Agricultural Focus

DRIVING LIFELONG PROSPERITY

Spring 2019

SPOTLIGHT ON ANNUAL INVESTMENT ALLOWANCE

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INSIDE

1919 100 YEARS 2019

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Increased annual investment allowance

ENSURE THE TAX BENEFIT IS MAXIMISED

The annual investment allowance (AIA) available for capital allowances increased in the 2018 Budget to £1 million until 31 December 2020. This means that the amount spent on new plant and machinery qualifying for a 100% tax deduction in the year of expenditure has increased.

However, when planning the timing of expenditure, a farming business needs to consider its accounting year end date and the timing and amount of other expenditure it has incurred in its financial year. This is because the manner in which the increased AIA becomes available means that it is not available to all businesses spending £1 million on new machinery. The £1 million allowance will only be available in respect of expenditure incurred after 1 January 2019.

HOW MUCH OF THE INCREASED ALLOWANCE WILL BE AVAILABLE?

The year end of the business incurring the expenditure needs to be considered to confirm what amount of the increase to £1 million will be available in the 2019 accounts.

- Any qualifying business with a year end of 31 December will be entitled to the full £1 million allowance in the year ended 31 December 2019.
- Any other qualifying business will only be entitled to a pro rata amount of the new allowance, depending on their year end.
- For example, a business with a 31 March 2019 year end will only be entitled to an allowance of £400,000 in the year (£200,000 + ((£1,000,000-£200,000) x 3/12)).
- The later that the year end of a business is in 2019, the higher the available allowance.

The timing of the expenditure during the period is also important, as the increased allowance will only be available if the extra expenditure is spent in the period from 1 January 2019 to 31 March 2019.

The increased allowance may allow a business to create a tax loss in 2019 which can be carried back to set against 2018 profits and result in a tax refund.

Additionally, for a sole trader or partnership, the availability of five year averaging of profits could mean that further tax refunds are available in respect of earlier years.

RELEVANT DATE OF PURCHASE OF EQUIPMENT FOR CAPITAL ALLOWANCES

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, extended payment terms cannot be available. 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 being 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 year end for a tax deduction to be obtained. Additionally, the hire purchase must be on 'normal' payment terms.

WHAT ENTITIES DO NOT QUALIFY FOR AIA?

AIA is not available to a partnership where non-individuals are members. Therefore, a partnership with a company or trust as a partner, will not qualify for AIA. Such partnerships are not uncommon, as corporate partners have been used for income tax planning and trustees included as partners in order to maximise inheritance tax reliefs under Balfour type principles. However, if capital expenditure is incurred in a corporate partner or a trust that is a partner, these entities may qualify for AIA.

For further information please contact **Peter Griffiths** on **01242 680000** or email: **peter.griffiths@hazlewoods.co.uk**.

BUYING A FARM TAX EFFICIENTLY

There is not a flood of activity in the farmland market, but there is a steady stream of property transactions.

When using borrowings to fund a purchase it is worth considering how to maximise the amount of income tax relief on the interest and also how to make the borrowings as efficient as possible for inheritance tax (IHT) purposes.

MAXIMISING INCOME TAX RELIEF ON INTEREST

A farm purchase may consist of several different types of property assets: farmland and buildings, farmhouse, commercial property units, furnished holiday lets (FHLs) and cottages either for use by farm employees or to let under assured shorthold tenancies. Interest is an allowable expense against both farming profits and rental income. However, income tax relief on interest incurred for the acquisition of the farmhouse will be restricted to the business use of the farmhouse, 25% (say). In addition, from 5 April 2017 through to 5 April 2020, higher rate income tax relief on interest for the purchase of let residential property is gradually being phased out, although there is no such restriction for interest incurred purchasing FHLs.

Generally, where borrowing is taken on to purchase a farm consisting of different types of property e.g. farmland, farmhouse and let cottages, then the interest cost is to be apportioned between the different types of property on a fair and reasonable basis e.g. pro rata on cost. This is likely to see some restriction of the tax relief available on the interest allocated against the private elements of the farmhouse and the residential rental income. In contrast, if the borrowing is taken on to purchase just the farmland then there would be no such restriction.

In order to maximise the income tax relief on interest, it may be worth using any available funds to purchase the farmhouse and let cottages while taking on borrowing to buy the farmland and any commercial property. The mechanics of this will need to be discussed with both your lender and solicitor, but might see different family members having slightly different interests in different property or different tranches of borrowing secured on different assets.

Where borrowing is being drawn down secured on existing property then it is also possible to claim income tax relief on the interest against the rental or farming income generated from the use of the original property, provided the amount of borrowing does not exceed the base cost of the asset in the borrower's hands. If this is commercial property or bare farmland, then this may be the most tax efficient approach where funds are to be used to buy a mix of property.

As well as considering the income tax efficiency of borrowings, it is also important to consider the IHT implications.

ENSURE BORROWING IS IHT EFFICIENT

Borrowing taken out prior to 6 April 2013 reduces the value of the asset upon which it is secured in calculating any IHT tax liability. Borrowing taken out from 6 April 2013 onwards must first be set against the assets the funds are used to purchase. If the assets are relievable assets e.g. farmland eligible for agricultural property relief (APR), the borrowing will reduce the asset value before APR is given. Therefore, the pre-2013 planning approach of always trying to secure borrowing on let cottages or the farmhouse no longer reduces the IHT estate where the funds are used to purchase relievable assets.

Steps taken to maximise the income tax relief on the interest deduction may mean that the borrowing is not as effective for reducing the overall estate for IHT purposes. However, where property is held as part of a mainly trading business then, under Balfour type principles, there may be ways of planning to minimise IHT without losing income tax relief on the interest.

PLAN AHEAD

Consider who should buy property; one purchase or several linked purchases? Consider where borrowing should be secured. Consider best way to maximise income tax relief on interest payments. Review IHT position. Consider the whether optimising income tax relief or IHT position should take priority. Plan ahead.

BUSINESS RATES

In most instances, land and buildings used for agricultural purposes enjoy an exemption from paying business rates; however, this position can change where diversification takes place.

Some of the common forms of diversification we see include farm cottages being used for furnished holiday letting (FHL), renewables such as land being used for solar plants, biomass boilers or anaerobic digesters, and disused farm buildings and grassland becoming a livery enterprise.

Starting with FHL; within the current system, owners pay council tax on their properties unless the property is let, or available to let, as holiday accommodation for more than 140 days per year. If this is the case, the Government can allow the property to register for business rates as opposed to council tax. Where the rateable value (RV) of the property is £12,000 or less, a claim for small business rate relief can be made, giving complete exemption from business rates. The Government has concerns that the current system is open to abuse and, in November 2018, announced a consultation to seek views on whether the current criteria should be strengthened to deter an exploitation of the relief by second-home property owners who are not running legitimate holiday let businesses.

In the case of renewables, there are currently some limited exemptions applied to agriculture, where the generation is used on site, or constitutes micro generation (less than 50 kw). For other installations, business rates are charged based on the RV. The RV was last revalued from April 2017 based on market and cost evidence as at 1 April 2015.

Most equestrian businesses, including livery businesses, are not considered agricultural activities and, therefore, do not qualify for the agricultural business rate exemption. In establishing the area liable to business rates, it is necessary to establish the purpose for which the land is occupied. Grazing land (used only for grazing) occupied by horses will be exempt from rating, but the stables, ménages, feed and storage areas have no exemptions. A relief known as stud relief is available for premises used for the breeding and rearing of horses (stud farms).

If you find yourself in the position of having a potential business rate liability, you may be able to claim small business rate relief. The relief covers property where the RV is less than £15,000 and your business uses only one premises. If the RV is below £12,000, no rates are payable.

MAKING TAX DIGITAL

With the 31 January tax return deadline firmly behind us for another year, it is an apt time to discuss the forthcoming Making Tax Digital (MTD), which could mean the end of the annual tax return.

HM Revenue and Customs' (HMRC's) ambition is to become one of the most digitally advanced tax administrations in the world, with MTD aiming to transform tax administration so that it is more effective, more efficient and easier to get right.

All businesses will be required to report income and expenditure on a quarterly basis, which will mean the end of the annual tax return.

Given the complexities involved in implementing MTD, the Government is staging its introduction with Making VAT Digital (MVD) the first step to be introduced which has a commencement date of 1 April 2019.

MAKING VAT DIGITAL

From 1 April 2019, all VAT registered businesses with a taxable turnover above the VAT registration threshold will be required to maintain digital records as part of HMRC's push towards MTD.

This will mean virtually all farming businesses will have to keep digital records and use MVD compliant software to record income and expenses and submit their VAT return.

It is estimated that around 20-30% of farming businesses will not automatically be compliant for MVD, so it is really important to ensure you are compliant by 1 April 2019. In our autumn 2018 focus, we highlighted when businesses may not be compliant for MVD and the options to consider if you are not.

There are a limited number of businesses that may be able to claim an exemption from the filing requirements, although it is doubtful this will cover many. If you think you may not be compliant for the changes coming on 1 April 2019, it is really important that you speak to your accountant as soon as possible.

MAKING TAX DIGITAL

The second stage of MTD which will require businesses to submit quarterly returns from approved software for income tax purposes will not commence before April 2020.

The proposed April 2020 changes extend much further, covering all VAT and non VAT registered businesses and extending the net to include property landlords too.

THE BENEFITS OF MTD

Whilst change can be daunting, submitting quarterly returns could be a real benefit to your farming business. The need to prepare and review information quarterly can give you the opportunity to make more informed business decisions. You and your advisers will have access to up to date, meaningful financial information that can be used to provide constructive advice enabling key business decisions to be made on an informed timely basis.

WHAT YOU NEED TO DO NOW?

If you realise that you are not compliant for MVD and MTD, ideally a solution should be put in place in advance of 1 April 2019. Depending on the size of your business, the number of enterprises and the type of management information you want to produce will determine the most appropriate software package for you.

If you require any advice on MTD or the software packages available please contact **Lisa Oliver** on **01242 680000** or **lisa.oliver@hazlewoods.co.uk.**

BUYING OUT A PARTNER OR DIVIDING A FARMING BUSINESS

Siblings often farm together for many years, but at some point the business, and probably the assets, will have to be divided or one sibling buy out the other.

Traditional farming, whether combinable cropping, beef or sheep, is unlikely to support the substantial debt levels that would be required for one sibling to fully buy out the other. It may be possible to service the debt at today's low interest rates on a significant amount of borrowing, but it would be very difficult to repay large amounts of debt out of post-tax profits.

Against this backdrop, when one partner wishes to leave a farming business and one wishes to continue, it can be challenging to work out a way forward that allows a fair split of the equity in the business while allowing the ongoing business to flourish.

There is no one size fits all answer, but there are a number of approaches that may make the process less painful. Here are some pointers to the sort of approach that might work.

VALUATIONS

What is each party's interest worth? If you start with a realistic valuation then a lot of time and aggravation can be saved. If you need outside valuation advice then use someone each party respects.

NON-CORE ASSETS

Are all the property assets required by the ongoing business and are all delivering a commercial return? The answer may be surprising.

TIMESCALE

A clean break may be required for all sorts of reasons e.g. capital required for new venture, but payment over a period of time will be a lot easier for the continuing business. Can this be made to work for both parties?

BORROWING

Be realistic about how much the continuing business can borrow to fund a pay-out and consider cash-flow implications of capital repayments out of post-tax profits.

SEPARATE JOINTLY OWNED PROPERTY

It is possible to exchange interests in jointly owned assets without incurring an SDLT or capital gains tax charge in the right circumstances which would leave individuals owning specific property rather than owning everything jointly.

INCOME

The outgoing party will still need income. Keeping an interest in the land and buildings and renting it to the continuing farming business may satisfy both parties.

PARTNERSHIPS

Remaining as a 'sleeping' partner in a farming partnership may preserve all sorts of tax benefits e.g. income tax relief on house and vehicle costs, inheritance tax (IHT) relief on farmhouse and IHT relief on rental property. But it is essential to document the agreement to prevent misunderstandings.

COMPANIES

Using a company may be tax efficient. Paying down debt through a company allows debt to be repaid net of 19% corporation tax rather than net of higher rates of income tax that could be as much as 42% or 47% with the NIC.

PRESS ON AND COMPLETE SPLIT

Do not put off difficult decisions. Using experienced professionals should make the process easier.

FAIR IS NOT ALWAYS EQUAL

Remember that you are dealing with family and trying to create a win-win situation. If the deal leaves everyone on good terms then that is a good deal.

Please contact **Nick Dee** on **01242 680000** or **nick.dee@hazlewoods.co.uk** if you would like to discuss your plans.

ENTREPRENEURS' RELIEF - A VALUABLE RELIEF

Entrepreneurs' relief (ER) can be available to farming businesses when selling business assets and continues to be a very valuable tax relief where there is no plan to reinvest the proceeds in other business assets.

This can occur when land and buildings are sold for development and the proceeds used to pay off existing borrowings, fund the retirement of a partner or make a gift to non-farming children.

The relief can reduce the rate of capital gains tax from 20% to 10%. Recent changes in legislation mean that the period of qualification has increased from one year to two years. Therefore, to enable an unincorporated farming business (partnership or sole trader) to claim ER on cessation of a trade, the business must have been in existence for at least two years. There is a further requirement that the business must be a trading business, which usually means that at least 80% of income is trading income. This needs to be considered where rental income is included in the accounts of the business and if rental has exceeded 20% of income in the past, then the accounts leading up to cessation of the business must be able to demonstrate that this was not the case for at least the last two years before cessation.

PLANNING

Where someone intends to claim ER, advice should be taken well in advance of the transaction, preferably at least two years beforehand. Planning in advance will allow time to make any changes needed to ensure the required qualification period is met and relief obtained.

Please contact **Peter Griffiths** on **01242 680000** or **peter.griffiths@hazlewoods.co.uk** if you would like to discuss the availability of ER.

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