaced by a single scheme with objectives which, as recently recommended by the Countryside Commissions, explicitly recognise the multi-purpose nature of forestry, including enhancement of the landscape, creation of new wildlife habitats, and (in the long term) provision for recreation and sporting uses.

3. The new unified scheme will embody a substantial differential in grant rates in favour of planting of broadleaves which was introduced with the Broadleaved Woodland Grant Scheme. This incentive has resulted in substantial increases in new planting of broadleaves. This differential will continue to apply, to the one native conifer species, the Scots pine, when this is planted in its traditional habitats in Scotland. As already planned, the Forestry Commission will review the broadleaves policy at the end of this year, in the light of experience in the years since the Broadleaved Scheme was introduced in 1985. For both conifers and broadleaves, significantly higher rates of grant continue to be available for smaller areas of planting. At present lower grants are paid for broadleaves in mixed plantations and higher for pure broadleaves. Under the new scheme the enhanced, higher grants will be paid for all broadleaves.

ANNEX A

* This text has been agreed inter-departmentally as a source for briefing.

4. A new supplement will be introduced for planting on land which is at present arable or improved grassland (defined as grass reseeded within the last 10 years), and will provide an incentive for a greater proportion of afforestation to take place on better quality land outside the uplands, as a number of environmental bodies have advocated.

5. In order to implement the European Community Directive on Environmental Impact Assessment by July of this year, the Government have proposed that anyone putting forward a proposal for afforestation on a significant scale in an area which is subject to national designation on ecological grounds should normally be required to prepare an environmental assessment before the proposal is considered. It is proposed that the Forestry Commission should also exceptionally be able to require an environmental assessment outside designated areas where a proposal involves particularly sensitive and complex ecological factors. The final arrangments for implementing the Directive will be decided in the light of the comments submitted on these proposals.

6. In the case of contentious applications for grant, which are referred to the Forestry Commission's Regional Advisory Committees, the procedures have recently been modified to allow members of the public to make a greater input. Where objections to applications are maintained, cases will continue to be referred to Ministers before any grant is approved.

ANNEX B

FARM WOODLANDS SCHEME

1. The intention to introduce a Farm Woodlands Scheme (FWS) was announced in February 1987 as part of the Alure package. Its aim is to take land, particularly arable land and improved grassland, out of agricultural production. The scheme offers farmers who plant on such land:

(i) annual payments of £190 per hectare in the lowlands, £150 per hectare in the disadvantaged areas and £100 per hectare in the severely disadvantaged areas. The payments, which substitute for income foregone from agricultural production, continue for 20 years for conifer plantations, 30 years for woodland containing 50% broadleaves, and 40 years for woodland exclusively oak and beech.

(ii) Grants towards the costs of planting would be paid under the Forestry Commission's Forestry Grant Scheme and Broadleaf Woodland Grant Scheme at the rates currently available (including those for mixed woodland).

(iii) The cost of planting, net of grant, could for tax purposes be offset against profits arising elsewhere in the business under Schedule D.

(iv) At the end of the cycle, FWS participants will, like other commercial foresters, have the possibility to harvest under Schedule B.

The scheme is due to start in the autumn, once the Farmland and Rural Development Bill has been enacted.

Immediate Effect of Proposed Change to Tax Arrangements for Forestry

2. In implementing the revised arrangements for forestry agreed by Ministers, the Finance Bill will have the effect of removing "occupiers of woodland" from Schedule D and Schedule B will be abolished. This will automatically apply to farmers who establish and operate woodlands under the FWS on a commercial basis as well as traditional investors in commercial forestry. Because farmers occupying woodlands would be removed from Schedule D, planting grants will no longer be taxed and costs of planting will not be eligible to set against profits arising elsewhere. Revenue from sale of timber will, following the abolition of Schedule B, also be free of tax. The annual income substitution payments -(i) in pargraph 1) - will be taxed as income.

3. The total rate of return to farmers (grant and income payment) under the FWS is, as intended, considerably higher than for investors in traditional forestry (see paragraph 20 of main paper), reflecting the wish to encourage farmers to switch from profitable, but surplus, agricultural production. Even after the Budget tax changes for smaller broadleaves and mixed plantations (which are likely to comprise the bulk of FWS planting rates of return will be in the region of 6-10%; (for conifer plantations for 10 hectares the rate of return would be 18%). However because the planting grants in general do not cover the full cost of planting, farmers under the FWS will suffer a financial disbenefit from the proposed change. Its size will depend on the costs of planting, the number of hectares planted and the farmers' marginal tax rate.

Options for the FWS

4. Officials from Treasury, Inland Revenue and agriculture departments have considered whether it is necessary to amend the FWS to compensate for the worsening of its terms following the proposed changes in tax arrangements. They have distinguished six options. Agriculture departments feel strongly that option 5 should be pursued which would make the same compensating adjustments as for traditional forestry. The Treasury favour option 6 which is for making no immediate change to compensate for the tax changes.

Option 1: Exempt the FWS from budget tax changes

5. This would leave the FWS with the existing proposed incentives (set out in paragraph 1) wholly intact, except that with the disappearance of Schedule B revenues from timber would no longer be subject to tax. The Treasury and Revenue consider that the maintenance of special arrangements for farmers will look strange in itself and encourage the FWS to be exploited by forestry interests. The Revenue also believe that it would be highly complex to distinguish different classes of woodland occupiers; that maintaining Schedule D relief for farmers without any Schedule B charge would introduce a further anomaly; and that this option by singling out one group for special treatment would be likely to raise severe technical problems that could not be resolved in time for the Finance Bill. Both the Revenue and Treasury consider this option will destroy the simplicity which is one of the attractions of the Government's decisions in respect of Forestry taxation.

Option 2: Exempt annual substitution payments from tax

6. There are serious objections to this. The payments have been publicly stated to be in lieu of income and therefore to exempt them from tax would be objectionable in principle to the Revenue and would require special legislation in the Finance Bill. The scale of additional benefit provided by exemption would be quite disproportionate - with a net present value varying from about £300-350 per hectare for a conifer plantation to £850-900 per hectare for an oak and beech plantation.

Option 3: Increase the scale of income substitution payments

7. Under this option the income payments would be increased so that over the 20-40 years span they would yield after tax a net present value equal to the additional cost per hectare which farmers would face from the changed tax arrangements. On average the increased annual payment would be some £23-30 for the average taxpayer and £38-£52 for the 40% taxpayer. However the option of increasing income over a long span of years is a response which does not fit well with any difficulties created by increased front-end costs. Moreover there must be serious objections to increasing payments which are related to the opportunity cost of alternative farming activity at a time when this is reducing as a result of agreement on agriculture stabilisers in the EC.

Option 4: A differential increase in planting grants as between types of Woodland

8. Under this option, there would be an attempt to relate the increase in planting grants under the FWS to the estimated differential effect of the changed tax arrangements as between conifers, broadleaves and mixed woodlands. The Revenue say that the average marginal tax rate for farmers throughout the UK is 28-30 per cent. On their estimate, the loss to the typical farmer is about £140 per hectare for pure conifers (25% of the estimated uptake) depending on the size of the plantation; £320 for pure broadleaves (marginal uptake) and £330 for mixed woodlands (75% of uptake). For the reasons given in paragraph 9 below, agricultural departments see major problems in any precise quantification of the variables affecting compensation. However given an estimated takeup of 75% in the lowlands and two-thirds of the total in England, they believe there is no justification in assuming the average UK marginal tax rate and think that 40% would be more appropriate. On this basis the increase for pure conifers would, for the typical farmer be £200 per hectare, for pure broadleaves £460,

and for mixed woodlands £450. One variant of this option, not supported by agricultural departments who consider it provides inadequate compensation, would be to make available the current level of grant under the BWGS for mixed woodland instead of the FGS broadleaf grant which is on average some £200 per hectare less. This would significantly improve the incentives for the majority of those particpating in the FWS, 75% of whom are expected to be planting mixed woodlands.

Option 5: Increased planting grants for FWS in line with that proposed for traditional forestry

9. The agricultural departments believe that the Government has attracted major political credit by introducing the FWS and should do nothing in the new tax arrangements for forestry to undermine its credibility or effectiveness. They therefore consider the financial disbenefits of the proposed change must be compensated in full. Not to do so, particularly when the Farmland and Rural Development Bill is still in the Committee stage in Parliament, would be politically damaging. Given the wide range of imponderables on farmers' marginal tax rates, costs and planting intentions in terms of area, it is very difficult to calculate precise compensatory adjustments. In these circumstances the most defensible arrangement in their view would be to apply the same flat rate increase (£500 per hectare) to each type of woodland and grant size band as for forestry. The Treasury point out that this proposal, which on the figures in paragraph 8 would seriously over compensate those concerned, would increase the overall public expenditure cost of the forestry package by £6m annually. The agriculture departments consider that this will be offset by the tax savings resulting from the policy change; although in practice the expenditure would tend to occur earlier than the tax saving.

Option 6: No immediate action to compensate for tax changes

10. The Treasury consider that, quite apart from expenditure considerations, there are several arguments for taking no special action on the FWS at this stage. First, in their view by the standards of forestry investment the FWS remains exceptionally generous, despite the slight worsening of its terms. Second, the position of competing agricultural products, particularly cereals, is now less favourable than when the scheme was first announced following agreement on stabilisers in the EC, so that the relative incentive to move out of agriculture into woodlands is probably little affected. The evidence from ADAS suggests that there is good interest in the scheme. Against this background it seems quite likely that the scheme will continue to meet its objectives without any

immediate enhancement. The FWS is in any event due to be reviewed after 3 years and this could be advanced if take up in the first two years proved particularly disappointing.

CONCLUSION

11. Ministers will need to decide whether any special action is needed in respect of the FWS; and, if so, which of the options is preferable.

W. BENYON, M.P.

HOUSE OF COMMONS
LONDON SW1A 0AA

Both FST & [illegible] for Monday on this. Relevant to possibilities of forestry changes (esp. deferment [illegible]). X, of course, is wholly without foundation.

27th February, 1988

1 MAR 1988

Dear Nigel,

I am sending you a paper produced by The Forestry Industry Committee of Great Britian concerning these rumours which abound, that the Chancellor is going to do away with Schedule D for forestry.

I realise he is in purdah and it is no good writing to him, but I do hope that everyone realises two things.

1. That if such action is taken, plantings will drop to next-to-nothing. This can be proved by the effect that the Labour Government's measures on capital taxation had in 1974.

X 2. There will be a burning sense of injustice because the forestry industry has not been allowed to match the consultations which have taken place in environment organisations.

I do realise how difficult this is, but if you could put in a word for us, I should be most grateful.

Yours ever

Bill

Nigel Forman, Esq., M.P.

THE
FORESTRY
INDUSTRY
COMMITTEE
OF
GREAT BRITAIN

Directors:
THE HON. JAMES GALBRAITH CBE, CHAIRMAN

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THE FORESTRY INDUSTRY: TAXATION

The whole forestry industry in Britain is becoming increasingly concerned by the pressure which is being brought to bear on the Government by certain groups, to change radically the taxation arrangements which relate to forestry.

Investment in forestry both by landowners and outside investors, is essentially based on confidence, which in turn depends on a consistency of policy. Any major changes in the present tax regime, introduced precipitously or without full consideration of the consequences throughout the whole of the forestry industrial chain, could have quite disastrous effects - not only on the flow of badly-needed investment into the countryside - but also upon an emerging manufacturing sector which is displaying a genuine potential for growth. The following points are particularly relevant:-

1. A policy of forestry expansion as pursued by successive governments, cannot be evaluated in isolation from the creation of a viable wood-processing or value-added forest products sector - which is its long-term objective.

2. During the last four years as more British forests have become productive, this growing natural resource has attracted over £650 million of new investment into the processing sector.

3. This investment has brought to the UK the latest timber processing technologies in the world. Together with the high quality of British timber and the large expanding domestic market for wood-based products, these leading technologies enable Britain to compete successfully in the international market place for forest products.

4. Planned expansions within British mills (already announced) are expected to involve a further £400 million of investment.

5. This investment in the forest products industry was actively and successfully sought by agencies such as the Scottish Forest Products Development Group as part of Government policy. Investors were encouraged to come to Britain by assurances of timber availability, continuity of supply, and consistency of policy.

6. Any change in policy that will affect the rate of planting in this country or effectively negate the stated target of 33,000 hectares per annum, will have an immediate effect on downstream investor confidence. The planned expansions will not go ahead, and the mills will not reinvest.

7. A policy of forestry expansion (i.e. new planting) requires investment from outside the industry. Integrated or traditional estates can only put a modest proportion of land under trees to maintain a viable balance between capital investment and essential cash flow. In attracting this additional investment, forestry has to compete in the investment market place - particularly with alternatives such as business expansion schemes and enterprise zones - and still overcome the major deterrents of illiquidity and length of rotation.

8. Despite the grant support and tax regime, new planting still falls significantly short of Government target levels. Nevertheless, the system has succeeded in attracting considerable sums of money into the countryside, which otherwise would have gone elsewhere (including abroad) and, given other alternatives, would not necessarily have been captured by the Exchequer in tax.

9. Given the long-term nature of forestry, the level of this investment depends on consistency of policy. Radical changes will result in an immediate drop in planting, both by traditional owners and investors (vide the introduction of Capital Transfer Tax by the Labour Government in 1974).

The resulting later shortfall in timber supplies will in due course put heavy pressure on the processing sector, leading to recessions or bankruptcies in the industry.

10. Commercial forests effectively create the main markets (by guaranteeing sufficient supplies) from which small growers and farm woodland owners can subsequently profit. Thus the expanding resource of larger forests increases the viability of smaller ones (while conifers are often criticised, it should be noted that 75% of our total timber and forest products requirements are for softwoods. The market is related to consumer demand).

11. In many remote areas, alternative investment is not feasible. Forestry can thrive - and thus ensure community stability through sustained and permanent employment - where other industries cannot or will not go.

12. An immediate cut-back in planting caused by lack of investment confidence arising from changes in the present forestry tax system will, in the present planting season, result in the loss of thousands of jobs. This will have an immediate effect in some rural areas - on schools, shops, services etc., as people leave or lose their livelihood. In the longer term tens of thousands of jobs - real and potential - will either be lost or not realised within the woodchain from nursery and forest, through harvesting and haulage, to the eventual processing mills. The majority of these job losses will occur in Scotland where forestry, as a primary industry, is making an increasing contribution to the economy (see 17 below - the Edinburgh University Sectoral Analysis).

13. Given present uncertainties in agriculture, forestry is emerging as a prime candidate for diversification. It is opportune now to encourage investment in better land rather than to deter it.

14. The potential of forestry as an alternative land use is underpinning the land market. Cessation of forestry investment and new planting (including on better ground) will have a knock-on effect on land prices that will seriously affect many farmers. It will also influence the attitude of banks involved in agricultural loans to farmers, who may have no alternative market (particularly in remoter areas) and can offer no other security.

15. In the horticultural sector, nurseries have already geared their stocks to the planting levels stated by the Government, with additional plants to supply the further 12,000 hectares per annum envisaged under the Farm Woodland Scheme. They have done this on the basis of discussion with Government on likely future requirements. The sudden fall in investment planting resulting from tax changes will mean that the large proportion of the seedling stock will be unused and destroyed - with considerable loss to horticulturalists.

16. The extensive damage caused by the October hurricane in south-east England will involve an extremely expensive programme of clearance and restoration over the next five years. In many cases, given the quantities of timber destroyed and the devastation caused, restoration is beyond the owners' means, and the Windblow Action Committee, established by Government, has reported on the situation and the need for restoration support. Changes to Schedule D taxation will further erode owners' ability - and indeed willingness - to meet the immense costs of replacing their trees and restoring the woodland landscape of the devastated area. Incentives are needed to encourage restoration, and changes to the tax system could not be more untimely.

17. Previous evaluations of forestry (Treasury Study of 1972 and the NAO Report of 1986) were based on the questionable assumption that the forest gate price of round timber captures the benefits to society of employment and added value in processing.

FICGB has set out to show more accurately - through proper sectoral analysis - the strength of the linkages into both the rural and national economies, and to quantify the important multiplier effects (that is the jobs created by the initial investment and the total employment which flows from it). This major study which is the first of its kind, is being undertaken by Edinburgh University with support from a number of Government departments and agencies, and will be available in April or May. It should, we believe, be considered in detail before any tax changes are entertained that would undoubtedly prejudice the development of our industry.

18. Since 1945, total post-war expenditure (through the Forestry Commission and taking into account 'adjudged'loss of Exchequer revenue through tax reliefs) amounts to an estimated £1,500 million. This has restored a depleted resource and created an increasingly valuable national asset. It has attracted £650 million of new investment in leading-edge processing technologies, with a further £400 million to come if the policy is not prejudiced. It has formed the basis of a manufacturing industry already producing forest products worth in excess of £700 million per annum. It has enabled us to capture a third of the UK newsprint market, and 45% of the particleboard market. The sum involved is insignificant compared with subsidy in other sectors, and in total amounts to a mere **133 days** of our import bill for forest products in one year alone. It represents one of the most far-sighted and effective public sector investment policies in post-war Britain.

The forestry industry's present renaissance is a success story which does credit to the faith of successive governments which have supported it. To sacrifice such a success would be to waste decades of patient investment, progressive research, development of sensitive management, and a well-deserved international reputation for pioneering renewable forests, rather than exploiting natural ones.

It is vital therefore that the Government should take fully into account both what has been achieved, and the potential which the forestry industry now offers, in renewing its long-term commitment to forestry so that in line with FICGB's strategy set out in "Beyond 2000", we can confidently plan our future and bring maximum benefit to the nation.

SECRET AND PERSONAL

FROM: N MONCK

DATE: 29 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Mr Burgner
Mr Bonney
Mr Donovan
Mr Call

FORESTRY : DRAFT FORESTRY COMMISSION BOOKLET

As background for your meetings on Tuesday and Wednesday of this week, I attach a copy of the draft booklet on the new Woodland Grant Scheme which the Forestry Commission has submitted to Mr Rifkind. Mr Ridley too has seen it.

2. It is a pretty prosaic document, based on the earlier booklets about the two schemes which will be replaced by the Woodland Grant Scheme. The side-lined passages on pages 1, 9 and 10 are some of the modest amendments which the DOE with our support have persuaded the Commission to include. The one on page 10 helpfully commits them to produce a glossy and free-standing booklet on the lines of their earlier "Guidelines for the Management of Broadleaved Woodland" (copy attached for you only).

3. I think it is probably right to keep the attached draft reasonably low key. But there is still scope for making a bit more of some of the environmental gains. In my brief for your meetings I will be suggesting that you ask Mr Rifkind to look at this from a political point of view to ensure that no environmental points are missed.

NM

N MONCK

BACKGROUND
MONCK TO CX 29 FEB DRAFT FORESTRY BOOKLET

18/226.

5 of 9

Draft FC Booklet

WOODLAND GRANT SCHEME

Contents

1. INTRODUCTION

The Woodland Grant Scheme introduced in April 1988 is intended to encourage the continued expansion of private forestry in a way which achieves a reasonable balance with the needs of the environment. The aims of the scheme are to increase timber production and ~~of~~ to promot~~ing~~e the contribution which new woodlands can make to rural employment, to the provision of alternative uses for surplus agricultural land and the enhancement of landscape, recreation and wildlife conservation. It is also designed to encourage restocking and rehabilitation of existing woodlands either by planting or by natural regeneration.

This new scheme succeeds the Forestry Grant Scheme and the Broadleaved Woodland Grant Scheme, which were closed to new applications generally with effect from .... [They will, however, remain open for applications put forward in association with the Farm Woodland Scheme to be introduced by the Agriculture Departments.] Work done under Forestry Grant Scheme or Broadleaved Woodland Grant Scheme plans of operations approved before the closure date of ... will continue to be eligible for grant under the existing provisions of those schemes, [as will work done under any plan of operations approved subsequently provided that the application of which the plan formed a part was received by the Forestry Commission before the closure date.] Existing contracts with the Forestry Commission under the Dedication Schemes will also continue.

2. WHO MAY APPLY

Applications may be made either by the owner (or owners) of the land or by a tenant, provided that all the parties concerned are joined in the application.

Any change of ownership between the date when an application is approved and the date of payment of the final instalment of the grant must be reported to the Forestry Commission by the original applicant, or by his personal representative.

3. AREAS ELIGIBLE FOR ENTRY TO THE SCHEME

Grants will be available under the scheme in respect of individual areas of 0.25 hectares and over. It will not be acceptable for individual areas of less than 0.25 hectares to be aggregated, except where, with the Forestry Commission's agreement, restocking is to be undertaken through the felling of very small groups of trees with the object of creating an uneven-aged wood.

4. MAIN FEATURES OF THE SCHEME

The objectives of the scheme are as follows:

a. to encourage timber production for domestic processing;

b. to provide jobs in and increase the economic potential of rural areas with declining agricultural employment and few alternative sources of economic activity;

c. to provide an alternative to agricultural production and thereby assist in the reduction of agricultural surpluses;

d. to enhance the landscape, to create new wildlife habitats and to provide for recreation and sporting uses in the longer term;

e. to encourage the conservation and regeneration of existing forests and woodlands.

The scheme is intended to encompass a wide range of management objectives and thus encourage multiple purpose woodland management. In order to comply with statutory requirements, the production of utilisable timber must be one of the objectives, although it will not necessarily be the principal objective. The latter could, for example, be to create a woodland which makes a positive contribution to the landscape and which is designed to create a diversity of wildlife habitats.

The scheme applies to the establishment of conifer and broadleaved woodlands and of mixed woodland whether by means of planting or by natural regeneration. The broadleaves rate of grant will apply to the planting and natural regeneration not only of broadleaves, but also to native pinewoods in specified areas of Scotland as described in the Forestry Commission Leaflet 'Native Pinewood Grants'. Applications relating to the establishment of broadleaved woodland will be subject to the provisions of the Guidelines for the Management of Broadleaved Woodland published by the Forestry Commission.

The scheme may also apply to the rehabilitation, whether by planting or natural regeneration, of neglected woodland under 20 years of age provided that the operation is not self-financing and that the woodland was not grant aided at the outset. Applications may also be considered for woodland in which natural regeneration under 20 years of age is already present.

5. PROVISIONS OF THE SCHEME

Applicants will be required to observe the following provisions:

1. The broadleaved component of existing woodlands must be retained or enhanced.

2. Ancient woodland sites must be replanted or regenerated with appropriate broadleaves either pure (for semi-natural sites) or in mixture (for sites which previously carried a coniferous or mixed crop).

3. Native pinewood sites must be replaced or regenerated with native Scots pine.

4. Conifer planting consisting mainly of one species must allow for a proportion of other conifers or broadleaves, preferably through the retention or reinforcement of any existing conifers or broadleaves.

5. Ancient Monuments must be protected from any operations which may damage the site.

6. SSSIs and NNRs affected by the proposals must be checked to establish whether planting or other associated activities are listed as potentially damaging operations. In other areas designated for their conservation or landscape value applicants must, in framing their proposals, have regard to the special features of these areas.

7. All public rights of way must be safeguarded and applicants must be prepared to enter into discussions with local authorities with respect to access agreements.

8. Hydrological safeguards must be observed in all operations which may affect the drainage of the site; domestic water supplies in particular must be protected.

The above provisions are described in more detail in the following paragraphs.

Broadleaved Component

The broadleaved component of existing woodlands may be pure or in mixture with conifers, of coppice origin or be the result of natural regeneration and may be much younger than the main coniferous crop. Provided the broadleaved element is capable of producing utilisable timber, it should be retained or replaced when replanting or regenerating the wood with the help of the new Woodland Grant Scheme. Any proposal to increase the broadleaved element will be accepted if it is considered to be silviculturally practicable and is capable of producing utilisable timber, especially if it also contributes to landscape or conservation values.

Ancient Woodland Sites

The Nature Conservancy Council (NCC) has prepared a draft Register of Ancient Woodlands which identifies sites that have been under woodland cover for many centuries. The entries are subject to verification and any dispute about their validity should be stated at the time when the application is made. The sites listed are those which are:

a. probably semi-natural ancient woodlands;

b. other ancient woodlands;

c. semi-natural woodlands of importance for nature conservation.

If a planting proposal affects a site so listed the fact must be recorded on the application form and the applicant must observe the provisions for such sites set out in the 'Guidelines for the Management of Broadleaved Woodlands'. A summary of these provisions is given in the following sub-paragraphs to enable applicants to see the main implications of the broadleaved guidelines.

Ancient woodland sites are defined by the NCC as those which have borne woodland of one type or another since at least 1600, although they may now, and indeed for some time, have been planted or even have been cleared of trees.

Ancient semi-natural woodland is ancient woodland which is thought to be mainly of natural origin and is therefore of particular conservation value. No woodland in Britain can be regarded as entirely natural - such is the influence of man on the environment - but these woods, on sites continuously wooded for a great number of years and having a tree and shrub layer composed of species native to the site, are the closest approximations to natural broadleaved forest to be found in Britain.

Other semi-natural woodlands. In its strictest form, semi-natural woodlands consist of trees which have regenerated naturally from seed, or of coppice regrowth from trees which are themselves natural seedlings. It is not possible to make firm distinctions, however, between truly semi-natural stands and long-established plantations of native species which may also have high conservation value. Sites in the latter category are also listed in the register and should be given particular care when proposing replanting under the Woodland Grant Scheme.

Native Pinewood Sites

The areas within which native pinewood grants may be payable have been agreed between the Forestry Commission and the Nature Conservancy Council. They comprise the native pinewood localities identified by H M Steven and A C Carlisle in their book "The Native Pinewoods of Scotland", together with additional areas which the Forestry Commission and Nature Conservancy Council have agreed as suitable for encouraging the extension of the native pinewoods. For further information please refer to the Forestry Commission Leaflet 'Native Pinewood Grants' available from your local Forestry Commission office.

Conifer Planting

Where site conditions are such as to restrict the choice of species the requirements of good landscape design and the interests of nature conservation must nevertheless be taken into account. This can be done by introducing other appropriate conifer or broadleaved species or by retaining existing natural regeneration present on the site. The higher grant provides an incentive for broadleaves to be used for this purpose and 5% broadleaves will normally be expected to meet this requirement.

Ancient Monuments

Landowners have a statutory obligation under the Ancient Monuments Act 1979 to protect any scheduled ancient monuments and historic buildings on their property. If there are any such features within an area covered by a planting application the applicant will be expected to agree to any necessary measures to avoid damaging the site. Similar arrangements will apply to unscheduled sites where these can be identified.

SSSIs, NNRs, ESAs and Other Designated Areas

Sites of Special Scientific Interest and National Nature Reserves will have a Management Agreement which lists a number of potentially damaging operations (PDOs). If any forestry operations are so listed, the NCC must be notified of the intention to carry them out before an application under the Woodland Grant Scheme can be considered.

Environmentally Sensitive Areas (ESAs) are strictly an agricultural designation, but the Forestry Commission has agreed to notify the NCC over those parts of any applications which fall partly or wholly within an ESA. There are similar arrangements with the Countryside Commission and the Countryside Commission for Scotland in respect of applications of 10 ha and above.

Arrangements exist for consulting local authorities and notifying other statutory authorities about applications arising in other designated areas such as National Parks, National Scenic Areas and Areas of Outstanding Natural Beauty. Details of these arrangements are to be be found in the Forestry Commission's leaflet 'Consultation Procedures for Forestry Grants and Felling Permissions'.

Public Rights of Way

In most cases the existence of public rights of way can be determined from maps held by local authorities. Even where a map has not yet been compiled the local authority may still be able to give advice. Footpaths which are not rights of way can be closed one day each year so there should be no question of creating rights of way by the preservation of existing footpaths or by the provision of new roads or footpaths.

Applicants will be required to undertake to enter into discussions, if requested by the local authority, with a view where appropriate to negotiating an access agreement; this undertaking does not, however, bind the applicant to enter into any such agreement.

Hydrological Safeguards

There are a number of special provisions which have been agreed by the water industry and incorporated into a Forestry Commission publication soon to be published entitled 'Water Guidelines'. As a general rule the observance of these provisions should meet the needs of water authorities.

6. PRACTICAL GUIDELINES

As outlined above in the provisions for the scheme, all planting, restocking and regeneration proposals are expected to have taken account of timber production and of silvicultural, landscape, recreation, nature conservation, archaeological and hydrological considerations. For the guidance of applicants a brief indication of the practical implications of the above provisions is given in the following paragraphs:

Timber production: There are few woods which will not yield utilisable timber. Even where the woods are managed primarily for some other purpose, it is clearly in the owner's interest to achieve a good financial return from timber sales in order to offset the costs of maintenance. On this and the following subject, FC Bulletin No 14 'Forestry Practice' provides detailed practical information.

Silviculture: The fundamental principle is to choose species well adapted to the soil, climate, drainage and exposure. Where there are alternatives, advantage should be taken of these in the design of planting for landscape or nature conservation purposes. A variety of silvicultural systems are eligible for grant so that the creation of all-age forest by means of selective natural regeneration, for example, will be grant aided on a pro-rata area basis. FC Bulletin No 62 'Silviculture of Broadleaved Woodland' complements Bulletin 14.

Landscape: The general objective should be to create irregular forest shapes at a scale which is in keeping with the surrounding landscape, emphasising natural features such as watercourses, gullies and crags by means of different species or age classes and avoiding unnatural straight lines and regular geometric shapes. Very narrow strips are not encouraged. Reference should be made to FC Booklet No 44 'The Landscape of Forests and Woods' by Dame Sylvia Crowe for further practical information.

Nature Conservation: Planting proposals which create diversity of habitat are likely to be valuable for nature conservation. This can often by done by retaining any existing tree cover, including dead and dying trees, and by keeping planting well back from streams, gullies, bogs and other features such as crags and rocky outcrops. Policy and Procedure Paper No 4 on the Forestry Commission's Nature Conservation Policy will be supplemented by Conservation Guidelines currently in preparation to replace Booklet 29 now out of print.

Recreation: Provision of recreation facilities is best left until the woodland is mature enough to be of interest, but all public rights of way must be kept clear when fencing, ploughing and planting. It is recommended that provision be made for stiles or self-closing gates to allow hill-walkers access to open country above the woodland even if no rights of way exist.

Archaeology: As well as scheduled ancient monuments, other non-scheduled artefacts which might be of archaeological interest must be protected. Advice must be sought as to their importance and any special precautions which may be required particularly when ploughing or draining the site. The Forestry Commission Booklet

'Archaeology in Upland Forests' (in press), provides practical guidance on the recognition of archaeological artefacts.

Hydrology: Domestic water supplies must be safeguarded and other measures must be applied to all watercourses. These include keeping drain ends well back from watercourses in order to trap sediment and avoiding planting too close to stream sites so that natural broadleaves or shrubs are able to seed-in. Forestry Commission Leaflet No 78 'The Management of Forest Streams' provides practical guidance and the Water Guidelines (in press) should be referred to for information on the provisions which have been agreed with the water industry.

The Commission will be revising and updating as necessary the publications mentioned above and producing in due course a digest covering the main points.

7. RATES OF GRANT

The planting of broadleaves on their own or in mixture with conifers will attract grant at a higher rate than that given for conifers alone and will be encouraged where sites are suitable. Grants will be paid at the appropriate rates in proportion to the area occupied by conifers and broadleaves respectively at the time of planting. The total area approved will determine the grant rate that applies to any component broadleaves and conifers.

Rates of grant are subject to review. The current rates of grant for planting, restocking and natural regeneration are shown in the following table.

Area approved for planting or regeneration (ha)	Rate of Grant	
	Conifer (£ per ha)	Broadleaved (£ per ha)
0.25-0.9		
1.0-2.9		
3.0-9.9		
10 and over		

The grant band will be determined in each case by the area of planting or natural regeneration for which approval has been given. Grants will be calculated to the nearest 0.1 ha and will be paid in instalments as a percentage of the rate current at the time they fall due.

Grants for new planting, including restocking will be paid in three instalments, 70% on completion of planting and further instalments of 20% and 10% will be paid at five yearly intervals thereafter, subject to satisfactory establishment and maintenance.

For natural regeneration the instalments will be 50%, 30%, 20%. The first instalment will be paid on the completion of approved work designed to encouraged regeneration, the second when an adequate stocking has been achieved (there will be no fixed time limit for this) and the third five years after, subject to satisfactory establishment and maintenance. Existing natural regeneration under 20 years of age will qualify for the second and third instalments only.

Neglected woodlands under 20 years of age with an adequate stocking of suitable species may similarly qualify for the second and third instalments of grant, payable at the rates appropriate to natural regeneration.

The maximum tree spacings normally acceptable for grant payment are 2.1 metres for conifers and 3 metres for broadleaves. Where the Commission considers it silviculturally acceptable, however, proposals to plant broadleaves at wider spacing may be permitted and grant paid on a pro rata basis.

8. BETTER LAND SUPPLEMENT

Applicants under the Woodland Grant Scheme who carry out new planting on arable or improved grassland of less than 10 years of age will be eligible for a supplement of £150 per hectare at the time of the payment of the first instalment of grant, subject to this having been approved in the plan of operations. The supplement will not be available for replanting or natural regeneration.

9. HOW TO ENTER THE SCHEME

Application forms (WGS ...) are available from the Forestry Commission's Conservancy offices listed on pages ... and ... of this leaflet.

Applications must be accompanied by a map showing clearly and accurately the boundaries of the land covered by the application. The map should be at a scale not smaller than 1:10 000 or 6" to one mile, but applications relating to areas of less than 10 hectares must be accompanied by a map at a large scale enough to enable the work proposed to be clearly identified. The map may be either an original Ordnance Survey sheet or a photocopy*, but if a photocopy is used it must be of good quality, showing clear definitions of boundaries etc, and free from any major distortion.

Full details of the conditions under which grant aid may be given are provided on the application form, and the Commission's staff will be pleased to advise how these apply in particular circumstances.

* OS maps are subject to Crown copyright and applicants will wish to ensure that they are not in breach of the copyright laws. A leaflet (OS leaflet No 8) explaining the regulations and setting out the scale of charges is available from the Copyright Branch of Ordnance Survey at Southampton.

10. PLANS OF OPERATIONS

Applicants will be required to work in accordance with a five year Plan of Operations approved by the Forestry Commission. The plan included with the applications must specifically refer to the aims of the new scheme and make proposals for achieving these aims.

The Plan of Operations also includes a Schedule of Work in which applicants will be required to set out in detail the work to be undertaken during the five year period. Where natural regeneration is planned, this work might include such operations as fencing, ground preparation and clearance of undergrowth. Any departure from the approved operations listed in the Schedule, without the prior written consent of the Forestry Commission, will result in grant being withheld. In cases where some deviation from the work specified in the Schedule is desirable or necessary on account of accident, damage or some other unforeseen circumstances, the Commission must be consulted and its approval obtained on Form WGS ... before any additional work is carried out. Where selective or clear felling is proposed approval will normally be conditional upon the area being restocked, in which case the restocking proposals must be included in the Plan of Operations.

Under the Town and Country Planning Acts, Tree Preservation Orders may not be made in relation to woodland which has been grant aided by the Forestry Commission under one of its schemes unless the Commission gives its specific consent to the making of the Order. Such consent will normally be withheld where woodlands are under satisfactory management. Woodland owners who have received grants are therefore encouraged to renew their Plans of Operations at the appropriate five yearly intervals since these would be regarded as evidence of good management.

The Forestry Commission will be pleased to give advice when Plans of Operations are being prepared or renewed.

11. APPROVAL OF THE APPLICATION

On receiving an application, the Forestry Commission will first ensure that the land is suitable for the work proposed. They will also ensure that the application complies with the provisions of the scheme as set out in

Section 5 above and with the Practical Guidelines set ~~on~~ out in Section 6. The Commission will undertake such consultations as may be necessary with other authorities in respect of any relevant land use, amenity or nature conservation aspects of the applicant's proposals. Further information on the consultation procedures is given in the Forestry Commission's leaflet 'Consultation Procedures for Forestry Grants and Felling Permissions.'

Work may begin when the Plan of Operations has been approved and signed on behalf of the Commissioners. Applicants should not commence work until the Plan has been so approved and signed otherwise this will result in the non-payment of grant, or might lead to the applicant being in breach of the felling licensing provisions of the Forestry Act 1967 and therefore liable to prosecution.

12. HOW TO CLAIM GRANTS

The work specified in the Plan of Operations may be carried out as soon as the Plan has been approved and signed by both parties. When planting or approved work designed to encourage natural regeneration has been carried out, the first instalment of the appropriate grant should be claimed by completing form WGS ... and returning it to the address shown on the form. Second and third instalments of grant should be similarly claimed when they fall due (see the section headed Rates of Grant on page ....).

Applicants are required to allow officers of the Forestry Commission to enter on the land at any reasonable time to consider proposals for work to be done or to inspect areas for which grant has been claimed; in all cases the final decision will rest with the Forestry Commission.

13. RIGHT TO RECOVER GRANT

If, in the opinion of the Forestry Commission, planting or natural regeneration has not been established or maintained to a satisfactory standard or the provisions of the plan of operations have not been complied with, the Commissioners may withhold or reduce any grant claimed and may seek reimbursement with interest (at a rate to be determined from time to time) of any earlier instalment of grant; the latter provision will not apply to first instalments of grant properly paid for work designed to lead to natural regeneration if, through no fault of the applicant, acceptable regeneration does not materialise. The obligation to refund grants in the circumstances described above will remain with the person to whom they were originally paid, notwithstanding any intervening transfer of ownership or tenancy. In the event of sale or other disposition, applicants would therefore be well advised to insist upon an appropriate indemnity if any grant instalments are still outstanding.

45/B.rj.2189/015

FROM: N MONCK

DATE: 29 February 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Burgner
Mr Cash
Mr Beighton) IR
Mr Marshall)

FORESTRY

You will be meeting the Forestry Ministers and Mr Ridley on Wednesday to settle the outstanding forestry issues. In advance of that formal meeting you will be talking to Mr Ridley and Mr MacGregor on Tuesday afternoon in order to get their support; in particular you will be aiming to detach Mr MacGregor from the other forestry Ministers who are seeking an excessive grant increase for mainline forestry. That will involve a concession to Mr MacGregor on the Farm Woodlands Scheme (FWS). He may also raise with you the separate proposal he has put to the Chief Secretary for a special grant supplement to pay for clearing up storm damage before replanting in the south east (see para 9 below). This brief is intended to cover both meetings but some passages for use only at the informal meeting are in square brackets.

2. You asked for year by year public expenditure costs and tax savings. The estimates in the attached tables, together with steady state figures where appropriate, are based on present income tax rates and Forestry Commission assumptions about the level of new planting and about the attractions of the transitional tax arrangements; they do not allow for higher rate changes. They assume the planting aim will be exceeded in 1988/89 and 1990/91 followed by a dip and a build up to 28,000 hectares in 1993/94. (The Inland Revenue assume much lower planting, with a larger share under the new grant scheme, particularly in 1990/91, followed by a build up to 29,000 hectares in 1993/94. We shall need to consider further the best figures to use in the FSBR).

3. If you can, I suggest you keep off the year by year figures for forestry (though not the FWS) and use the steady state figures in table 3 (page 7) of the paper.

4. Annex A contains the announcement of the Farm Woodlands Scheme by Mr Jopling in February 1987.

Objectives

5. Your objectives are:

(a) to keep the flat rate increase in forestry grants to £350 per hectare and not the £500 Mr Rifkind wants;

(b) to keep the increase for the Farm Woodlands Scheme to the same figure and to make no change for conifers;

To achieve (a) and (b) you will probably need to concede that the transitional tax arrangements can last for five instead of four years and perhaps also give up the structural changes in grants, such as a reduction for areas of conifers larger than 40 hectares.

(c) to get the grant increases announced as soon as possible, at least in outline; to get Mr Walker to clear his speech due on Thursday after the Budget; and to ensure that presentation will maximise the chance of winning the support of moderate environmentalists without overselling the changes.

The Size of the Forestry Grant Increase

6. **Line to take:**

(a) Increase of £350 per hectare corresponds to present average value of tax incentives (42 per cent average marginal rate - see para 11 of officials paper). Wrong to go for grant increase of £500 equivalent to tax relief to compensate 60p taxpayers and overcompensate the rest. Would mean raising Exchequer subsidy per hectare on average. [Impossible to present in context of Budget generally. Surprised Mr MacGregor has supported this, given the earlier deal on public expenditure increase of £10 million ~~compared~~ corresponding to published estimate of present Exchequer cost of tax relief. In fact my proposed figure of £350 would mean incremental public expenditure of around £13 million in steady state if planting aim were achieved.]

(b) Some reduction in internal rate of return shown in table 4 of official paper for higher rate taxpayers. BUT this is relatively small. Makes no allowance for continuation of downward trend in costs shown in Chart B after 1987/88. Very rapid increase in planting shown in Chart A, almost reaching the planting target in 1988/89, suggest present Exchequer subsidies more than adequate. Profitability of forestry will not change for exempt funds and will rise for basic rate taxpayer. For all these reasons grant increase of £350/hectare consistent with maintaining present forestry policies. Bound to be some uncertainty after major change in method of delivering subsidy. In any case need to review instruments (and also aims) of policy in a few years time.

(c) On structure of grants you favour proposed differentials in favour of broadleaved, but may be scope for some reduction in grant increase for larger conifer areas (a reduction of £40 for over 40 hectare areas would save £1 million a year). But this or other shifts within conifer structure very much a matter for colleagues.

(d) May be able to help on transitional points (para 8 below).

Farm Woodlands Scheme

7. You need to settle this item on Tuesday. **Line to take:**

(a) Quite strong arguments for leaving FWS unaltered, because:

- a much more generous scheme, with annual income payments and hence a much better rate of return than for traditional forestry (at least 6 and up to 11 per cent real after Budget changes for mixed or broadleaved planting, depending on where planting takes place; this compares with about 4 per cent on traditional forests);

- if Mr MacGregor says the relevant comparisons are with farm enterprises not traditional forestry, you could say that the FWS is not really aimed at best quality cereal land but at more moderate ("grade 3") arable land and improved grazing land, including such land within farms with a high average quality;

- very few farmers (about 8 per cent of them in 1987/88, with 21 per cent paying no tax) pay higher income tax rates and they will stand to lose much less by Budget changes to forestry tax than investors in traditional forestry. (This is true even for richer farmers in English lowlands, who MAFF claim will take up most of FWS.);

- the recent EC agreement on stabilisers will make some agricultural production, particularly cereals, less attractive. So some diminution in FWS can be tolerated without undermining the scheme.

(b) No case at all for increasing grants for planting conifers (25 per cent of FWS area assumed to be pure conifers and half the remaining 75 per cent). The post Budget rate of return for conifers will still be around 18 per cent, much higher than for broadleaves. Absurd to increase still further the incentive for a type of planting that few people want. (MAFF have not challenged this figure, which is calculated on planting in Severely Disadvantaged Areas, including the lower planting grant of £100 per hectare annually for 20 years. High rate of return reflects much lower planting costs for conifers);

(c) Maximum increase on existing grants* must therefore be £350 pa. This would fully compensate for tax losses of about £330 for mixed woodlands and pure broadleaves, assuming an average marginal tax rate of 28-30 per cent which Inland Revenue considers the right assumption on present tax rates. (If Mr MacGregor presses for a further £100, as in para 8 of Annex B ~~,~~ of paper you could reply - don't believe either 40 per cent average marginal tax rate or that farmers would dare to use that argument.)

Transition

Line to take

8. Subject to satisfactory outcome on grant levels can agree:

(a) to add a year to the transition which would end in April 1993 instead of 1992;

(b) to agree to proposal in para 29 of officials paper that applications received before Budget day should be eligible for transitional treatment.

---

*NB "Existing grants" means the (lower) broadleaved grants under the Forestry Grant Scheme and not the higher BWGS grants (see table on page 6 of official paper. Important to use these words but to avoid reminding Mr MacGregor that on average increase for forestry broadleaves will be more than £350.

Storm Damage

9. Mr MacGregor wants something positive to say in a debate next week. Annex B sets out the background.

[**Line to take**

(a) given tax and grant changes makes no sense to announce anything before Budget;

(b) prepared to look at proposal in para 30 to make transitional arrangements apply to work on storm damage, provided Mr MacGregor and/or other forestry departments can produce a specific proposal that appears workable and that the idea of a special grant is dropped.

(c) if pressed further Prepared to look at supplement after Budget if Forestry Commission absorbs costs.]

Announcement and Presentation

(a) Timing

Line to Take

10. Need to minimise hiatus between Budget and full grant announcement.Must get grant increases announced as soon as possible. Mr Rifkind must surely see political case for that. Hope sensitivities of part-time Forestry Commissioners could be handled by Chairman who has, quite exceptionally, been given early information before Budget. Would it be possible to go further than officials have agreed and publish grants on day after Budget with glossy printed booklet later? If really impossible, propose as a fallback, Financial Secretary could announce on Wednesday after Budget that increased public expenditure provision for forestry would allow grant increase equivalent of £350 an acre, equal to present average tax subsidy, with more for broadleaved on average; a statement of this kind would still allow part-time Commissioners to do fine-tuning within the extra public expenditure.

(b) Environment: ask Mr Ridley to confirm that he is satisfied package will win support from moderate environmentalists. Is he satisfied with draft Forestry Commission booklet, or does he think it needs to do more to present the environmental benefits than previous Forestry Commission booklets (which have understandably been written primarily for foresters) have tried to do? Can Mr Rifkind look at this from political point of view to make sure it includes clear statement of environmental improvements?

(c) Mr Walker's speech: awkward timing of EFG lunch on Thursday after Budget. Mr Walker will presumably recognise need to clear his speech in advance of Budget with other Ministers present; hope he will pick up points in Budget Speech and make point that while forestry policy is being maintained, there is some improvement in the balance which, to quote the 1985 Act, the Commission is obliged to achieve better afforestation and timber production and

> "... the conservation and enhancement of natural beauty and the conservation of flora, fauna and geological or physiographical features of special interest."

As Mr Walker (like Mr Rifkind) is both an Environmental and a Forestry Minister he would be well placed to say this.

(d) Briefing: official group should be asked to produce Q & A briefing so that we have a properly co-ordinated line.

NM

N MONCK

45/B.rj.2189/016

SECRET AND PERSONAL

Table 1 (Forestry Commission planting assumptions 1987/88 tax rates)

£ million

	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	Steady State Increment
TAX RECEIPTS (SAVINGS)							
Forestry (average marginal rate 42%)	0	-½	-½	3	5	11	
Farm Woodlands Scheme (FWS) (average marginal rate 28-30%)	0	½	1½	2	2	3	
Total rounded	0	0	1	5	7	14	
PUBLIC EXPENDITURE							
Your Options							
(a) Forestry grants increase £350	1.1	2.2	1.1	4	6.5	8	12.8
(b) FWS: grant increase of £350 excl conifers (incl conifers)	0.6 (1.7)	1.3 (3.4)	1.3 (3.4)	1.3 (3.4)	1.4 (3.8)	1.5 (4.2)	1.5 (4.2)
(a) + (b) excl conifers	1.7	3.5	2.4	5.3	7.9	9.5	14.3
Forestry Ministers' Options							
(c) Forestry grants increase £500	1.2	2.5	2.8	6.6	9.7	11.6	17.9
(d) FWS grant increase of £500 incl conifers	2.4	4.8	4.8	4.8	5.4	6.0	6.0
(c) + (d)	3.6	7.3	7.6	11.4	15.1	17.6	23.9

Notes: Forestry Commission assumptions about new planting and use of old grant scheme (and transitional tax arrangement) and new grants scheme.

Steady State 29,000 hectares a year new private sector planting plans 5m replanting

FWS Scheme 6,000 hectares in 1988/89 and 12,000 a year thereafter; the scheme is subject to review in 1991, but is assumed to continue. 25% of FWS area pure conifer; the other 75% assumed to be mixed, split equally between conifer and broadleaved. Grant increases added to Forestry Grant Scheme levels.

SECRET AND PERSONAL

Table 2 (Forestry Commission Assumptions)

INCREMENT TO PEX

£ million

	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	Steady State Increment
Traditional Forestry (Private Sector)							
Existing Provision	11.1	12.0	12.2	12.6	12.9	13.0	
Grant Increase							
Forestry Ministers' +£500	1.2	2.5	2.8	6.6	9.7	11.6	17.9
+£415	1.2	2.3	1.8	5.1	7.9	9.5	15.0
+£375	1.1	2.2	1.4	4.4	7.0	8.6	13.6
Your option +£350	1.1	2.2	1.1	4.0	6.5	8.0	12.8
+£230	1.0	1.9	-0.3	1.9	3.9	5.1	8.7
Farm Woodlands Scheme							
Mr MacGregor's option +£500 (incl. conifers)	2.4	4.8	4.8	4.8	5.4	6.0	6.0
+£390 (incl. conifers)	1.9	3.7	3.7	3.7	4.2	4.6	4.6
+£350 (incl. conifers)	1.7	3.4	3.4	3.4	3.8	4.2	4.2
Your option +£350 (excl. conifers)	0.6	1.3	1.3	1.3	1.4	1.5	1.5
+£280 (incl. conifers)	1.3	2.7	2.7	2.7	3.0	3.4	3.4

ANNEX A

ANNEX A

AGRICULTURE, FISHERIES AND FOOD

Rural Economy

Mr. Cash asked the Minister of Agriculture, Fisheries and Food what measures will be taken to sustain the rural economy.

Mr. Jopling [*pursuant to his reply*, 22 January 1987, c. *721*]: With the European Community now producing surpluses in many of the main agricultural commodities, a new balance of policies has to be struck, with less support for expanding production, more attention to the demands of the market, more encouragement for alternative uses of land, more response to the claims of the environment, and more diversity on farms and in the rural economy.

The Government are therefore taking a number of new policy initiatives to assist the process of change. A scheme will be introduced to encourage the development of farm woodlands to take land out of agricultural production. This will build on the existing forestry grant schemes, but will also provide for annual payments to cover the gap between planting and the likely first income from most types of timber. The payments will vary by area in recognition of the fact that the agricultural income foregone from planting trees on farms will be higher in some areas than in others, but the maximum rate of aid will be £125 a year per hectare. The aim is to plant up to 36,000 hectares over the first three years of the scheme, at the end of which the scheme will be reviewed. The detailed arrangements will be the subject of consultation with interested parties prior to the introduction of appropriate legislation, but the scheme will incorporate provisions for the protection and enhancement of the environment, including special encouragement for broadleaved trees.

The Government also propose an expansion of the forestry programme, with particular emphasis on the private sector and with due regard to environmental considerations. The planting of a higher proportion of trees on low ground of better quality than hitherto will be encouraged by the release to forestry of better quality land; the Forestry Commission will keep in mind the need to encourage planting on this land in their regular reviews of grant rates. We shall continue to encourage broadleaved planting by higher rates of grant, as now. The aim is new planting of 33,000 hectares a year, compared with a current planting target of 30,000 hectares.

The designation of Environmentally Sensitive Areas under section 18 of the Agriculture Act 1986, the first of which are due to come into force next month, will be extended early in 1988. In doing this the Government will build on the lists proposed by the Countryside Commissions, the Nature Conservancy Council and their equivalent in Northern Ireland. There will be consultations on the detailed arrangements.

Diversification of enterprise on farms will be encouraged by the introduction of a scheme under section 22 of the Agriculture Act 1986, providing for the grant-aiding of ancillary businesses on or adjacent to farms. This will include activities such as value-added food processing and the provision of recreational and amenity facilities. There will also be extra help for marketing of the products of diversified businesses. In working up these schemes it will be necessary to ensure that they are complementary to the activities of the existing agencies working in this field, particularly the Development Commission, COSIRA, the small firms service, local enterprise agencies and tourist boards.

Within my budget for research, development and advice I shall be placing more emphasis on the possibilities for novel crops and livestock which have a prospect of being realistic alternatives to commodities in surplus, and on the socio-economic and environmental implications of the changing farming scene.

Finally, my right hon. Friends the Secretaries of State for the Environment and for Wales are today putting out for consultation a draft circular containing guidance on the future planning regime for agricultural land. It will include more encouragement to local authorities to take a positive attitude to diversification and to be helpful about the conversion of redundant farm buildings.

These new initiatives are expected to cost about £25 million a year when they are fully operational. This comprises an estimated £10 million on farm woodlands, £3 million on traditional forestry, £7 million on ESAs— doubling the existing provision — and £5 million on diversification and marketing. The alternative use of land will lead to compensating savings in CAP expenditure. This does not imply any change in the overall public expenditure totals.

In addition, I and my right hon. Friends the Secretaries of State for Scotland, for Wales and for Northern Ireland, plan to publish next month a document setting out how the Government see the changes affecting farmers, emphasising that it is for individual farmers to decide how to run their own businesses, but describing how the Government's policies towards farming are being adjusted to reflect the changing scene and potential in the rural economy as a whole. The Government's overall objective is to facilitate the conditions which encourage a healthy rural economy based on enterprise, adaptability and fair competition.

ANNEX
B

2834/38

ANNEX B

STORM DAMAGE TO WOODLANDS IN SOUTH EAST ENGLAND

1. The Minister of Agriculture wrote to the Chief Secretary on 31 December seeking agreement for special compensation to farmers affected by the storms in October 1987. Measures to assist orchard owners and glasshouse owners, together with enhanced rates of grant for replanting hedges and shelter belts, were announced in November. The Countryside Commission has funded a programme for replanting amenity woodlands.

2. On our advice the Chief Secretary has resisted making any special announcement about further aid to woodland owners on the grounds that major changes to the grants available for replanting are imminent. The Minister is likely to come under pressure for a positive response when the Agriculture Committee's report on the results of the October storms is debated (probably on 8, 9 or 10 March). We continue to take the view that an announcement at that stage would be premature.

Background

3. Approximately 20 per cent of the trees in south east England were blown down in the storm. 70 per cent of these were in private sector woodlands; the area is approximately 12,000 hectares. A Forest Windblow Action Committee, made up of representatives of the Forestry Commission, woodland owners and the timber processing industry, was set up after the storm to assess the damage and give advice on clearance, marketing, etc. The Committee recommended:

(i) a transport subsidy to cover the extra cost involved in moving timber (mainly conifers) to more distant markets;

(ii) a supplement to the normal Forestry Commission planting grants in order to cover part of the additional costs of preparation and planting on windblown sites.

The Minister of Agriculture concluded that a transport subsidy is not necessary but does wish to pay a supplement to the planting grants in order to encourage the owners concerned to replant. He claims that he is under strong pressure to provide financial assistance for this purpose and is concerned that, if special assistance is not provided, many owners will be deterred by the costs involved and will take no action to replace blown trees. He considers that, if that happened, the Government would be criticised for failing to take positive steps to restore the woodland environment in south east England.

4. The Minister proposes that the supplement should be £150 a hectare for conifers and £400 a hectare for broadleaves. The Forestry Commission consider that this would cover approximately 50 per cent of the additional costs involved in planting on windblown sites compared to replanting normal sites. The Commission calculate that the existing planting grants under the Forestry Grant Scheme cover, on average 15 per cent of costs and that grants under the Broadleaved Woodland Grant Scheme cover 25 per cent of costs. Owners also benefit, of course, from the tax regime for forestry. The current rates of grants are set out in the main paper. These were reviewed by the Forestry Commission during 1987; it concluded that a general increase was not necessary.

5. The Forestry Commission estimate that the supplement would cost £3.55 million if all the windblown area is replanted with trees of the same type as before. The cost of planting grants, on the current rates would be £6.3 million. The likely pattern of planting grants would be:

			£ million
	Planting grants (old rates)	**Supplement**	**Total**
1988-89	1.1	0.59	1.69
1989-90	1.5	0.89	2.39
1990-91	1.5	0.89	2.39
1991-92	1.1	0.59	1.69
1992-93	1.1	0.59	1.69
Total	6.3	3.55	9.85

The Minister of Agriculture has sought Treasury agreement to increase provision for the Forestry Commission by these amounts but has not offered any offsetting PES savings.

6. The Minister says that that the Forestry Commission intend to contain the administrative costs associated with the grant payments within existing provision and also the costs of clearing and replanting its own estate (the latter costs are estimated at approximately £1 million a year for the next five years) but he has put up a marker that a bid may be made in this year's Survey.

7. The Chief Secretary has accepted the woodland owners who decide to replant will continue to be eligible for Forestry Commission planting grants. He has, however, resisted the proposed supplementary grant towards clearance costs.

Prep

FINANCIAL SECRETARY TO THE TREASURY

FROM: FINANCIAL SECRETARY

DATE: 1 March 1988

CHANCELLOR

Discussed with PS/FST & agreed to suppress.

cc Chief Secretary
Sir P Middleton
Mr Anson
Mr Monck
Mr Burgner
Mr Marshall - IR

FORESTRY

I had a meeting with the RSPB today and my office will circulate a note of this in due course.

2. But one point the RSPB raised I had not heard before: forests are exempt from rates (and presumably will be exempt too from the community charge). There is, therefore, a further incentive for forestry compared with farmland, or even moorland.

Ch
Farmland is exempt from (non domestic) rates too.
AA

NL

NORMAN LAMONT

RIDLEY 1/3

SECRET AND PERSONAL

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
SW1P 3AG

CH/EXCHEQUER	1/3
REC.	01 MAR 1988
ACTION	MR MONCK
COPIES TO	CST FST EST SIR P. MIDDLETON MR BURGNER

1 March 1988

MR RIDLEY 1/3

Dear Nigel

SUPPORT FOR FORESTRY

We are to meet tomorrow to discuss the note by officials circulated with your Private Secretary's letter of 29 February. I am sure we must look very carefully at the new grant rates now being proposed, in the light of possible public reaction.

The new supplement for planting on arable and improved grassland (annex A, para 4) is an important step towards encouraging forestry to come down the hill, and preserving environmentally important upland areas. However to make a real impact, it needs to be a significant amount. I gather the figure in mind at the moment is a single payment of £150 per hectare and I would press strongly for this to be increased to £300 per hectare. The additional cost could be met from the savings achieved through the other modifications I propose below.

I believe the basic planting grants for conifers could be attacked as excessively generous, especially as public criticism has been tending to focus recently on the total Government support for forestry, rather than merely the question of tax relief. In my view the grant for large-scale conifer plantations (10 hectares and over) should be increased by only £230 over the present figure to £470 per hectare. For smaller areas of conifers however I would be prepared to accept your proposal that the grant should be increased by £350 per hectare for each band, corresponding to the Inland Revenue's estimate of the benefit which has been obtained from the present tax relief. In the Farm Woodland Scheme, on the other hand, the rate of return is boosted by the annual payments farmers will receive and will be 18% even after the tax changes. It would be unjustifiable to increase it still further and grants for planting of conifers under the Farm Woodland Scheme should therefore remain at the same levels as in the present Forestry Grant Scheme (the first column of table 1, para 17).

For environmental reasons we must continue to give strong support to the planting of broadleaves and I would therefore support an increase of £350 per hectare in each of the present grant rates under the Broadleaved Woodland Grant Scheme, and I would also apply these new higher rates to planting of broadleaves under the Farm Woodland Scheme.

However I do have strong reservations about applying these new higher rates to any broadleaved planting within a mixed plantation, as paragraph 5c proposes. This would give an undeserved bonus to what might in some cases by purely token use of broadleaves, with no real significance silviculturally, or for landscape or wildlife. There ought to be a threshold therefore and I suggest this should be set at 50% broadleaves.

I accept however that, even below the threshold, there might be some financial incentive for people to include a proportion of broadleaves and that could be provided by paying grants £350 per hectare higher in each case than the present broadleaved rates under the Forestry Grant Scheme (the figures in parentheses in table 1).

I am copying this letter to Malcolm Rifkind, John MacGregor and Peter Walker.

Yours ever
Nicholas

NICHOLAS RIDLEY

45/B.rj.2189/022

SECRET AND PERSONAL

FROM: N MONCK

DATE: 1 March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Burgner
Mr Call

FORESTRY

behind

This is a supplementary note covering the proposals in Mr Ridley's letter of 1 March. I attach a page containing quick estimates of the costs and savings attributable to these proposals compared with the following "Chancellor's proposals":

(a) **Forestry**

(i) an increase of £350 per hectare on top of the "present" grants for conifers and the BWGS broadleaved grants in table 1 on page 6 of the Officials Paper;

(ii) a supplement of £150 per hectare for planting on improved land.

(b) **Farm Woodlands:** an increase of £350 for broadleaved only on (lower) FGS rates.

I have taken copies

2. The attached page is intended to be suitable for handing round. I think it will be necessary to do that if you are to have any chance of a proper discussion of Mr Ridley's proposals and using them to get good decisions which are now urgent.

Doubling the supplement for planting on improved land

3. You may find the results - extra costs of £3.3 million a year - surprising. But we have to allow for the behavourial effect which Mr Ridley is after. The costs are likely to rise in a non-linear way for this reason.

4. We advise you to resist this on cost grounds and, if Mr Ridley presses, to concede a supplement no higher than £200 per hectare.

Increasing grants for conifer plantations of 10+ hectares by less than £350

5. You will want to go for this hard, though Mr Rifkind and probably Mr Walker are likely to resist despite the relatively small reductions in the rate of return.

6. But our advice is against applying this proposal to conifers on farm woodlands. The reason is that it would risk prompting farmers to keep their conifer areas just below 10 hectares. This could actually have the effect of raising average costs because more planting would qualify for higher grants on the smaller areas.

7. If this difference from forestry grants is thought to be a presentational problem, there is a way out. The cut-off for forestry plantations could be 40 hectares instead of 10. 40 hectares is the upper limit for Farm Woodlands Scheme and the forestry savings with this cut-off point would be almost the same as with 10 hectares, because the proportion of planting between these two figures is small.

Farm Woodlands Scheme : add £350 to Broadleaved Woodland Grant rates

8. You could concede this to Mr MacGregor provided he agrees that there should be no increase for FWS conifers. Mr Ridley will support you on that.

Paying a lower grant for broadleaves accounting for less than 50 per cent of mixed plantations

9. This would be a useful saving.

Conclusion

10. On the whole Mr Ridley's letter should be helpful. But two of his proposals cost money and doubling the supplement costs a lot. They are attractive on environmental grounds but there will be resistance from the Forestry Ministers and you will want to ensure that any cost increases you concede are at least matched by savings.

N MONCK

ANNEX

MR RIDLEY'S PROPOSALS : ESTIMATED COSTS AND SAVINGS

Doubling the supplement for planting on arable and improved grassland

1. The present proposal is assumed to apply to 4,000 hectares a year by 1990/91, costing £0.6 million a year. Doubling the supplement might double the area to 8,000 hectares, directly adding £1.8 million a year. But the increase in broadleaved and small scale planting would add about £40 a hectare to the average grant cost over total UK forestry planting, adding another £1½ million on the assumption that the steady state proportion of broadleaved in total planting is 25 per cent instead of 20 per cent. So total extra cost is £3.3 million a year.

Increasing grants for conifer plantation of 10+ hectares by £230 instead of £350

2. We assume no effect on planting as real rate of return would fall very little - from 4.1 per cent to 3.8 per cent. The steady state saving would be £3 million a year. Corresponding figures for grant increases of £270 and £310 would be savings of £2 million and £1 million a year.

MR RIDLEY'S PROPOSALS COSTS + SAVINGS

Farm Woodlands Scheme : add £350 to Broadleaved Woodland Grant rates

3. This costs £0.8 million a year when planting reaches 12,000 hectares a year on the assumption that 75 per cent of all planting is in mixed woodland and that half that (37½ per cent) is broadleaved. This cost would be halved by the next proposal.

Paying a lower grant for broadleaves accounting for less than 50 per cent of mixed plantations

4. This would save about £1 million a year, of which £0.6 million would be on forestry and £0.4 million on the Farm Woodlands Scheme.

MACGREGOR 3/3

MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister

Ch/ I am sparing you the back pps. on this - Mr Monck will advise. 2/3

CH/EXCHEQUER
REC. 02 MAR 1988
ACTION Mr MONCK
COPIES TO CST, FST, EST, Sir P. MIDDLETON, Mr BURGNER.

SECRET AND PERSONAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
Treasury
Parliament Street
LONDON
SW1P 3AG

Right structures wrong figures. N.

3 March 1988

Dear Chancellor

SUPPORT FOR FORESTRY

I promised to write to set out my reactions to our discussion this morning as part of the preparation for the further meeting we are to hold.

Taking first the question of the grant rates for conifers, Nicholas Ridley has suggested that for traditional forestry planting over 10 ha, the grant increase should be £230/ha but that for smaller areas under 10 ha, the increase should be £350/ha for each of the bands concerned. We also discussed at the meeting some form of differentiation of grant rates for areas over 40 ha as between England and the other territories. Finally, Nicholas has suggested increasing the "better land" supplement from £150/ha to £300/ha.

Taking them in reverse order, I support the environmental and "agricultural surplus" objectives behind Nicholas' approach to the "better land" supplement and therefore could agree to his proposal there; it would be essential that the supplement applies in England irrespective of any differential rates agreed for the main scheme, but I do not think this is in dispute.

On the differential territorial rates, it is for Malcolm Rifkind and Peter Walker to make the case. It would obviously cause me difficulty and there would be criticism from English growers. But if it was necessary to achieve a final package I would be prepared to go along with the idea in principle. I would first need to see more precise proposals on this so as to be able to assess the effects in practice.

On the £230/ha proposal, I repeat what I said this morning: I would be prepared to accept this for England provided that the £350/ha increase Nicholas suggested for conifers should be

SECRET AND PERSONAL

extended also to the 10-40 ha band and that this be the rate also under the Farm Woodland Scheme, as you suggested this morning might be a possible way of solving the FWS issue. I cannot accept Nicholas' suggestion that grants for planting of conifers under the FWS should remain at the same levels as in the present Forestry Grant Scheme. This would undoubtedly mean a lower incentive than exists under the FWS at present for both conifers and mixed woodlands.

Turning to broadleaves, I accept that Nicholas' suggestion for an increase in the "better land" supplement, if accepted, has to be taken into account. So the £500/ha figure proposed by the Forestry Commission, which they thought necessary to achieve the overall level of planting to which we are committed, could be reduced to take that into account. But if we are to achieve the level of broadleaved planting which we seek under the FWS, I really do feel that we would have to stick at £450 for pure broadleaves (ie roughly the figure in option 4 and for the reasons set out there). This is of course a reduction from the £500 I was seeking under option 5.

On mixed plantations, I note what Nicholas Ridley has suggested. As the next step, I would like officials tomorrow to confirm precisely how the Forestry Commission would propose to administer the new grant structure proposed in paragraph 5 (c) so that we can see how the figures for typical cases would work out in practice. Subject to this, however, I recognise that a 50% broadleaved content has been agreed as a cut-off point to distinguish between the 20 and 30 year payments of income supplement under the Farm Woodland Scheme. Depending on the outcome of the statistical study by officials, therefore, I would not rule out exploring Nicholas' proposal further.

On the overall costings you suggested that the financial envelope should be £12 million for traditional forestry and £2 million for the Farm Woodland Scheme. In the time available at the meeting, we were not able to go into this in any detail. I should therefore repeat the view I expressed at the meeting that the £12 million will not be reached for some time and that if we are therefore not to see a drop in plantings this has to be taken into account. In the case of the Farm Woodland Scheme, I am concerned that the £2 million figure could jeopardise the scheme and therefore would wish to see the rates I have advocated above.

Finally, on the question of the transitional arrangements, (paragraph 35 (d)), I believe it is desirable that Schedule D should continue if possible to be available for people who have submitted applications before 15 March but which have not yet been approved, for the reasons given in the officials' Report. Also I do hope that we can agree on a compromise for the transitional period at 5 years.

I should also record here that it is also vital that the transitional arrangements apply to the costs incurred by woodland owners in clearing up after the October hurricane. As this is entirely an English problem, however, I am writing to you separately in more detail.

PB. behind

I am copying this letter to Malcolm Rifkind, Peter Walker and Nicholas Ridley.

Yours sincerely

for JOHN MacGREGOR

(approved by the Minister and signed in his absence)

45/B.rj.2189/025

SECRET AND PERSONAL

FROM: N MONCK
DATE: 3 March 1988

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Burgner
Mr Hughes
Mr Call

Mr Beighton) IR
Mr Marshall)

FORESTRY

You will be meeting the Forestry Ministers and Mr Ridley for the second time at noon tomorrow.

2. I attach the note which the official group were asked yesterday to produce. It reflects our meeting this morning, which I have described to you, and has been prepared by Mr Burgner. It has not been agreed in detail with departments but I think they will regard it as fair. It deals with Mr Ridley's suggestions and with the possibility of having a differential grant system in England and Scotland. It is discouraging about both and ends by directing Ministers back to officials' original report. The DOE representative reserved Mr Ridley's position but did not have an answer to most of the points made by the forestry and agricultural departments.

3. The Ministers will have been briefed that this is the last chance of settling the new grants before the Budget, that discussions after it could take a damagingly long time from the point of view of forestry confidence and would bring in other Ministers with a different view of priorities etc. The forestry and agriculture departments accepted the need for urgent decisions but recorded that their Ministers did not accept your expenditure envelope.

4. As time is likely to be short I suggest you might shape the meeting as follows:

(a) last chance to decide grants before Budget. Better for forestry confidence and for Government as a whole if new grants announced quickly. But if we can't agree, ready to leave decision until after Budget, as originally envisaged at No 10 meeting. Could take some time to resolve and picture could look very different then;

(b) official paper takes a further look at Nicholas Ridley's ideas but officials are pretty discouraging. Subject to Mr Ridley's comments, suggest we return to questions posed at end of officials' original report; proposals already embodied a balance between forestry policy and environment etc;

(c) may help if I spell out the complete package I propose rather than taking elements individually (see paras 5 to 6 below) including points on transition;

(d) announcement and presentation. (see paras 10 to 11 below)

Proposals - Line to take

Forestry

5. (a) improved land supplement of £150 or perhaps £200;

(b) raise conifer grants by £350 and broadleaved by £350 on the BWGS rates, ie on average by about £550 on the FGS rate (which currently applies to broadleaves in mixed plantations). New rates to be:

Hectares	Conifer	Broadleaved
	£	
0.25 - 0.9	980	1550
1.0 - 2.9	855	1350
3.0 - 9.9	770	1150
10 and over	590	950

(c) transition (see paras 27-30 of earlier report): can agree

(i) pipeline cases (para 29) should qualify, provided of course that they don't get new higher grants;

(ii) so should costs of clearing and replanting after October storm damage [for woodlands "managed on a commercial basis with a view to the realisation of profit", though you need not mention this, as they really ought to know. See Annex A to this brief from Mr Beighton] until the end of the transitional period;

(iii) transition should last for 5 years, ie till April 1993 instead of 1992.

Farm Woodlands Scheme

6. (d) no change for conifers (ie old FGS grants);

(e) new broadleaved grants as in 5(b) above for all broadleaved, not just beech and oak;

General

7. Recognise no one gets everything they want out of this. I was certainly going further than I would like in the envelope I defined on Wednesday of £12 million for forestry and now to steady state public expenditure increment of £13 million for forestry for sake of raised broadleaved share. And Farm Woodlands could easily cost more than my figure of £2 million, eg if very large differential in favour of broadleaf (£700 or so per hectare) prompts half of 9000 hectares a year of mixed woodlands to be broadleaved (4500 x increase of £520 = about £2½ million. £520 is £350 plus the gap between the FGS and BWGS grants in the 3-9.9 hectares band).

8. My £350 general increase is not a negotiating figure but a rational one based on the Inland Revenue's estimate of the average marginal tax rate. It enables us to say, in the words of the Forestry Commission's draft briefing notes (see para 6 of Annex B to this brief) "The new grant rates will be set at a level to maintain the existing level of support" for forestry. [If pressed: to get agreement you could move to £375, equivalent to an average marginal tax rate of 45 per cent. Anything higher than this would be difficult to justify on this basis: you would be increasing the subsidy per hectare, which was not what your colleagues agreed. Para 11 of officials earlier report explains the Inland Revenue's average marginal rate.]

9. Some key defensive points are in Annex C.

Announcement and presentation (if a deal is done)

10. (a) **Timing:** we have agreed on announcement in week after Budget. If it has to wait longer or even that long, would probably be helpful if Financial Secretary announced in debate on Wednesday after Budget that increased public expenditure provision would allow grant increase of equivalent to £x a hectare equal to present average tax subsidy, with some more for broadleaved on average; a statement on these lines would

still allow part-time Commissioners to do fine tuning as proposed within the agreed amount of public expenditure;

(b) **Environment:** is it agreed that package should win support from moderate environmentalists? Can Mr Rifkind look at the draft Forestry Commission booklet from a political point of view to make sure it includes environmental bull points, though present workmanlike draft is broadly all right provided it is supplemented by printed glossy version later as agreed;

(c) **Mr Walker's speech:** awkward timing of EFG lunch on Thursday after Budget. You will want to confirm that Mr Walker will clear his speech in advance of Budget with you and other Ministers present; hope he will pick up presentation in Budget Speech and make point that while forestry policy is being maintained, there is some improvement in the balance which, to quote the 1985 Act, the Commission is obliged to achieve better afforestation and timber production and

> "... the conservation and enhancement of natural beauty and the conservation of flora, fauna and geological or physiographical features of special interest."

As Mr Walker (like Mr Rifkind) is both an Environmental and a Forestry Minister he would be well placed to say this.

(d) **Briefing**: official group should be asked to produce Q & A briefing so that we have a properly co-ordinated line. It should also in due course concert press notices from Revenue and Commission.

11. If there is no deal, (c) and (d) would still be relevant.

NM

N MONCK

81

BUDGET SECRET : TASK FORCE LIST

COPY NO 1 OF 5

INLAND REVENUE
CENTRAL DIVISION
SOMERSET HOUSE

FROM: L J H BEIGHTON
DATE: 3 March 1988

Mr Monck
HM Treasury
Parliament Street
LONDON SW1

ANNEX A

FORESTRY : MR McGREGOR'S LETTERS

1. Storm damage

There is no problem here so long as we are talking about commercial woodlands, i.e. woodlands that are "managed on a commercial basis with a view to the realisation of profit". If an occupier is now on Schedule D he will get the costs of clearing and replanting as a revenue expense deductible in the normal way until the end of the transitional period. It is just possible that some of the expenditure would be on capital rather than revenue account, e.g. if he decided to put up a better fence or a new road, and in that case he would get capital allowances but the full amount of the cost would not have been written off before the end of the transitional period. It seems highly probable however that the bulk of the expenditure incurred would be revenue rather than capital. If an occupier is now on Schedule B he will be able to elect to go onto Schedule D until the end of the transitional period for any existing woodland (and presumably woodlands which were not existing last autumn were not damaged!).

I suppose that Mr McGregor's letter could be read as asking for relief for damage to amenity woodlands but these have never* been within the tax charge (either Schedule B or D) so nothing that the Chancellor is proposing in his Budget would affect the situation. It would clearly be difficult to give relief for amenity woodlands: to take it to its logical extreme, should I get relief for the cost of lopping a tree in my garden that was damaged in October?

Finally, farm woodlands. There is no problem here in relation to orchards, whether hard fruit, soft fruit or hops. Clearance costs will be a revenue item and farmers will similarly get a deduction for replanting costs as stock in trade provided that that is done within a reasonable period. The cost of replanting shelter belts however would be a capital item attracting agricultural buildings allowance. The transitional cut-off for commercial woodlands will not apply.

* not quite right: Revenue say they were within Schedule B until 1963

Dg

ANNEX B

FORESTRY ASPECTS

DRAFT BRIEFING NOTES BY THE FORESTRY COMMISSION
(with m.s. Treasury amendments)

1. The Government remains of the view that a continuing expansion of forestry is in the national interest and that long-term confidence in both forestry and wood-processing industries in this country is fully justified. This was endorsed by the statement of the Government's new policies for alternative land use made on 9 February last year which announced an expansion of the forestry programme with the aim of ~~to~~ 33 000 hectares of new planting a year, with particular emphasis on the private sector and with due regard to environmental considerations. The planting of a higher proportion of trees on low ground of better quality is also being encouraged. This ~~target for new planting will continue to form an important part of Government forestry~~ policy has not been changed.

2. The United Kingdom and the EEC generally are expected to remain large importers of wood products. A recent study by FAO foresees a growing demand for wood worldwide, with the European region experiencing a growing deficit. The continuing growth in consumption in both developed and less developed countries, taken with the depletion of forest resources in many regions, provides the assurance that, even over the very long timescale involved, demand for wood will remain bouyant.

3. Building up the country's wood resource has been a prerequisite for the creation of a modern wood-processing industry. Since 1980 the industry's capacity has been expanded by the investment of over £650 million. As has been well illustrated in the Forestry Industry Committee of Great Britain's study "Beyond 2000", this has resulted in the establishment of sawmills and processing plants which are among the most up to date in the world. This expansion has extended and diversified the UK's manufacturing base [at the time when many other industries have been contracting.] omit

4. Wood production from our existing forests will increase into the next century to some 10 million cubic metres a year - almost double the present levels. Production from the expansion promoted by our present

policies will begin to supply wood from thinnings in about 20 years time. This wood will be the base for a much expanded wood-processing industry on the scale which other Member States of the European Community already enjoy.

5. Increasing timber output can be expected to provide more employment, mostly in rural areas where the forests are situated. The new planting programme will add to this, ensuring that forestry contributes more to employment in rural areas. It will also provide an alternative to agricultural production and thereby assist in the reduction of agricultural surpluses.

6. The new grant rates will be set at a level to maintain the existing level of support which has resulted in a steady increase in the rate of planting ~~towards the target~~. There will be a supplement to encourage planting on better land.

7. The new scheme will be simplified in accordance with representations made by the industry for a unified scheme to replace the present schemes. There will be a single rate for all broadleaved planting set at a higher level which will give a substantial additional incentive for broadleaved planting and also favour the wider use of mixtures.

8. The conditions of the new scheme will be essentially the same as those they have replaced, and have been unified so as to give a common approach to all planting or natural regeneration (including that of coniferous crops). (They will build on developments in recent years designed to improve the environmental aspects of forestry.) The native pinewood grant rate will also be increased.

9. The grant Booklet will contain a new guidelines section for those submitting applications.

Forestry Commission
19 February 1988

ANNEX C

DEFENSIVE POINTS

£350 will damage planting aim

1. I doubt it very much. The real rate of return is only 0.2 per cent less than with a £500 grant increase (which would cost £5 million more a year in a steady state). Costs are on downward trend. Planting under the present regime was rising fast and expected to hit the aim in 1988/89.

No date attached to planting aim. May well be a dip after change of regime, as with Forestry Commission's own projections even with a £500/hectare increase.

Farm Woodlands (conifers)

2. Accept return will not be as (absurdly) high post-Budget as before. But real return with no increase in present Forestry Grant Scheme conifer rates is at least 18 per cent for a 28p taxpayer or over 15 per cent for a 40p taxpayer. Both these rates of return include the annual income payments, which are meant to match alternative farming enterprise income (pre-summit). Within those figures 5½ per cent comes from the woodland enterprise - more than enough to make farmers switch income brackets.

Higher increase for broadleaved good for environment, though over-compensating for tax changes. Good take-up for the scheme as a whole, of which only 25 per cent is conifers, is expected. Mr MacGregor does very well out of the broadleaved increase as well as getting 80 per cent of the £150 supplement. [£350 FWS conifers will cost about £1 million a year]

Public expenditure takes time to build up

3. Yes. But so do the tax savings. The cost of the tax relief is currently estimated at £8½ million and would not reach £12 million until the late 1990s. This is a presentational trick. The fair way to look at costs is in terms of steady state costs or at average subsidy per hectare. You agreed public expenditure should match tax saving.

Employment in forestry

4. Forestry Commission figures show that over 90 per cent of the jobs produced by forestry come 35 years after planting, even with conifers. These delayed jobs are expensive. In the north Scotland subsidy per man year is about £8,000, ie more than typical earnings of £6,500 a year. This is nearly double the subsidy per job needed for operations of Highlands and Islands Development Board.

OFFICIAL GROUP NOTE

117/cr/920/16

SECRET AND PERSONAL

FORESTRY AND FWS GRANTS

Note by Officials

This note discusses the scope for varying the grants package in ways proposed in the Secretary of State for Environment's letter of 1 March within the steady state cost envelope defined by the Chancellor at his meeting on 2 March. It also takes account of the Minister for Agriculture's letter of 3 March. The cost envelope was £12 million a year for forestry grant increases and £2 million a year for the Farm Woodlands Scheme (FWS) although Forestry Ministers have since indicated that they do not regard these figures as an agreed constraint. The note also covers the proposal for an increased supplement for planting on improved land in Scotland and the possibility of different grant arrangements in England, Scotland and Wales. The note reports the views of officials expressed at a meeting in the Treasury on 3 March.

2. The paper measures costs and savings by comparison with the following package on **forestry grants**:

(a) an increase of £350 per hectare on top of the present grant rates for conifers and for Broadleaf Woodland Grants Scheme (BWGS) broadleaved (in table 1 on page 6 of the officials paper); grants would be paid pro rata for mixed plantations at the rates appropriate to the size of plantation;

(b) a supplement of £150 per hectare for planting on improved land.

For **farm woodlands** the base is no change in existing Forestry Grant Scheme (FGS) or BWGS rates.

3. As table 3 of the officials earlier paper shows, this package would have a steady state incremental public expenditure cost of £12.8 million a year or £1 million more than the steady state tax costs. The general grant increase of £350 per hectare corresponds to the average value of the present tax treatment as estimated by the Inland Revenue. The extra £1 million reflects the bigger average increase assumed in table 1 for broadleaved, resulting from adding £350 to the present BGWS rather than the (lower) FGS rates in table 1.

4. In discussing the further changes in this note, some allowance needs to be made for the "supply side effect", ie the changes to the level of planting as a result of increasing or reducing the level of incentives. Officials have

not been able in the time available to quantify this, but have tried to indicate where they consider the effect is likely to be large.

Raising the supplement for planting on improved land

5. Officials considered what benefit, if any, there would be in doubling the supplement for planting on arable and improved grassland from £150 per hectare to £300 per hectare as had been suggested. The main instrument for encouraging increased planting on better quality land is through the FWS; it is estimated that most of the annual increment under the FWS will be on improved land (11,000 hectares). The proposed supplement was intended as a signal to encourage more planting on improved land but, unlike the FWS it was not intended to compensate for agricultural income foregone - to achieve this it would have to be several times higher. The supplement has been estimated to produce an additional 4,000 hectares annually and officials thought it was unlikely that doubling the supplement would have much effect in terms of extra planting. The additional expenditure would therefore have a heavy deadweight content. (If, against officials' expectations, doubling the grant led to a significant increase in the amount of improved land available the costs would be substantial, since the higher grant would be payable over the larger area). Officials (except for DOE whose position was reserved) concluded that this option was not to be recommended; and their preference is for leaving the supplement at its existing level. If Ministers none the less decided in favour of some increase, officials consider this should be limited to £50, ie a total of £200 per hectare, which might raise the cost by £0.3 million.

6. The possibility was also considered of differential rates for Scotland and Wales, ie confining any increase in the supplement to England. Although the majority of the 4,000 hectares take-up is expected to be in England, Scottish and Welsh Office officials are opposed to any departure from the principle of supplement on a national basis.

Increasing Grants for Conifer Plantations of 10+ or 40+ hectares by £230 instead of £350

7. This would reduce the real rate of return from an estimated 4.2% to 4.0%. The reduced grant would apply to the great majority of all [conifer] planting, of which 93% is in plantations of 10+ hectares and about 90% in plantations of 40+ hectares. Assuming the planting aim is met, the savings from lower grant increases for 10+ hectare conifer plantations are shown in the following table.

Grant increase	GB savings
£	£m
230	3
270	2
310	1

However Forestry Commission officials and officials from the forestry departments consider that a grant level of £350 would make it difficult to meet the planting aim and that a figure of £230 would be a major disincentive and would have serious consequences for present and future planting levels (although this would of course produce a large financial saving). The quantity of new conifer planting in England annually is very small (444 hectares in 1986-7); and the savings from a lower grant increase for larger areas of conifers in England would be negligible. However the existence of larger incentives in Wales and Scotland would leave the Government exposed in view of the recent environmental criticism to some of the planting in those territories eg Flow country).

Paying a lower grant for broadleaves accounting for less than 50% of mixed forestry plantations

8. The proposal is that the grant rates for broadleaves accounting for less than 50% of mixed plantations would be arrived at by adding £350 to the FGS rates which, as table 1 of the officials paper shows, are lower than the BWGS rates by between £310 and £130 per hectare.

9. Officials noted that the effect of this would be to discourage broadleaf planting, mainly in the uplands where conditions made a minority of broadleaves in the mixed plantations a realistic and desirable objective. In addition Forestry Commission officials maintained that the 50% criterion (or indeed any alternative figure) would create inflexibility. The overall effect would therefore be a lower level percentage of broadleaf planting, contrary to Ministers environmental aims and inconsistent with the aim of achieving 20% broadleaves in new planting. The resulting share of broadleaves might remain close to the present level of 13 per cent. If the effect were on that scale, the saving would be £1.4 million.

10. A variant of this proposal would be for broadleaved grants to be based on present FGS instead of BWGS rates with an immediate saving of £1 million. The ultimate saving would be greater because the level of broadleaf planting would not be likely to increase as currently expected since the incentive to do so would be considerably weakened. Again this appears inconsistent with Ministers' environmental objectives.

Farm Woodlands Scheme

11. Mr Ridley proposes adding £350 to the BWGS grant rates for mixtures of over 50%, whereas mixtures of less than 50% receive grants of £350 over the FGS rates. This would be intended to increase the proportion of mixed plantations which would have at least 50% broadleaved. Mr MacGregor has proposed an additional £450 per hectare for broadleaves in addition to the rate that would have been paid under the FGS (for mixed plantations) or BWGS (pure broadleaves). Treasury note that Mr Ridley's proposed addition of £350 combined with the BWGS rate effectively adds about £550 per hectare to what farmers planting mixed plantations (75% of the FWS) might have expected to obtain; and that both this and the £450 proposed by Mr MacGregor considerably over-compensate on Inland Revenue calculations for the proposed tax changes.

Farm Woodlands Scheme - Rates of Return

12. Annex B of the officials paper, paragraph 3, states that even after the Budget changes rates of return for smaller broadleaves and mixed plantations (which are likely to comprise the bulk of FWS planting) will be in the region of 6-10 per cent; and for conifer plantations of 10 hectares the rate of return would be 18 per cent. MAFF officials dispute the figure of 18 per cent on the basis that it takes no account of the income foregone for agricultural production which itself had a real rate of return of about 12 per cent; and that the relevant figure for conifers in the FWS is therefore about 6 per cent. The Treasury maintain that 18 per cent is the relevant figure in this comparison. The difference between the two activities (6 per cent) represents a more than adequate incentive to shift farmers from existing agricultural production into the FWS.

CONCLUSIONS

13. Officials have considered a number of alternative proposals, some suggested by Ministers, others with the object of seeing whether within the framework of existing forestry policy savings might be secured so as to remain within the envelope of £12 million plus £2 million for FWS defined by the Chancellor.

14. There was broad agreement on the following points:

(a) Departments (with the exception of DOE officials who reserved their position) saw no advantage in increasing the improved land supplement. If Ministers favoured an increase, their recommendation was that this should be limited to an additional £50 per hectare maximum.

(b) There was no rationale for different levels of grants in the three territories (England, Scotland and Wales). Differentials would provide no practical benefits (particularly having regard to the very low rate of conifer planting in England) and would be difficult to defend politically.

(c) The grant rate for broadleaves in traditional forestry plantations should apply pro rata irrespective of the proportion in particular plantations; the addition of a 50% breakpoint would not be helpful. (DOE officials reserve their position).

15. If Ministers accept the advice in paragraph 14, it would seem sensible to return to the main propositions in the earlier note by officials. That paper aimed to strike a balance by giving considerably greater emphasis to environmental considerations within the framework of existing forestry policy. Specifically, in addition to the new supplement for improved land, the proposals give a large increase in the incentives for broadleaves, by aligning the broadleaf rates in the Forestry Grant Scheme with the BWGS (an average increase of some £200 per hectare) in addition to the general increase which Ministers have yet to determine. The result is expected to increase the broadleaved percentage in new planting from 13 per cent at present to 20 per cent.

16. If Ministers accept officials advice on these points, decisions are now needed on the following:

(a) Traditional forestry - what increases to grant levels which officials believe should be across the board, should be made to compensate for tax changes (table 3, paragraph 9 of the Officials paper).

(b) FWS - what increases, if any, are needed

- for conifers?

- for broadleaves?

- if any increase is agreed for broadleaves, should this be an addition to the FGS rates (which is the scale which most of those in the FWS are currently expecting to apply) or BWGS rates (previously reserved for pure broadleaves only)?

(c) Transitional tax provisions - should the transitional availability of Schedule D be available for people who have submitted applications before 15 March which have not been approved?

- should the transition last 4 or 5 years ie ending April 1992 or April 1993?

- subject to practical considerations, should the transitional arrangements apply to clearance and replanting of woods after storm damage in October 1987?

Northern Ireland

17. There would be no immediate effect of Ministers decisions on Northern Ireland where there is little private planting. If it were subsequently decided to adjust grant levels, there should be little difficulty in abosrbing the costs in the Northern Ireland block.

3rd March 1988