Agricultural Focus

DRIVING LIFELONG PROSPERITY

Autumn 2018

SPOTLIGHT ON FARMING PARTNERSHIPS

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INSIDE

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DRIVING LIFELONG PROSPERITY

The flexibility of partnerships can cause problems for the unwary

The majority of farm businesses still trade as partnerships. This is a flexible structure that allows profits to be divided according to the contribution of the respective partners, with profit sharing arrangements being varied from year to year if required.

Many farm partnerships have evolved over the years with family members introduced as partners when they have been deemed to be involved in the business for an appropriate time or as they have married in to the family. Introducing more family members allows profits to be spread around and reduces the likelihood of profits suffering higher rates of income tax.

Partnerships can also allow assets to be held tax efficiently for inheritance tax (IHT) purposes. Tax cases such as Farmer and Balfour have reinforced the view that where assets are held as partnership assets then, provided the partnership is viewed as mainly (more than 50%) trading, not only will 100% agricultural property relief (APR) from IHT apply to agricultural land and buildings, but 100% business property relief (BPR) will apply to other assets held as partnership assets as well. Sensible IHT planning has lead to a lot of valuable property with non-agricultural value e.g. let cottages, land with hope value etc. now being held as a partnership asset rather than owned outside the partnership with the owners just allowing the partnership to use the property.

The position has now arisen where it is not always clear which property is held as a partnership asset and which partners therefore hold a beneficial interest in that property. This may not cause a problem for many years while everyone is in agreement, but can be a major problem in the case of death, divorce or a dispute between the parties.

A well-drawn partnership agreement is a good starting point to clarify which assets are to be treated as partnership assets and who has an interest in these. However, over time what started off as a really useful document can be superseded by events and by the treatment of assets in the partnership accounts. It is really important that a good trail should be maintained to show the intentions of the parties at key times and that the partners should understand what is and is not shown on the partnership balance sheet.

A quick health check might consider the following questions:

1. **DO YOU HAVE A PARTNERSHIP AGREEMENT?**
   Many husband and wife farming partnerships have run for years without anything in writing, but when introducing the next generation in to the partnership and particularly when the younger generation marry, then it is a really good idea to have a written agreement.

2. **IS IT CLEAR WHICH PROPERTY IS HELD AS A PARTNERSHIP ASSET?**
   Ideally, the property held as partnership property will be clearly identified as such in a schedule appended to the partnership agreement. It may be that the legal title is vested in one or more people, but that the intention was that they are holding the property on trust for the partnership; or it may be that property has been purchased using retained partnership profits or partnership borrowing since the agreement was written. Given the relatively low cost of property in the past, it may be difficult to identify exactly which property is included in the land and buildings total in the partnership balance sheet.

3. **WHO HAS A BENEFICIAL INTEREST IN THE PROPERTY?**
   The property may be identified as partnership property in the partnership agreement and shown as such on the balance sheet, but who has an interest in the property? The older generation may have inherited or purchased the property many years ago and then invited one or more of their children into partnership. Has an interest in the property been gifted at that stage? Has there been a transfer of partnership capital that could be construed as a gift of the underlying property? The clearest way to identify a partner's interest is to have partnership property capital that represents the property and to have the property capital split between the partners in the appropriate ownership proportions. At the same time the partnership deed should record the interests of the partners in the partnership property.

4. **WHAT RATE OF IHT RELIEF WOULD APPLY TO A PARTNER'S PARTNERSHIP CAPITAL?**
   APR from IHT at the rate of 100% will apply to capital represented by farmland, farm buildings and farmhouses and cottages appropriate to the land occupied. BPR at the rate of 100% should apply to any other partnership capital, provided the partnership is predominantly trading. The position may be less clear cut where there is a significant amount of rental property or rental income, a significant value of investment assets or large cash reserves in the partnership. Check the position with your advisers.

5. **IF SOMEONE LEAVES THE PARTNERSHIP WHAT CAN THEY WITHDRAW?**
   Generally, a partnership agreement will provide for the partnership assets to be revalued to market value and the increase in value to be shared in the appropriate capital profit sharing ratio. The outgoing party will then be able to withdraw the value of their capital over a specified period. This is not necessarily the same as the partner being able to withdraw specific assets or being able to withdraw all their capital on day one. Provisions are generally drafted to safeguard the business. Do you know what these are?

6. **WILL YOUR WILL OPERATE WITH THE PARTNERSHIP ACCOUNTS AND THE PARTNERSHIP AGREEMENT TO LEAVE YOUR ASSETS WHERE YOU WISH?**
   With the inclusion of let cottages (say) within the partnership balance sheet for IHT planning reasons, can you still leave these to non-farming children after your demise? Steps taken by your accountant to minimise your IHT exposure, such as introducing property assets on to the balance sheet, may come as a surprise to the person who drafted your Will many years earlier. Does everything still work?

   Farm land and property often makes up the largest part of a farmer's or landowner's estate. It is well worth making sure it is clear who owns what property and that the property is held tax efficiently for IHT purposes.

Please contact Nick Dee on 01242 680000 or nick.dee@hazlewoods.co.uk if you would like to discuss farm partnership issues.

THINKING OF PASSING YOUR MAIN RESIDENCE ON TO THE NEXT GENERATION?

In the right circumstances, there can be inheritance tax (IHT) savings made by giving away your main residence to those you want to benefit from it, such as your children. However, before doing so, always bear in mind the tax implications, which will largely depend upon whether you intend to move out of the property or remain in situ.

For IHT purposes, if you make an outright gift of your property to your children this would be a potentially exempt transfer (PET). This means that there would be no immediate IHT charge due and, if you survive 7 years from the gift, the property would fall out of your estate on death, irrespective of any agricultural property relief available. If you do not survive 7 years the PET would fail and be brought back into account on death. Taper relief would reduce the rate of tax chargeable after 3 years.

For capital gains tax (CGT) purposes, if the property has always been your main residence then the gift would be tax-free because it would qualify for principal private residence relief (PPR). If it has not been your main residence throughout the whole period of ownership, then a proportion of the gain may be chargeable to CGT, which could trigger a charge on transfer. However, if gifting an interest in a farmhouse, then it may be possible to holdover any gain not covered by PPR

Whilst it may be possible to make the gift without triggering an IHT and CGT charge, you should also bear in mind the following:

1. If you continue to live in the property after the gift then you would need to pay a market rent to the new owner to ensure that there is no reservation of benefit and the gift is effective for IHT purposes. The rent would need reviewing regularly to ensure it continues to be at market value. The recipient of the property would have to pay income tax on the rents they receive. This tax would be payable at the recipient's marginal rate of tax, which could be as much as 45% if they are an additional rate taxpayer.
2. If you are making other regular gifts, and these qualify as gifts out of your surplus income, you should bear in mind that in having to pay an annual rent to continue to live in your property, this will reduce the amount of surplus income that you have available to give away.
3. Local authorities could conclude that the gift of your main residence is 'deliberate deprivation of assets' and, hence, they may still take its value into account in any tests for funding of residential care home fees.

4. Assuming the recipient of the property does not immediately move into the house, the property will not have always qualified as their main residence. This could make their IHT planning more difficult, as they could then trigger a capital gain on a future gift.

5. Always ensure that transfers of the property are carefully documented to avoid any ambiguities at a later date.

Always bear in mind all the implications before gifting your main residence.

Please contact Shirley Roberts on 01242 680000 or shirley.roberts@hazlewoods.co.uk if you have any questions regarding possible gift of a main residence.

LAND WITH DEVELOPMENT POTENTIAL

IS THE LAND BEING HELD TAX EFFICIENTLY?

There still exists a large demand for land with development potential in good locations. It is usually possible to structure a sale of farmland used by an individual owner in their own farming business, such that entrepreneurs' relief (ER) is available, which can reduce the rate of capital gains tax payable to 10% on the capital gain.

The relief can be available where the land is held outside of a farming partnership by the individual landowner reducing their interest in the partnership by an absolute amount of 5% and then selling the land shortly after. This usually allows more flexibility and does not require the partnership to cease.

However, the inheritance tax (IHT) relief available in respect of farmland can differ significantly if the land has development potential, depending on whether the land is held outside a trading partnership or included in the partnership balance sheet.

Agricultural property relief for IHT is available up to the agricultural value of farmland. Business property relief (BPR) is available in respect of the full market value of farmland including any development potential.

However, if land is held outside of a partnership, BPR is restricted to 50%. For example, consider a 50 acre block of land with an agricultural value of £10,000 per acre, but with a full market value including development potential of £100,000 per acre. If the land is held on the partnership balance sheet, then potentially no IHT will be suffered on the death of one of the landowners. However, if the land is held outside a partnership, then potentially half of the full market value of £5 million is chargeable to IHT at a rate of 40%, which could result in an IHT liability of £1 million.

Therefore, although holding land outside the partnership may offer more flexibility regarding a future sale, the age profile and IHT position of the individual landowners needs to be considered as there may be significant IHT at stake.

If you would like to discuss possible ER planning opportunities, please contact Peter Griffiths on 01242 680000 or peter.griffiths@hazlewoods.co.uk.

MAKING VAT DIGITAL (MVD)

From 1 April 2019, all VAT registered businesses with a taxable turnover above the VAT registration threshold will be required to maintain digital records as part of HM Revenue and Custom's (HMRC's) push towards Making Tax Digital (MTD).

This will mean virtually all farming businesses will have to keep digital records and use MVD compliant software to record income and expenses and submit their VAT return.

It is estimated that around 20 - 30% of farming businesses will not automatically be compliant for MVD, so it is really important to ensure you are compliant by 1 April 2019.

WHEN MIGHT YOU NOT BE COMPLIANT?

Paper based cash books will become a thing of the past as all information will need to be uploaded digitally.

Spreadsheets may be an option in the first instance, although they will need to be digitally enabled, or bridging software will need to be used to be MVD compliant. HMRC has said it will not be providing a free bridging link at this stage.

Software requiring updates will not be compliant. If older software licenses are being used that have not been upgraded recently, they may need updating to ensure compliance for MVD.

Non-compliant MVD software - HMRC has released a list of compliant software; the majority of farm specific software providers are included on this list. In order to check if your software package is complaint, there is a list on the HMRC website, or contact Hazlewoods and we will be able to confirm if your software is MVD complaint.

EXEMPTIONS

HMRC has said there will be exemptions if it is not reasonably practical for you to submit your VAT return online - this may be due to age, disability, religious beliefs or remoteness/lack of broadband. If you think any of these apply to you then contact Hazlewoods and we will be able to discuss the application for an exemption with you. If HMRC consider that an exemption is not appropriate, digital assistance may be available to help you get online support.

PARTIAL EXEMPTION CALCULATIONS

For partially exempt businesses, a monthly, quarterly or annual adjustment may be required. Only the total for the adjustment will need to be included digitally, not details of the underlying calculations; so, the partial exemption adjustment will now need to be included within the accounting software rather than just as a manual adjustment.

WHAT YOU NEED TO DO NOW?

If you realise that you are not compliant for MVD then ideally a solution should be put in place well in advance of 1 April 2019. Depending on the size of your business, the reports you want to produce and the number of enterprises you have will determine the most appropriate software package for you. Hazlewoods will be able to assist and advise you on the available options.

For anyone that currently uses manual cashbooks or spreadsheets, the most appropriate transition may be to a cloud-based package.

THE CLOUD

The Cloud is a platform that stores data and information which is accessible anytime, anywhere, from any device. There is the opportunity for farmers to use the Cloud as part of their everyday record keeping, ensuring all aspects of their financial records are totally up to date and providing them with the real time information they require to run their business successfully.

ADVANTAGES OF A CLOUD BASED PACKAGE:

Cost - upfront costs are reduced. There is no initial start-up cost, but instead a monthly subscription cost. As accountancy and taxation rules and regulations change, the software will be automatically updated, at no additional cost.

Access - just having one computer, with only one user being able to access the information will be a thing of the past. Multiple users can access the information from smart phones and tablets, which will allow you to be connected to all your financial affairs at any time.

Time - bank transactions can be fed into the system daily, so this frees up time that would have previously been spent entering each transaction.

Real time information - a major disadvantage of traditional software is that key advisers do not have access to the most up to date financial information that could be used to advise businesses and add real value. The Cloud means information can be completely up to date and gives farmers the ability to concentrate on other aspects of the business, without feeling like you are tied to the farm office.

Accountant relationships - your accountant will be able to access the data throughout the year, and advise on how to record transactions and also enter the year end journals on to the software directly, ensuring all data is up to date and relevant. With up to date, meaningful financial information, key business decisions can be made on an informed timely basis; this changes accountant/client relationships from being purely based on compliance, and allows better collaboration with other professional advisers.

If you are interested in finding out more about cloud based accountancy packages, and how they may help your business please contact Lisa Oliver on 01242 680000 or lisa.oliver@hazlewoods.co.uk.

VAT PARTIAL EXEMPTION

HOW DOES THIS AFFECT ME?

Partial exemption is one of the most complicated areas of the VAT system. This coupled with the ongoing diversification of many farming businesses can easily lead to farmers incorrectly calculating their VAT position. For most farmers the days of all their outputs being zero-rated and the majority of the VAT paid on their inputs being reclaimable are long gone.

For example, the modern farm now has far less reliance on farmworkers which, in turn, leads to a reduction in the requirement to provide farmworker accommodation. Rather than leave a cottage to decay, the farmer lets the cottage for a regular monthly income. This commercially sensible step will change the farmers VAT status from one of wholly taxable to one of partially exempt.

BUT WHAT DOES THIS MEAN?

By changing the use of the cottage to a let cottage rather than one of farmworker accommodation, the cottage has moved from being part of the standard/zero-rated farming business to a new exempt VAT supply. No VAT is charged on the rent but, more importantly, the input VAT on purchases now needs to be allocated between the different types of supplies, either the taxable farming supplies or the exempt rental supply. As potentially none, or not all, of the input VAT paid on costs relating to the let cottage can be reclaimed, this can lead to a reduction in the amount of input VAT allowable.

Where a farmer is making mixed VAT supplies, a partial exemption calculation is required. **Step one,** the VAT on the input costs is allocated to either the vatable standard and zero-rated activities or to the non-vatable exempt. There will be some input costs on which the VAT cannot be allocated specifically to either supply but falls across the two. The standard method of allocating the VAT on these costs is to apportion it between vatable and non-vatable in the same ratio as the vatable outputs are to non-vatable outputs.

Step two, if the total amount of input VAT relating to the exempt supplies falls within the de-minimis limits, the input VAT can be reclaimed in full.

In summary, provided the input VAT attributed to exempt supplies (including the proportion of the mixed costs) does not exceed either £1,875 a VAT quarter or 50% of all input tax incurred, then the farmer is able to claim all of the input tax suffered. This calculation generally takes place each time the farmer produces his VAT return and is also subject to an annual review where the whole year is looked at in total and a potential adjustment required. However, if the business was 'de minimis' in the previous VAT year (i.e. able to reclaim its VAT in full) then it can opt just to do an annual calculation.

In the scheme of things, letting one cottage may not have a regular impact on the total amount of input VAT to be reclaimed. However, at times there are likely to be exceptional costs that could lead to a restriction, such as:

- Significant one off costs relating to the exempt supplies, such as a full refurbishment of a let cottage.
- A major reduction in the farming activities, such as a change to letting out a large proportion of the farmland rather than farming in hand.
- The conversion of a disused farm building into a commercial or residential let.

If you are caught by the partial exemption restrictions, there are ways you can potentially improve your overall input VAT recovery, such as:

- Planning in advance for the timing of major capital expenditure and repairs. Possibly spreading large one-off costs across two different VAT years.
- Looking at the benefits of opting to tax on land and commercial property. This would lead to VAT being charged on the rental income, but also full recovery of input VAT on costs relating to the let property.
- A possible restructure of the business and removing some of the exempt income into a different ownership. Beware though, as this may lead to a stamp duty land tax or capital gains tax charge and a change in the inheritance position; so only proceed when you know the overall impact.
- Review your suppliers. Can you change to use non-VAT registered suppliers for your exempt activities?
- Is there a more effective use for the assets? Could the cottage be used as a furnished holiday let which is a standard-rated VAT supply.
- Is there a good reason to try and agree a different method of allocating costs other than the standard method based on outputs which will give you a better outcome?

Please contact Julian Millinchamp on 01242 237661 or julian.millinchamp@hazlewoods.co.uk if you have any VAT queries.

BEATERS' PAY; WHAT ARE THE REQUIREMENTS?

Beaters largely consider a day's beating as a hobby or a bit of fun and would not consider it as a form of employment. However, shoots need to consider the appropriate treatment of beaters' pay to ensure they are complying with legal requirements.

The nature of the working relationship will need to be looked at to determine whether the beaters are employed or self-employed. It may be difficult to argue that a beater is self-employed, so assuming beaters will qualify as employees, they may be regarded as 'daily casuals', in which case they can be paid without deduction of income tax and national insurance.

To qualify as a daily casual the following must apply:

- Beaters must be taken on for one day or less;
- Beaters must be paid at the end of that period; and
- There must be no contract for any further employment.

If the shoot is already running a payroll, which would usually be the case if a gamekeeper is employed, any amounts paid to beaters will need to be reported to HM Revenue and Customs under real time information in the normal way.

If the shoot does not operate a payroll, then the shoot will be required to keep a record of the beaters' full names, addresses, date of birth, gender and national insurance number, as well as the amount paid to them.

Even if tax and national insurance does not need to be deducted, it is still taxable income and it is the beaters' responsibility to ensure that any tax paid is due. Although, to guarantee there is no tax underpayment, many shoots do pay the tax on behalf of the beaters (assuming they are utilising their personal allowance elsewhere).

As beaters are likely to be classed as 'workers', the national living wage (NLW) and national minimum wage (NMW) need to be considered. The NMW applies to under 25s and the NLW applies to over 25s. The only exceptions are if:

- the beater is genuinely self-employed ; or
- the beater is a volunteer and is just paid expenses.

Lunch and a brace of pheasants do not qualify as payment towards the NMW or NLW. If lunch is provided in a local pub or restaurant, it should be recorded as a benefit in kind; whereas, lunch provided by the shoot on its own premises for everyone involved in the shoot is not taxable.

Please contact Lisa Oliver if you would like to discuss the way beaters are paid.

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