Agricultural Focus

DRIVING LIFELONG PROSPERITY

Winter 2016

WELCOME TO THE WINTER 2016 AGRICULTURAL FOCUS

INSIDE

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

Farmers averaging of taxable profits – the new rules

Farmers averaging of taxable profits for individuals (but not companies) has been available for many years and allows the profits of two years to be averaged, if the profit of one year is less than 75% of the profit of the other year.

For the 2016/17 tax year and subsequent years, the rules have been changed to also allow averaging over five tax years. Going forward, two year averaging is still possible but the options are either a two year average or a five year average only.

A five year averaging is available if either:

- A loss arose in at least one but not all of the five years; or
- The profits of the relevant year, or the average of the previous four years, is less than 75% of the other.

As previously, averaging is not available in the year of commencement or cessation which will include the year that an individual joins or leaves a partnership.

The option of averaging over five years may be beneficial for farming businesses where there has been significant volatility in profits in recent years. This is likely to include potato growers, dairy farmers and businesses who have incurred significant capital expenditure to take advantage of the high Annual Investment Allowance available on plant and machinery.

Five year averaging may reduce total tax liabilities, but may not be beneficial for all partners in a business, depending on their financial circumstances.

GOING FORWARD

Before April 2017, farming businesses should forecast their taxable profits, if accounts will not be completed by that date, to assess whether five-year averaging may be beneficial.

If the level of expected profits are such that five year averaging is not available, it may be possible to accelerate expenditure that qualifies for capital allowances to ensure that the 2017 taxable profits will be at a level that five year averaging will be available.

Hazlewoods can complete profit forecasts to assist businesses in this planning.

If you have any questions on farmers averaging, please contact Shirley Roberts (shirley.roberts@hazlewoods.co.uk).

Selling land for development - how will this be taxed?

When land is sold for development it is usually charged to tax as a capital gain. If the land qualifies for Entrepreneurs' Relief (ER) with no restriction, the effective Capital Gains Tax (CGT) rate will be 10%. With no ER, the rate will now be 20%.

Where individuals have been made an offer to sell land for development and it is part of a large development that involves other landowners, it is likely that they will be required to enter into what is known as an equalisation agreement. This is likely to have an adverse tax consequence, meaning that the effective tax rate will be more than the expected CGT rate of 10% with ER.

WHY...?

With the larger developments, involving different landowners, it is likely that the developers will not want to buy all of the land at the outset, as they may not actually build on some of the land for a number of years. Therefore, it is likely they will want to acquire different tranches, at different times, from different landowners. Under an equalisation agreement, this will normally result in different landowners receiving amounts for a sale of their land, redistributing part of the proceeds amongst the other landowners and then receiving proceeds from the other landowners when they sell their land.

For example, if the development involves only two landowners who each own land worth £10 million, which has been used in a farming trade and qualifies fully for ER with a very low base cost, then if each landowner sold their land to a developer in separate transactions, both should suffer CGT at a rate of 10%.

If the two landowners enter into an equalisation agreement, meaning that they will each distribute to the other landowner 50% of the proceeds received on a sale of their land, each landowner will again pay CGT at a rate of 10% on their £10 million proceeds. However, they will also pay 20% capital gains tax on the £5 million proceeds they received from the other landowner with no deductible base cost and without a tax deduction for the £5 million proceeds they have passed to the other landowner. This means that they will have an effective tax rate of 20% ((£1m + £1m)/£10m), as the £5m receipt from the other landowner will not be eligible for ER as it is not for the sale of a trading asset.

Where the development does not involve two equal landowners, the landowners may have an effective CGT rate of lower or higher than 20%, depending on their ownership.

For example, if the development involves landowner A with land worth £1.2m (60%) and landowner B with land worth £0.8m (40%). Landowner A will have an effective tax rate of 18% (((10% x £1.2m) + (20% x £480k))/£1.2m)) as they have given away 40% of £1.2m and received 60% 0f £0.8m. Landowner B will have an effective tax rate of 22% as they will have given away and received the reverse of A. I could go on... but hopefully the principle is understood. For those having trouble sleeping, this principle of double taxation was established in the tax case of Burca v Parkinson.

IT COULD BE EVEN WORSE...

Before you start to think that 22% is an acceptable tax rate, the effective tax rate gets even higher where more landowners are involved, meaning that each landowner gives away more of their proceeds and hence receives back a higher proportion of proceeds, which are then taxed at 20%. For example, if you have a development involving four different landowners each owning land worth £1 million, they will have an effective tax rate of 25%. As they will pay 10% tax on the proceeds they receive of £1 million for selling their land, give away £750,000 to the other landowners and then receive £750,000 back which will then be charged to tax at 20%.

Obviously, the effective tax rate will be even higher for situations where individuals do not qualify for ER on the proceeds that they receive for the sale of their land.

POSSIBLE PLANNING

There is planning that can be put in place to reduce the effective tax rate using cross options, pooling arrangements or restrictive covenants. However, there is no 'one size fits all' solution, as each of the possible planning options will depend on whether the different landowners

are prepared to work together and to what degree. When detail of the equalisation arrangements are known, it should be possible to estimate whether any of the planning options can reduce the tax position and by what amount.

Most equalisation agreements will 'go together' with a promotion agreement. This will involve promotion fees, which will be subject to VAT, therefore the land will have to be opted to reclaim the VAT.

GOING FORWARD

Without planning, any equalisation arrangement will definitely increase the effective tax rate of landowners who are selling land. By how much, will depend on the number of other landowners involved and what proportion of the total value different landowners own.

If you have any questions on selling land for development, please contact Peter Griffiths (peter.griffiths@hazlewoods.co.uk).

STAMP DUTY LAND TAX ON RESIDENTIAL PROPERTY – WHAT RATE WILL APPLY?

THAT DEPENDS!

The way in which the Stamp Duty Land Tax (SDLT) liability is calculated on the acquisition of a residential property changed in April 2016. As result, where an individual acquires a residential property, they already own an interest in a residential property, and the property they are acquiring does not qualify as their main residence, the additional rate of SDLT will apply to the residential property being acquired. This means that an additional rate of 3% will apply across all the bands when calculating the SDLT. Therefore, for example, a 3% rate of SDLT will apply to the band up to £125,000.

The rules are quite complicated. If you already own a residential property you should check before buying an additional residential property how the new rules will apply and what your SDLT liability will be. This will include an interest in a residential property owned as part of a partnership interest.

If an individual already owns a residential property and they acquire a part interest in another residential property, the additional rate will apply to the whole cost of the additional property, even if the individual acquiring the remaining interest does not own another residential property. This needs to be considered where parents are assisting children in acquiring their first property by acquiring a part interest in a property.

For example, if house owning parents assist one of their children to buy their first main residence by owning a 50% interest in the £300,000 property, additional rate SDLT of £9,000 will be charged (£300,000 x 3%).

Where the 'mixed rate' of SDLT applies to a transaction because there is a commercial purpose, the additional rate will not apply. For example, if an individual owns five residential properties and acquires a farm to live in and run as a farm, the additional rate will not apply to the value of the house included in the transaction. However, the mixed rate will not apply to a house with, for example, 5 acres which is merely just a house and a large garden.

Therefore, a farm being acquired for £2million with a house worth £500,000 would not suffer the additional rate. However, a house alone, being acquired for £500,000 would suffer the additional SDLT of £15,000 (£500,000 x 3%).

If you have any questions on SDLT please contact Nick Haines (nick.haines@hazlewoods.co.uk) or Peter Griffiths (peter.griffiths@hazlewoods.co.uk).

TAX FREE DIVIDEND ALLOWANCE – USE IT OR LOSE IT

Many farming businesses now operate as a limited company. This could be alongside an existing partnership to undertake a business expansion and allow borrowings to be repaid from a lower rate of tax. Therefore, there may be no extraction of profits from the company at the moment.

CHANGE IN TAXATION OF DIVIDENDS

From 6 April 2016, a £5,000 tax free dividend allowance was introduced. In addition, all dividend income is now received gross of tax with no tax credit.

Therefore, it is likely to be tax efficient for shareholders to receive an annual dividend of £5,000, if they have no other dividend income, and retained profits allow, even if the dividend is not extracted from the company but remains as a loan to the company.

PAY A DIVIDEND TO ALL SHAREHOLDERS ?

Individuals receiving child benefit or tax credits should check how additional income may affect their entitlement to these amounts. In addition, a tax-free dividend is unlikely to be the most effective use of a loss where an individual is claiming loss relief against total income.

TRANSFER OF SHARES TO A SPOUSE

Where shares in a company are held solely by one spouse, the transfer of shares to the other spouse could be tax efficient to allow a further £5,000 of tax-free dividend income to be extracted from the company.

CLOUD ACCOUNTING – IS IT FOR YOUR BUSINESS?

Farming businesses are becoming increasingly technology focused and in the last couple of years there has been a rapid increase in the popularity of cloud based software, mainly due to the advantages it can offer to all businesses. These can include efficiency (both time and cost), access, security and the ability to utilise real time information. Information being completely up to date can give farmers the ability to concentrate on other aspects of the business.

Hazlewoods have been developing cloud solution packages for farming businesses with a variety of options and add-ons to suit individual client's needs.

These packages will allow you to choose the level of input you require from Hazlewoods and ensure you have complete control on the every day running of your business, with real time information being available from any device. Automation of processes will save time and mean focus can be shifted on to the running of the business.

Clients can access their data and monitor transactions throughout the year, with monthly or quarterly management accounts being prepared if required. With data being totally up to date, accurate profit forecasts can be prepared and discussions throughout the year will ensure the appropriate timing of expenditure is considered. Profit forecasts will also enable estimates to be provided regarding any future tax payable.

With up to date meaningful financial information, key business decisions can be made on a 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 (lisa.oliver@hazlewoods.co.uk).

Gifts to the next generation –

ANY CAPITAL GAINS TAX IMPLICATIONS?

The availability of the Inheritance Tax (IHT) reliefs of Agricultural Property Relief (APR) and Business Property Relief in respect of a farming partnership, can mean that on the death of a partner, the value of their partnership interest does not suffer any IHT. In addition, the Capital Gains Tax (CGT) free uplift means that the next generation inherit assets with a tax base cost of market value.

This means that holding assets until death and then passing on to the next generation can be tax efficient. However, this may not fit in with the objectives of moving the business forward. Therefore, assets such as land and buildings are often gifted to the next generation during an individual's lifetime.

If the assets have been used in the farming business throughout the period of ownership of the individual making the gift, no CGT liability should arise on the gift, as any capital gains are held over until a future sale or are 'washed out' on the death of the individual receiving the gift.

However, if the land has not always been used in the business, for example has been rented out for a period, this will result in gift relief being restricted, meaning that a CGT liability is likely to arise, if the land is currently used in the owner's business.

PLANNING

If the land is currently being rented out, but qualifies for APR, then a non-business use restriction will not apply. Therefore, before making a gift, the use of the assets should be reviewed to confirm whether there are any potential restrictions based on previous use and whether this can be prevented by changing the use of the asset.

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