Autumn 2013

Agricultural Focus

Sowing the seeds for future prosperity

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DRIVING LIFELONG PROSPERITY

CAP reform - cessation of milk quotas

Ensure tax relief is maximised

The details that have been released about the changes to be made to the CAP, have confirmed that milk quotas will cease from March 2015, as was expected to be the case from previous announcements.

What will the tax effect be for individuals and businesses holding milk quota?

If the milk quota was acquired on introduction, and therefore nothing was actually paid for the quota, this will have no tax implications. Where the milk quota has been acquired in the market, and an amount actually paid for it, a capital loss will arise in March 2015. The amount of the loss will generally be the amount that was paid for the quota, as the quota will be regarded as having a nil value.

How can this loss be utilised?

If the milk quota is held by a limited company, the capital loss will only be available to set against capital gains of the company. Where the quota is owned by a partnership, or a sole trader, the loss will be available to set against capital gains of the business, and also against capital gains made by individual partners or a sole trader on non-business assets.

Possible planning

As a capital loss brought forward is only set against capital gains after the annual exemption (currently £10,900) has been utilised, if capital gains are to be crystallised by individuals to utilise the capital loss, it may be tax efficient to crystallise the gains after 5 April 2015, as the loss will arise in the tax year ended 5 April 2015.

As any milk quota held is already likely to be regarded as worthless, it should be possible to make what is known as a negligible value claim in order to accelerate the use of the loss. If such a claim was made "today", it would establish the

loss on the milk quota as arising in the tax year ended 5 April 2014. It could also be possible to claim the loss as arising two years earlier, if it can be proved that the quota was also regarded as having a negligible value two years ago.

Whether this is tax efficient to do so will depend on what capital gains have been made, or are to be made, and what rate of Capital Gains Tax will be paid on the gains.

Farmhouses and Agricultural Property Relief

With property prices rising again, securing Agricultural Property Relief (APR) on the farmhouse could result in a significant reduction to the Inheritance Tax liability on death. To qualify for APR the farmhouse must be character appropriate to the land and be occupied for the purposes of agriculture.

Due to the potential value of the relief there have been several cases in recent years where HM Revenue & Customs (HMRC) have challenged a claim for APR on the farmhouse, some of which have been won by HMRC and others by the taxpayer.

Hanson v HMRC is a significant recent case that was won by the taxpayer. The deceased was the life tenant of a trust that owned a farmhouse, resulting in the farmhouse being part of his estate on death. The deceased's son and family had lived in the farmhouse for a number of years and the son farmed about 215 acres. The son owned 128 acres, the deceased part owned 25 acres and the remainder was rented from a third party.

The question before the tribunal was whether the farmhouse and the land needed to be in common ownership or common occupation when considering the character appropriate test. The tribunal decided that common occupation was required and the deceased was able to claim APR on the farmhouse even though he did not own the majority of the land used in the farming business that was run from the farmhouse.

This case will be beneficial to families where the farmhouse and land are not in common ownership.

Inheritance Tax changes
on debt relief

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

We highlighted in the Agricultural Focus Summer edition, that the 2013 Budget had announced that this deduction will be restricted following Royal Assent of the 2013 Finance Bill, and that the changes will apply to all deaths after that date, and likely to mean an increase in IHT liabilities.

The new rules had originally stated 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.

Amended changes put in place

The changes were subsequently amended and the restriction regarding what assets borrowings incurred can be set against when calculating an IHT liability, will now only apply to new debts incurred after 5 April 2013. However, it is likely that refinancing or rearranging a debt after 5 April 2013, where the debt was originally incurred before 5 April 2013, will also fall under the new treatment.

Going forward

Although the amended changes mean that individuals will still be able to obtain the most tax efficient treatment for debts incurred before 5 April 2013, they will need to be aware of the restricted relief that is available for any new borrowings incurred after 5 April 2013, as this will affect future IHT liabilities. Farmers and landowners 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 and loans to directors or shareholders
Changes to the tax rules

Historically, most farming businesses have been operated as a partnership. Many farming businesses now operate as a limited company, sometimes "alongside" an existing partnership. This can be tax efficient.

A company is a separate legal entity which has implications when loans are made to directors or shareholders. The rules relating to the tax treatment of such a loan have changed since 5 April 2013.

Where such a loan is made, if it is not repaid within nine months of the end of the accounting period in which the loan was made, an amount of 25% of the loan still outstanding at the nine months date must be paid to HM Revenue & Customs. This is only refunded when the loan is totally cleared.

Previously, it was possible to prevent this charge arising by repaying the loan in the required timescale and subsequently withdrawing the amount shortly afterwards.

From 5 April 2013, this will not be possible without incurring the 25% charge. If there is an "expectation" that the loan will be subsequently withdrawn, the 25% charge will be due. Individuals and companies affected by the change should review their current arrangements to ensure they are tax efficient.

Entrepreneurs' Relief
Sale of land for development

Entrepreneurs' Relief (ER) is a valuable tax relief which can reduce the rate of Capital Gains Tax (CGT) payable on a sale of land from the current maximum rate of 28%, to a rate of 10%. Each individual has a lifetime limit of £10 million for the relief.

We are seeing a lot of interest from developers in acquiring land for housing, particularly on the edge of existing towns and villages. Even where a farming business is to continue, this can offer an opportunity to obtain a large amount of funds which, for example, may be required to sort out future succession/inheritance issues. Hence rollover relief will not be claimed, and ER will significantly reduce any CGT payable.

The qualifying requirements for ER mean that a straight sale of land with no change in a farming business will not qualify for the relief. However, it may be possible to structure a business change so that a sale of land for development qualifies for ER and significantly reduces the CGT payable.

VAT on self storage?

No - Storage

In the Agricultural Focus Autumn 2012, we reported on the new VAT rules, which came into force on 1 October 2012, on what HM Revenue & Customs termed 'self storage'.

In the intervening period, it has become clear that the "branding" of the changes was totally misleading - in fact the new rules apply to VAT on virtually all storage.

Where any building, such as a spare barn, unit or container, is let for the storage of goods then it is a taxable supply for VAT. Farmers who are VAT registered must charge VAT on the rent. A building is caught by the rules if it is implicit in the legal documentation that it is being let for storage, or if it is furnished for storage or it is actually used for storage. Where the building is a storage facility, VAT should be charged on the rent even if the tenant has left it empty.

Nevertheless there are some exemptions, and in particular where the building is used to house live animals.

It is the responsibility of the landlord to ensure that they charge VAT on the letting of the building if it is used for storage. Where farmers are letting surplus buildings they need to know what the tenant is using them for at all times including when the tenant allows a third party to use the building for storage. It is important to communicate regularly with the tenant, and the contract should require the tenant to notify any change of use.

If a building has been used for storage since 1 October 2012 and VAT has not been charged on the rent, it will need to be charged retrospectively.

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