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Agricultural Focus

Sowing the seeds for future prosperity

Contents:

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

Welcome to the latest edition of our Agricultural Focus. In this issue we highlight tax planning opportunities for farmers, landowners and agriculturally related businesses. Please call if you would like to discuss any of the points raised.

Planning for succession

There are lots of issues to consider when reviewing what to do with your farming business and the related property assets. Asset rich, income poor is a fair description of a lot of farming businesses. Frequently profits have been re-invested in the farming business for many years without really thinking through the implications for retirement and non-farming children. Tax planning is part of the overall picture, but comes some way down the list.

Questions that need to be considered include:

1. Is there likely to be a viable farming business for the next generation?

If the answer is no then does this change your plans about what to do with the farm? Should you consider selling sooner rather than later so that you have more cash available during your lifetime? Should you encourage children towards alternative careers?

2. How important is it for you to preserve a farming business?

The main aim of virtually every farmer used to be to hand on their farming business in at least as good a condition as they inherited it. With falling real income over the last generation then for some this is just not possible. Where it is possible then the amount of capital required to support the farming business may compromise what can be done for non-farming children.

3. What will you live off in your old age?

The answer is likely to be a combination of:

- share of farm profits;
- rent from farmland or other property;
- off-farm income;
- proceeds from sale of capital assets;
- State Pension plus possibly personal pension.

The answer will have knock on implications for succession plans.

4. Where will you live?

If you plan to stay in the main farmhouse then this could be an expensive property to run. Where will the next generation live? What will be the implication on your Inheritance Tax (IHT) position? If you can claim Agricultural Property Relief (APR) then this may keep IHT down, but if the property is not eligible for APR then IHT may increase because of the high value of the main farmhouse.

5. How can you be fair to all your children?

Traditionally the eldest son inherited the farm, but generally preserving the farming business will mean leaving a disproportionate amount of capital to those involved in farming. Gifting cash or other assets sooner rather than later may be one way of redressing the balance, but again is not possible for all.

6. What can the next generation contribute to the farming business and what will be a fair return?

The next generation can bring labour and new skills. This may permit a new enterprise to be created, increase scale of current activities or may just substitute for labour from the older generation. A careful assessment is required to see if the size of the cake can be increased or whether it is likely that the existing cake will have to be cut in a different way.

The answers to these questions will form the framework of the overall plan and then this will need to be refined to minimise the impact of tax.

A good plan will generally be in writing as this aids the thinking process and leaves less room for misunderstanding. There must be good communication so all family members know where they stand with no false or unrealistic promises or expectations. The plan should be revisited regularly.

Consider lifetime gifts of assets but with due regard for the risk of death, divorce or dispute in either the older or younger generation. There is rarely a tax reason for making lifetime gifts of business or agricultural property, but do not under estimate the benefit to the younger generation of knowing where they stand.

A partnership agreement is likely to be essential to record and protect the different interests. Up to date wills are essential. Consider the role of trusts to protect assets. Do not let the cost put you off taking professional advice. The cost of getting it wrong is likely to be far higher.

There is a lot that can be done to plan for succession and also to plan to minimise the impact of tax.

Entrepreneurs' Relief

Entrepreneurs' Relief is an extremely valuable tax relief. However, it is an "all or nothing" relief and it is easy to fall foul of the qualifying criteria. Therefore, individuals should review their postion at least 12 months before any transaction, so that where possible they will qualify for the relief.

The relief can save you up to £1.8 million by reducing the Capital Gains Tax payable on the sale of a business (or interest in a business) and related assets to a rate of 10%, from a rate of 28%. There is a qualifying period of 12 months for the relief. Each individual currently has a lifetime limit of £10 million of gains on qualifying disposals. However, the relief is designed to be available on the sale of a business, which does not usually happen with a farming business, where assets are usually sold.

When business assets are sold at around the same time as a business, if matters are structured correctly the capital gains on the assets should also qualify for the relief. Therefore, if you are planning to sell farmland and buildings in the future the transaction should be structured to ensure that Entrepreneurs' Relief will be available on the sale. This can be done by the individual owners of the land and buildings also disposing of part of their interest in the business at the same time. This could involve a transfer of part of a partnership share to the next generation.

As the qualifying period for Entrepreneurs' Relief is 12 months, any potential sales of assets should be reviewed at least 12 months in advance. This is so that any planning required to maximise Entrepreneurs Relief can be implemented before the transaction takes place.

VAT treatment for the provision of "self-storage"

Is your treatment correct ?

Many farmers and landowners offer "self-storage" facilities to individuals and other businesses. Recently, two tax tribunals examined the use of containers for self-storage and how the income generated should be treated for VAT.

In both cases the tribunals ruled the income to be VAT exempt. This means that no VAT is charged, but VAT incurred can be recovered as long as the partial exemption limits are not exceeded.

If self-storage facilities are being offered, the VAT treatment should be reviewed to ensure that it is correct. Where VAT has been accounted for in relation to self-storage, where the income should have been VAT exempt, it may be possible to claim a refund.

Capital allowances

Annual Investment Allowance

Make the most of the allowance before it disappears

Maximising the relief from the the Annual Investment Allowance (AIA) before April 2012 could reduce the top rate of tax for an unincorporated business from 50% to 40%, or 40% to 20%. For a company, the top rate of tax could be reduced from 27.5% to 20%.

Currently, businesses can spend up to £100,000 on an annual basis on qualifying plant and machinery and obtain a full tax deduction in the year of expenditure. With effect from 6 April 2012 (1 April 2012 for companies), the AIA limit is being reduced to £25,000. Therefore businesses should review their capital spending plans in the near future and consider whether planned future purchases of plant and machinery need to be made before April 2012 in order to fully utilise the £100,000 AIA limit, and accelerate the available tax relief. A business with a year end other than 31 March or 5 April will need to calculate what expenditure can be made before April 2012 to maximise the available allowance.

To ensure that tax relief is obtained at the earliest opportunity, if an asset is being purchased outright, with no finance, the acquisition date for tax purposes is the date that the invoice is issued. However, if there is a gap of more than four months between the invoice date and the date on which payment is required to be made, the expenditure is not incurred until the date on which payment is required to be made.

If an asset is to be acquired with hire purchase, the acquisition date for tax purposes is the date that the asset is brought into use. Therefore, for agricultural machinery, the machinery must have been delivered before the relevant date for a tax deduction to be obtained, and the hire purchase must be on "normal" payment terms. If the machinery is a tractor which needs to travel on public roads to move around the farm, to be brought into use a tractor would have to be issued with road tax.

Expenditure on buildings

Ensure available tax relief is maximised

There is no longer any tax relief available for expenditure on an agricultural building, except when the building is sold, or if it is demolished a capital loss should be available. Plant and machinery capital allowances are available on plant and machinery, and also expenditure incurred in order to "install" the plant and machinery. Additionally, capital allowances at a lower rate are available on "integral features", which include water systems.

Therefore, when constructing a new building, or an extension to an existing building, expenditure should be reviewed to identify items that can form part of a capital allowances claim. Such items will include a reinforced floor on which an item of plant is to be situated, or piping that forms part of a rainwater harvesting system.

It is often easier to identify such expenditure in the early stages of construction when additional information can usually be obtained from the contractor.

Employing family members

Can family assistance be tax deductible?

Help from family members in farming businesses is a common occurrence. It may be possible to structure this in a tax efficient manner.

Family members can be paid the market rate for any work they undertake for a business, whether the business is a limited company or an unincorporated business such as partnership or sole trade. A partner cannot be paid a tax deductible "wage" for work undertaken for a partnership in which they are a partner, but a tax deduction could be available for services they provide to a partnership from another business that they own.

When employing family members it must be ensured that the amounts paid are the market rates for the work carried out, and are the same as would be paid to an unconnected individual.

As each individual is entitled to a tax free personal allowance of £7,475 for the year ended 5 April 2012, it can be possible to obtain a tax deduction for amounts totalling £7,475 paid to a son or daughter who is, for example, in full time education but also works in the family business. If they have no other income, such as bank interest, they will not suffer any income tax on the amounts received. To avoid incurring a National Insurance liability in respect of an individual over the age of 16, amounts paid should not exceed approximately £135 per week.

For a partnership or sole trader where the business owners are 40% taxpayers, paying total wages of approximately £7,000 to a family member who is not a taxpayer will achieve a tax saving of at least £2,800 (£1,400 where the business owners are 20% taxpayers).

Surrender and re-grant of a lease

Is any lease arrangement maximising available Inheritance Tax relief ?

Landowners, who let land before September 1995, could discuss with the tenant the possibility of a surrender and re-grant of the lease so that 100% Agricultural Property Relief (APR) is available on the land. Otherwise, relief may only be available at a rate of 50%. There are particular tax issues that need to be considered where the tenant is a company to which the landowner is connected. Hazlewoods have experience of dealing with such issues.

APR is available where an individual owns farmland occupied by another party for the purposes of agriculture, after a period of seven years. If the letting was entered into before September 1995, the rate of relief is only 50%. However, the rate of relief is 100% where the letting commenced on or after 1 September 1995.

Where the land has potential development value, APR is restricted to the agricultural value of the land. As the landowner is not using the land in their business, they will not qualify for Business Property Relief (BPR). Where the potential development value is significant it should be considered whether matters need to be restructured to ensure that BPR is available on the total value of the land, and reduce a potential Inheritance Tax liability.

Furnished Holiday Lets

The previous Government had indicated that the tax breaks available to Furnished Holiday Lets (FHLs) would be removed. The coalition have tweaked the FHL rules and have changed the qualifying conditions. However, FHLs can still offer tax planning opportunities.

From 6 April 2011 lossses are only available to carry forward and set against profits from the same FHL business.

The qualification rules for an FHL are changing with effect from 6 April 2012. To qualify for the advantageous tax treatment for FHLs in the future, any letting must be:

- let on a commercial basis - HMRC will look at this aspect carefully
- the accommodation must be available to the public for at least 210 days in the tax year
- and actually let for at least 105 of those days
- the total period of 'longer term occupation' must not be more than 155 days during the relevant period (a period of 'longer term occupation' is a period of letting to the same person for longer than 31 consecutive days).

If it is only the 105 day letting requirement not met, an election can be made for the property to still be treated as a FHL for a period of up to two years. Therefore this requirement need only be met once every three years.

Any capital gains on the sale of qualifying properties are eligible for Entrepreneurs' Relief, and therefore may benefit from tax rate of only 10%. The usual qualification rules for Entrepreneurs' Relief will apply regarding the sale of a business. Therefore, if the FHL activity consists of only one property, the sale of that property may qualify for Entrepreneurs' Relief, as the whole business has been sold. Whereas the sale of one property out of three qualifying properties owned would probably not qualify. FHL properties are eligible for capital gains gift holdover relief, and also rollover relief either when replaced, or as a qualifying purchase against which gains on other assets may be set.

Qualifying properties may also be eligible for Inheritance Tax Business Property Relief, although the ownership of only one FHL property is unlikely to qualify for the relief. In addition, capital allowances can be claimed on the cost of furniture and equipment for FHL properties.

Therefore, although the rules are changing and some currently qualifying properties may not qualify in the future, many owners of FHL properties are likely to still qualify for the advantageous tax treatment available. They should however ensure that their activity is effectively run as a business and meets the qualifying requirements.

Renewable energy ventures

Many businesses have entered into, or are planning to enter into, renewable energy ventures. This may be the construction of a wind turbine, the installation of solar panels, or the construction of an anaerobic digester, to provide energy for an existing farming business, or to provide energy "for sale".

The scale of current farming activities, and the scale of a renewable energy venture which is generating energy to sell, may mean that a current farming business is no longer regarded as mainly farming. This would have particular significance for Inheritance Tax reliefs available to a farming business.

Therefore, before entering into a renewable energy venture, the effect on currently available tax reliefs should be considered. If the activity is likely to be regarded as not farming, a separate business entity may be required in order to ensure that currently available tax reliefs are not lost. For example, this could be a new limited company.

Business entity

Is your structure tax efficient?

Most farming businesses are conducted through a partnership or sole trade. However, farming companies are becoming more common. The type of entity through which a farming business is conducted can significantly affect tax liabilities.

Profits made by a partnership or sole trade are taxed on the owners of the business when the profits are made. This could be at an income tax rate of 20%, 40% or 50%, with Class 4 National Insurance, also being due at a rate of 9% on an individual's profits between £7,225 and £42,475 and at a rate of 2% over this level.

Profits of a company are taxed at a rate of 20% when profits do not exceed £300,000, and at a marginal rate of 27.5% where profits are between £300,000 and £1,500,000. Profits are not taxed on the shareholders who own the company until they are extracted from the company. Therefore, if the owners of the business do not extract from the business all of the profits, it may be more tax efficient to undertake the business through a company, and not a partnership or sole trade, as profits are likely to be taxed at a rate of only 20% until extracted from the company.

Alternatively, a limited company could be introduced to a partnership as a corporate partner, which can also be tax efficient. How a business is structured should be regularly reviewed to ensure that profits are being extracted in a tax efficient manner and that the allocation of profits reflects the input to the business of the individuals involved. This is particularly relevant to a family business where some individuals may effectively be providing assets, while the younger generation run the business on a day-to-day basis.

Next steps

Hazlewoods agricultural team offers wide ranging experience in all aspects of accounting, business and tax advice to farmers, landowners and agriculturally related businesses.

Our in-depth knowledge and experience of this sector allows us to fully understand our clients' issues and advise accordingly.

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