Summer 2013

Agricultural Focus

Sowing the seeds for future prosperity

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HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Introduction to Agricultural Focus

It is difficult in any walk of life to get the right balance between risk and reward. In business, steps taken to increase profits may expose the business to greater risk and greater volatility. It is then a delicate balance trying to work out how much extra cost to take on to try and manage this volatility.

In farming over the last 18 months we have all seen the impact of the weather on the best laid plans. Reduced 2012 yields, reduced crop establishment and yield potential for 2013 harvest and higher feed costs for every livestock business. There is a limit to what can be done about the weather, but many farmers are taking steps to try and manage risk and volatility in other areas of their business whether through reviewing their cropping mix, marketing strategy, combine capacity or approach to buying inputs.

Subsidy is a significant part of farming incomes and we have already seen greater interest this year in hedging against the impact on single payment cheques of a falling euro. We have also had many discussions on the possible timing of interest rate rises and the arguments for staying on relatively cheap variable rates compared to the greater certainty of fixing rates albeit at an immediate extra cost.

The most important step is to try and quantify the risks that your business is exposed to and try and ensure that you have a strategy in place to limit the downsides. No one approach is right for everyone, as some well capitalised businesses can stand a much greater degree of volatility than one with high rent and finance costs. However, with volatility comes opportunity. The next few years may be an exciting time for those in a position to grasp the opportunities.

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Inheritance Tax planning

Debt deduction restriction announced in Budget

Previously, where an individual has borrowed money which will still be outstanding on death, it has been Inheritance Tax (IHT) efficient to secure the debt against property which does not qualify for Agricultural Property Relief (APR) or Business Property Relief (BPR), regardless of the use of the funds. Such an asset would normally be residential property that is not a farmhouse.

Future position

However, the 2013 Budget announced that this deduction will be restricted following Royal Assent of the 2013 Finance Bill, which is likely to be in July. The changes will apply to all deaths after that date, and likely to mean an increase in IHT liabilities.

The new rules will mean that where an individual has a liability outstanding at the date of death, to the extent that the funds have been used to acquire, maintain or enhance the value of property qualifying for APR or BPR or woodland, for which there are special IHT reliefs, the liability will first be deducted from the value of those assets and not the property on which it is secured. As the debt is reducing the value of assets on which IHT was not due because of the reliefs available, the estate will now potentially pay additional IHT.

Trusts

As a result, trustees will no longer be able to plan to minimise a ten year charge by borrowing and investing in relievable property two years before the charge. For trusts with a ten year charge coming up in the second half of this year this change could have an immediate impact.

Going forward

Farmers, landowners and trustees who will be affected by the change need to review their business structure and ownership of property to ensure that the right strategies are in place in the future to minimise IHT liabilities.

Companies, partnerships and corporate partners - where next?

With the rates of Corporation Tax decreasing, and the Income Tax and National Insurance equivalents increasing over the last five years or so, the use of limited companies by farming businesses has never been more popular.

Some business owners have decided to incorporate the whole business, some have decided to trade both as a company and a partnership, and some have decided to introduce a company as a partner in the trading partnership.

Following an announcement in the 2013 Budget, there is now a consultation taking place into the use of companies in combination with partnerships, followed by a planned law change taking effect from 6 April 2014. It is likely that the pricing of goods and services between a company and related partnership and also the division of profits within a partnership will both come under more scrutiny.

It is likely that a company that is a partner in a partnership must clearly and demonstrably be a partner and therefore entitled to a profit share of some sort, and secondly that its profit share, when allocated, is appropriate for the circumstances.

It is important in the first instance to ensure that the corporate partner has a clearly defined presence. This can be shown by:

a) the company being included as a partner on the VAT registration;

b) a signed partnership agreement;

c) identification of the company as a partner on letterheads, business cards, etc.;

d) a company bank account; and

e) any profit allocation being transferred to the company;

The second area under scrutiny is the profit allocation. Hitherto there has been no specific requirement for a partner's profit share to represent a commercial return. However, it is likely that the arbitrary allocation of profits and losses may well come under attack by HM Revenue and Customs in the next Finance Bill. It will therefore be important to ensure that there is an identifiable and documented method for dividing profits and that the profits allocated to each partner are reasonable.

We will be pleased to discuss the role of your company with you.

Inheritance Tax planning

Transfer of property onto partnership balance sheet - cause a problem with your Will?

Many farming partnerships do not have farmland and buildings held a as a partnership asset. This may be for historical reasons, where land was originally owned by mother and father, and children have come into the partnership at a later date.

However, this may not be Inheritance Tax efficient as Business Property Relief will only be available at a rate of 50%, whereas if the property is held as a partnership asset, relief will be available at a rate of 100%.

This is likely to be an issue where the market value of the land and buildings would not be covered by Agricultural Property Relief, as there is development potential or demand from "lifestyle buyers", as Agricultural Property Relief will only cover the agricultural value. Or property may not be regarded as farming assets, for example let properties.

As a result, it can be tax efficient for the owners of the property to transfer the property to the partnership. Concerns about effectively transferring property to other partners who do not currently have an interest in the property can be overcome by the use of a separate capital account.

Even though "rights" to the property can be preserved by the use of a separate capital account, the property should still be regarded as a partnership asset. As a result, the property will be inherited on death by the individual who will inherit the partnership share of the relevant partner.

Review Wills

Therefore, the situation could arise whereby mother and father wish to leave certain property to children that are not involved in a farming partnership. If this is the case, their Wills need to be structured correctly such that these bequests still occur. If Wills are not reviewed following such property transfers, it is likely that a bequest of transferred property to an individual who is not currently a partner in the partnership will fail, and could result in future family disputes.

State pension

What will you qualify for?

The state pension system is to be significantly revised with effect from April 2016. Individuals should ensure that they are aware what their entitlement to a state pension will be, and how they can maximise their entitlement with additional National Insurance contributions or credits.

Currently, the maximum state pension payment is £110.15 a week. Those eligible can increase this with pension credit and the second state pension (S2P), which was formerly known as the State Earnings Related Pension Scheme or SERPS. From April 2016, the proposal is for a flat rate state pension worth about £155 a week. It will replace the current system and end the concept of a second state pension.

For workers retiring from April 2016, the qualifying number of years you will need to make National Insurance Contributions for, to get the full state pension, will rise from 30 years to 35 years. Also, a minimum qualification period of 10 years will be re-introduced (for the past three years there has not been a minimum qualification period). This means that no amount of state pension will be available unless National Insurance Contributions have been paid for at least a decade.

Individuals who have not been required to pay National Insurance through employment or self-employment can receive "National Insurance credits" in certain circumstances, which count towards their state pension entitlement. This includes periods for which they were caring for children, or caring for someone sick or disabled. If an individual is not covered by contributions or credits, but would like to preserve their entitlement to state pension, it can in certain circumstances be possible to pay voluntary National Insurance Contributions.

Confirm current entitlement

Going forward, the right to receive the flat rate state pension, which historically has always been index linked, is a valuable entitlement. The necessary personal pension fund required to obtain a similar pension is likely to be as much as approximately £200,000. Therefore, individuals should confirm what state pension they are likely to receive based on previous contributions and credits, and what future contributions they can make to maximise their entitlement. Individuals can apply to receive an estimate of what state pension they will receive based on previous contributions and credits on form BR19 from www.direct.gov.uk/pensionforecast.

Hazlewoods Financial Planning can advise in respect of pension planning through personal pension contributions. Please contact Gary Cook on gary.cook@hazlewoods.co.uk if you would like to discuss pension planning.

Renewable Heat Incentive installations

Minimise the investment payback period

The Renewable Heat Incentive (RHI) scheme in its current format has been running since November 2011 for non-domestic installations, and is due to be extended to domestic installations from the summer of 2013.

The current scheme provides for payments to be received for up to 20 years for the production of renewable heat and biomethane. The payments received will depend on the type of installation producing the heat, and the scale of generation. The most common type of installations in use by farmers and landowners are anaerobic digesters and biomass boilers. However, the scheme also covers solar thermal (hot water) panels, ground source heat pumps and water-source heat pumps.

Capital allowances available

As with expenditure on a tractor, which is incurred to produce an income stream, expenditure on installations covered by the RHI scheme are likely to qualify for capital allowances under the same eligibility criteria as other plant and equipment acquired. That is to say, the installation performs a function, which in this case is the production of renewable heat or biomethane. Therefore, it is likely that the majority of expenditure on the acquisition and installation of anaerobic digesters and biomass boilers will qualify for capital allowances, which will be available as a tax deduction.

VAT

Where an RHI installation is used to create heat used solely for business purposes then all VAT incurred should be recoverable. However, where heat is being used for domestic purposes, this is likely to restrict the amount of VAT that can be recovered on the cost of the installation.

Maximise the tax deduction

The RHI can provide both a reduction in power costs for a farming business, and a welcome income over a period of up to 20 years. The cost of the installation should be eligible for capital allowances. However, to ensure that the investment payback period is minimised, a detailed review of the planned costs will be required to ensure that the available tax deduction is maximised.

Furnished Holiday Lets

Ensure that you qualify for Inheritance Tax relief where possible

Many farmers and landowners have let properties that potentially qualify as Furnished Holiday Lets (FHLs). If the lets qualify as FHLs by meeting the requirements regarding the number of days that the accommodation is available to the public and the number of days that the property is actually let, then the property will qualify for advantageous tax treatment. This will include potentially being eligible for Inheritance Tax Business Property Relief (BPR). This will mean that the value of the property is not chargeable to Inheritance Tax.

Recent tax case

In recent months, there has been much comment regarding the availability of BPR for FHLs, following the success of HM Revenue & Customs (HMRC) in the Pawson case. The outcome of this case was that BPR was not available to the taxpayer in respect of the value of the property being let.

The result of this case reinforces the need to ensure that properties are let on a commercial basis in order to qualify for FHL, and are run as a business. This means that additional services to a normal residential letting must be provided. The additional services that should be provided will include changing bed linen, cleaning the property on a regular basis and the provision of meals.

The services offered mean that the letting is more akin to a hotel. The whole letting should be recognised as being a business rather than an investment activity. As with all other businesses, the owners need to register for Class 2 National Insurance if they are not paying such contributions elsewhere.

Review current arrangements

If individuals consider that their current FHL arrangements will not be regarded as a business, they should restructure the letting and the services provided, if obtaining BPR on the property value is part of their Inheritance Tax planning. All cases considered by HMRC will be considered on a case-by-case basis and depend on the particular facts of each case.

Future let properties energy efficiency requirements

Do you comply?

Farmers and landowners need to ensure that let properties meet future Energy Performance Certificate requirements, and consider what work is required to the properties if the requirements are not currently met.

From 2016, a tenant can request that the landlord implements recommendations and the landlord will be legally obliged to carry out work. From 2018 it will be illegal to let property with an Energy Performance Certificate rating lower than band E.

Therefore, landlords need to ensure that future requirements are currently met, or that any work required is scheduled well in advance of the relevant dates.

Any work carried out will be eligible for tax relief against rental income as a repair, except where the work will be classed as a capital improvement to the property.

Remuneration planning

Ensure remuneration is received in a tax efficient manner

As we are only a short period into the tax year to 5 April 2014, now is an appropriate time to ensure that income is received in the most tax efficient manner. This is particularly relevant for married couples.

1 Married couples should use both personal allowances and basic rate tax bands

For the year ended 5 April 2014, each individual has a tax free personal allowance of at least £9,440 and a 20% tax band of £32,010. Income between £41,450 and £150,000 is charged to tax at 40%. Where an individual has taxable income over £100,000 they will lose some or all of the personal allowance giving an effective tax rate of 60% on income between £100,000 and £118,880. Income tax is charged at 45% on income exceeding £150,000.

Possible planning could include varying profit shares in a partnership, closing an interest-bearing account to bring forward the date of receipt of interest or ensuring that dividends paid from a company are paid to the spouse with the lowest tax rate.

2 Child benefit

Child benefit will be restricted where one individual in a household has an income over £50,000. Where possible, income should be equalised between husband and wife and "partners" to ensure that the child benefit restriction is minimised.

3 Pension contributions should be considered particularly where tax relief at 40%, 45% or even 60% is available

The rules relating to tax relief on pension contributions now allow an individual to contribute up to 100% of earned income (for example salary, or partnership profit) subject to an annual limit of £50,000. However, any unused relief can be carried forward for up to three years. Therefore, pension contributions can be a useful tool in reducing the amount of income suffering higher rates of tax. Individuals should be aware that the annual limit is due to be reduced to £40,000 from 6 April 2014.

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