

# Agricultural Focus

Sowing the seeds for future prosperity

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# Introduction to Agricultural Focus

Last year I attended a local agricultural show on the first Saturday in September and spoke to two farmers who had been harvesting until just after midnight the day before, apparently so that they could come along and confirm that the 2011 harvest was safely gathered in. What a difference a year makes!

After the gloomiest and wettest summer for many years, some farmers still have a lot to cut, despite the good weather in early September. Those who thought they had sold forward 50% of their feed wheat are now finding out that they have in fact sold closer to 70% of their crop and much of that was still in the field by the same show date this year.

It also seems there is a limit to the number of wet weather jobs. This year many farmers and landowners, having cleared everything else, have decided to get their financial records in to their accountant early. Even some clients who have never appeared this side of Christmas have been ringing up regularly for an update on progress.

Many businesses are showing good profits based on the 2011 harvest. However, with tougher conditions now for both arable and dairy farms, many are facing large January 2013 tax bills at just the time that sales may be falling sharply. It will be essential to plan cashflow carefully over the coming months.

Larger profits, lower rates of capital allowances and reduced tax relief on pension contributions have led many to review the tax efficiency of their farming businesses over recent years. The opportunity to use a company in some way to grow your business without suffering the higher rates of income tax is proving attractive. There is no one size fits all approach and it is not right for everyone, but we will happily discuss the options with you.

Finally, increasing personal allowances, the phased loss of personal allowance where income exceeds £100,000 and the proposed reduction in the additional rate of income tax from 50% to 45% from 6 April 2013, mean that it may pay handsomely to plan carefully when

profits are realised or when income is drawn from a company. We outline a number of approaches that could together significantly reduce the tax burden.



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## Remuneration planning - minimise total tax liability

For the tax year ended 5 April 2013, each individual has a tax free personal allowance of £8,105. The next £34,370 of income will suffer income tax at a rate of 20%. Total income exceeding £42,475 will suffer income tax at a rate of 40%, until total income exceeds £150,000, when income will be taxed at a rate of 50%. 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 £116,210.

Farming businesses should ensure that the individual owners of the business plan their extraction of remuneration to fully utilise tax free personal allowances. Similarly, the income of a husband and wife should be equalised, to ensure that one is not paying tax at a higher rate than the other. Additionally, it should be ensured that income is not taxed at 40% in the 2014 tax year, whilst the 20% tax band has not been fully utilised in 2013.

Possible planning could include:

- varying profit shares in a partnership
- ensuring that dividends paid from a company are paid to the spouse with the lowest tax rate
- interest bearing accounts are transferred to

- the spouse with the lowest tax rate
- dividends are paid before or after 5 April, to fully utilise lower rate tax bands
- close interest bearing accounts in the 2013 tax year to accelerate the receipt of income and fully utilise lower rate tax bands
- the use of pension contributions

From 5 April 2013, the 50% tax rate is to be reduced to 45%. Therefore, where income is expected to exceed £150,000 in the 2013 tax year, where possible, planning should be undertaken to delay income arising until after 5 April 2013.



# Changes to Child Benefit rules - ensure that the benefit is not reduced

The recipients of Child Benefit may find that the amount they receive is reduced with effect from January 2013, depending on the income received by their "household", as a result of changes to be introduced.

Child Benefit is, and will continue to be, received on a "flat rate" basis, irrespective of the income of the recipient. However, with effect from January 2013, Child Benefit will be clawed back where one person in a household has an annual income of more than £50,000. The claw back will be 1% in Child Benefit for every £100 earned over £50,000, with the Child Benefit being reduced to nil where income exceeds £60,000.

The new rules mean that if a husband and wife each have an annual income of £50,000, there will be no claw back of the Child Benefit received. However, if for example, the husband has total income of £60,000, while his wife has no annual income, there will be a claw back of all the Child Benefit received, even though total joint income is £40,000 less than if they each had income of £50,000.

Therefore, a husband and wife should ensure that their remuneration planning for the year ended 5 April 2013 minimises the claw back of any Child Benefit received.



# Business structure - could it be more tax efficient ?

Many farming businesses are not incorporated and operate either as a sole trader or partnership. This may have been the structure when the business was originally set up. However, this may no longer be the most tax efficient structure.

The owners of an unincorporated business suffer income tax on the profits made by the business as the profits are made, irrespective of whether the income is extracted from the business. The owners of an incorporated business, operated through a limited company, will only suffer income tax when income is extracted from the company. Profits made by the company will suffer corporation tax at a rate of

20%, until profits exceed £300,000 per annum, when the marginal corporation tax rate is 25%.

As the owners of an unincorporated business will suffer income tax at a rate of at least 40% when profits exceed £42,475 per annum for one of the owners, there may be tax advantages to operating a farming business through a limited company, when not all of the profits made are extracted from the business.

Additionally, where a business has borrowed funds to finance a new project, undertaking this project through a company may also be more tax efficient. As the loan repayments are made from

profits taxed at a rate of 20%, instead of 40%, 50% or even 60%, leaving more profits to repay the borrowings. The company could be separate from an existing partnership, or could be introduced as a new partner. Introducing a corporate partner into an existing partnership can also be tax efficient with regards to income tax.

Where changes are planned to the structure of a farming business, the possible effect on the entitlement to Single Payments should be considered, to ensure that the planned changes do not have an adverse effect on the entitlement.



# Furnished Holiday Lets

## - valuable tax reliefs can be available

Many farmers and landowners have residential properties which are let out. A residential property let as domestic accommodation will be treated as an investment asset when sold and potentially chargeable to Capital Gains Tax (CGT) at 18% or 28%. The value of any such asset is also potentially chargeable to Inheritance Tax (IHT) on death. However, if a property qualifies as a Furnished Holiday Let (FHL), valuable tax reliefs can be available, including Business Property Relief on death, meaning that the value of the asset may not suffer IHT.

### How does a property qualify as a Furnished Holiday Let?

To qualify the property must be let on a commercial basis with additional services being offered compared to what would be expected from a "normal" let property. HM Revenue & Customs will consider the commercial aspect carefully in deciding whether a property qualifies as a FHL.

Examples of additional services that would be expected to be provided for a FHL include a regular laundry service for towels and bedding, regular cleaning of the property, the provision of meals.

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 tax year (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.

### What are the tax benefits?

The tax benefits have been restricted in recent years but there are still valuable tax reliefs available for a qualifying FHL property.

Capital gains on the sale of qualifying properties may be eligible for Entrepreneurs Relief, therefore may suffer a tax rate of only 10%. FHL properties are eligible for capital gains gift holdover relief, and also rollover relief when

replaced, or as a qualifying purchase for the rollover of gains realised on other business assets. Capital allowances can be claimed on the cost of furniture and equipment for FHL properties.

Qualifying properties can also be eligible for IHT Business Property Relief on death, meaning that the value of the asset may not suffer IHT. A recent tax case gave a favourable judgement for the tax payer in respect of the availability of Business Property Relief for a FHL property. However, any FHL property should be run as a business to maximise the possibility of obtaining Business Property Relief.



# VAT treatment of a new farmhouse - check for any planning restrictions

Most things that are purchased are subject to VAT. A new house is an exception as it is zero rated. The zero rating of new residential accommodation means that the person constructing the house can reclaim VAT on related expenses whilst not having to charge VAT on the onward sale.

The relief also extends to DIY housebuilders, for whom there is a VAT refund mechanism that enables them to reclaim the VAT they incur. This ensures that VAT does not become an additional cost to farmers who choose to build a new farmhouse for themselves.

The relief depends on the building qualifying as zero rated residential accommodation. However, the terms of the planning consent allowing the construction of a new farmhouse need to be considered, as this can affect the ability to reclaim the VAT incurred. A recent

case has illustrated the relevance of planning consent for farmers constructing a new farmhouse.

In the case, a farmhouse had been built with a stipulation in the planning consent that the house could not be sold separately, and would always be ancillary to the agricultural use of the land. As a result, the Court concluded that the house did not qualify for zero rating, as its separate use/disposal as residential accommodation was prohibited.

Therefore, farmers proposing to construct a new farmhouse should ensure that the potential for zero rating, and the ability to reclaim VAT incurred, is considered at an early stage. This should be when making and negotiating an application for planning consent, when terms will be discussed that can affect zero rating. Failing to secure zero rating can be costly.

If you have any VAT issues, please call Adam Lloyd in the Hazlewoods VAT Team on 01242 237661.



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# Proposed changes to the VAT treatment of listed buildings

## - minimise the VAT liability

It is not unusual for farmers and landowners to own properties which are classed as protected (listed) buildings. Legislation was announced in the 2012 Budget which may mean a future VAT liability will arise as a result of work carried out on a listed building, if this does not occur before the end of September 2015. This is an extension of the original deadline for the transitional arrangements which was 20 March 2013. However, listed building consent must have been applied for by 21 March 2012.

### What is the current VAT treatment of listed buildings?

Currently, zero-rating applies to "approved alterations" to a listed building and to the first sale or long lease of a substantially reconstructed listed building. Approved alterations cover works under planning consents and comprise changes to the fabric of the building. The ability to zero-rate the first sale or lease means that VAT can be recovered on the cost of the reconstruction work carried out.

### How will the proposed changes affect the VAT treatment?

The proposed changes will mean that future approved alterations are likely to be standard rated and therefore incur a VAT cost of 20%. It is possible that the reduced VAT rate of 5% might be available for work that would previously have qualified for zero rating as an approved alteration.

The zero-rating is not to be removed entirely for the first sale or long lease of a substantially reconstructed listed building. It will be retained for buildings reconstructed from a shell. Otherwise the sale of the reconstructed building will be exempt from VAT, resulting in irrecoverable VAT on project costs.

### How can you maximise VAT recovery?

If work is planned in the future on a listed building, and listed building consent had been applied for by 21 March 2012, the possibility of carrying out the work before the end of

September 2015 should be considered in order to minimise future VAT liabilities. Similarly, the first sale or long lease of a substantially reconstructed listed building may need to take place before the end of September 2015.

If you have any VAT questions, please call Julian Millinchamp in the Hazlewoods VAT Team on 01242 237661.



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## Changes to VAT rules for "self storage"

In the Autumn 2011 edition of Agricultural Focus, we commented on two Tribunal cases in which the taxpayers had successfully argued that their provision of self-storage facilities amounted to the grant of a "licence to occupy land" to the customer and was therefore VAT-exempt.

HMRC saw these decisions as creating a distortion between the VAT-exempt "provision of facilities for self-storage" (where the customer is given rights over a specified area), and the VATable "provision of storage" (where the supplier can choose precisely where the customer's goods are stored). Accordingly the law has been amended so that all provision of facilities for self-storage from 1 October 2012 onwards will be VATable.

It is for the supplier to determine whether what is being provided comprises "facilities for self-storage". The first consideration is whether the supply comprises the use of a "relevant structure" - i.e. a container or other structure that is fully enclosed, or a unit or building. The

second determining factor is the way the facilities are advertised and the agreements entered into. Where facilities are suitable for a variety of purposes and agreements do not specify a particular use, the supplier should obtain written confirmation from his customer of the use to be made of the space and retain it with his VAT records.

Where the customer has prepaid for self-storage that will be provided on or after 1 October, the supplier must account for a 20% "anti-forestalling charge" (effectively output VAT) on the value of the supply pertaining to the post-September period. This can be treated as input VAT by business customers on receipt of an invoice from the supplier.

Depending upon the precise circumstances, including the level of turnover generated, it may be possible to continue to

provide facilities for self-storage on a VAT-free basis by conducting the trade in a separate entity from other business activities, provided that the operation is conducted on a genuine "arm's length" basis. We would be pleased to advise further.



# Pay As You Earn - Real Time Information

## - how will it affect your business?

The next 12 months will see significant changes to the way in which farming employers report Pay As You Earn information to HM Revenue & Customs (HMRC), in respect of payments made to employees.

Real Time Information (RTI) is the name given to the changes, and will provide HMRC with detailed payroll information during the tax year. Currently employers provide information to HMRC once a year. However, under RTI, employers will be required to submit complete and reconciled data to HMRC every pay run, which could be monthly or weekly. For large agricultural businesses who operate their payroll on a weekly basis, this is likely to be a significant change.

All employers will be required to operate their payroll using RTI from October 2013. Depending on the size of the payroll, some employers will be required to operate the system from April 2013. Failure to comply with RTI, and provide the required returns may result in penalties for non-compliance, which could arise on a monthly or weekly basis, depending on the frequency of the pay run.

The returns required by RTI will require certain information to be held by employers in respect of employees. This will include harvest employees. If this information is not complete, the relevant returns will be rejected, and penalties could be charged.

### How can you prepare for RTI?

All employers should carry out a review of their payroll records and the process undertaken when employing new staff. The introduction of RTI will result in administrative changes in the way employers manage and operate their payroll.

Hazlewoods operate the latest payroll software and are a registered BACS bureau. If you are concerned about the changes to take place under RTI, and how they may affect your business, our payroll team will be happy to discuss your payroll requirements.



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