Agricultural Focus

DRIVING LIFELONG PROSPERITY

Spring 2019

SPOTLIGHT ON CHANGE AND DIVERSIFICATION

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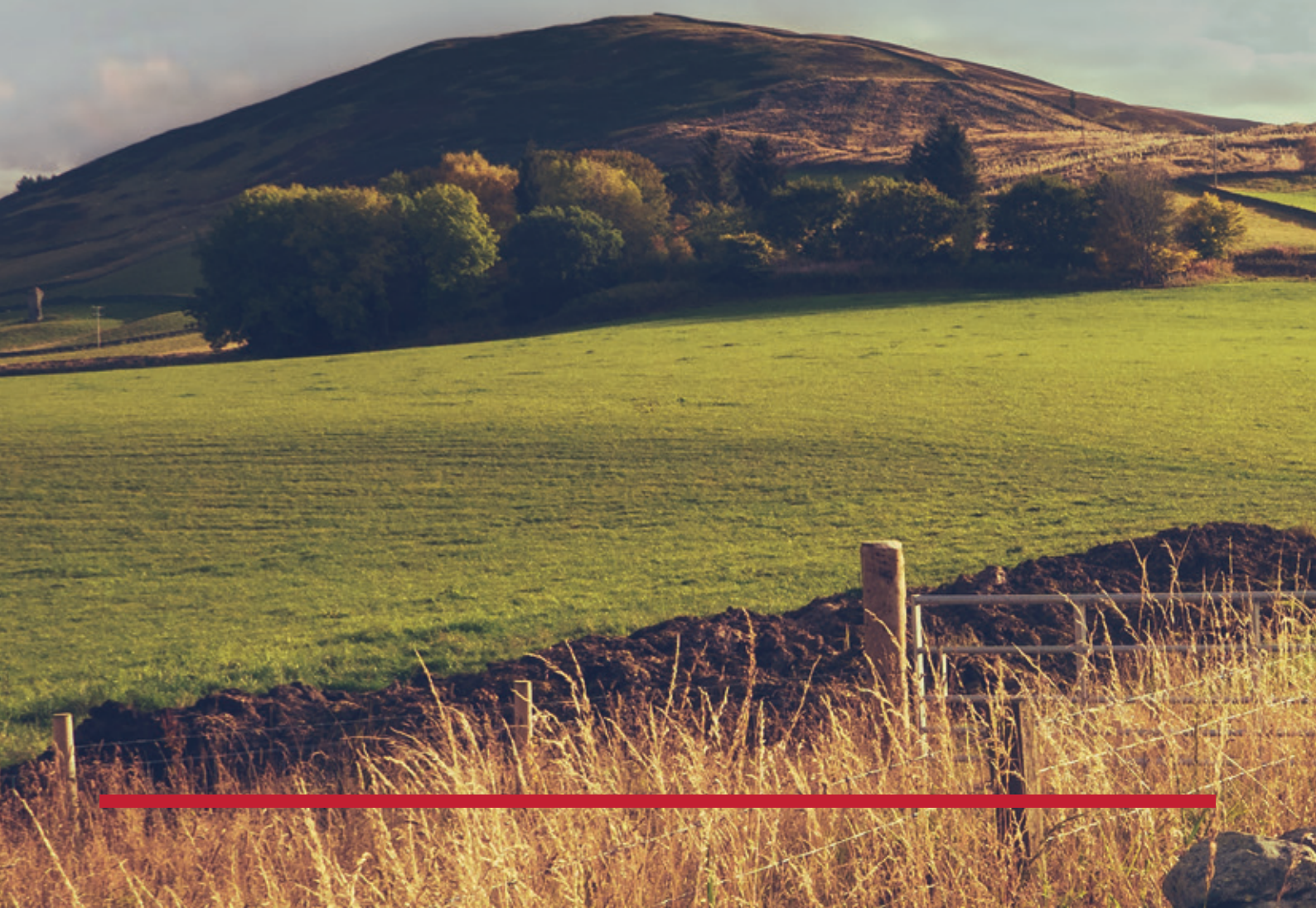
DRIVING LIFELONG PROSPERITY

Is your neighbour a potential collaborator or competitor?

Historically, UK farmers have not been great at working together, but increasing costs, reducing support payments, fewer active ingredients for controlling pests and weeds and the uncertain outlook for commodity prices is pushing many landowners to revisit their approach to arable farming. Collaboration with a neighbour, particularly over labour, power and machinery costs, now seems more likely to be contemplated than competition to push rents to unsustainable levels. The landscape is changing.

The arrangements that are being used to share or spread costs cover the full spectrum from using specialist contractors just for particular operations through to full blown contract farming or share farming arrangements. However, there are lots of ways to share labour and machinery costs other than using a contractor and it is variations on these arrangements that seem to be showing the most rapid growth. The full range of options include:

1. Use a contractor for certain operations and pay by the operation.
2. Use a contractor to grow crop on a stubble to stubble basis.
3. Share purchase of equipment e.g. main tractor, cultivation equipment, sprayer, drill, combine etc. informally with neighbour each with a percentage ownership.
4. Create joint venture (JV) entity to buy or hire in equipment and labour to carry out contracting operations for joint venture landowners.
5. Full contract farming arrangement with contractor paid basic contracting fee and share of divisible surplus.
6. Full share farming arrangement with contractor receiving a share of the gross margin in return for supplying labour, power and machinery.



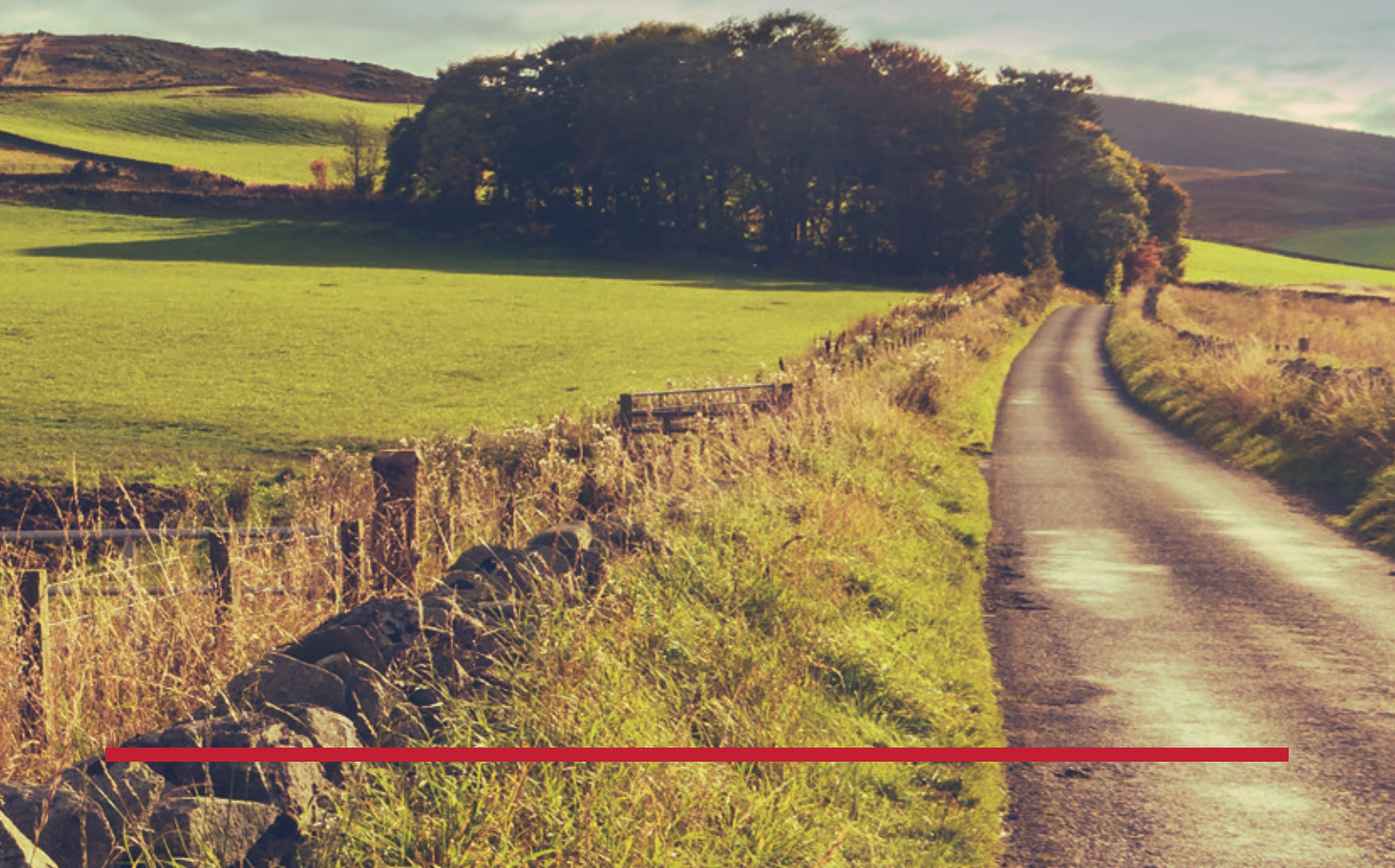
Buying equipment jointly with a neighbour can be a gentle introduction to reducing costs and may be an approach that works for years.

Alternatively a JV business that can buy its own kit, access hire purchase funding and contract for third parties may be preferred. The choice of JV would typically be a limited liability partnership or a company, with a company being chosen unless the sale of existing equipment gives an unacceptable income tax charge for the JV parties. The JV business will charge the JV partners a rate to at least cover costs. It is then a question for the JV partners as to the extent that the JV business should be seen as a profit centre as opposed to just a cost sharing vehicle.

It is important that any documentation, whether individual invoices or overarching agreement, is consistent with what happens on the ground. If the landowner pays a set fee for contracting and gets a set return for the crop then it is difficult to see that the net return to the landowner is anything other than a rent, whatever the documentation purports to say. A degree of landowner risk is an important element of the landowner being seen to trade.

All these approaches, properly carried out, allow the landowner to remain in occupation of the land, meaning they should keep the tax advantages associated with being a farmer. Generally, income will be classed as trading profits which can be important when considering pension contributions, gains on the sale of assets used in the trade can be rolled over and the farmhouse itself may qualify for agricultural property relief (APR) from inheritance tax. APR on the farmhouse is perhaps the relief most at risk if the farmhouse is no longer seen as the centre of the farming operations and this emphasises the need for the occupier of the farmhouse to take a full and demonstrable role in the farming business with minutes maintained for the regular farmhouse meetings.

Cost-sharing arrangements typically stop short of pooling output or sharing gross margins, but for some that will be the next step. If you want to chat about what structure might work for you then please do call.



BARN CONVERSIONS AND NEW BUILDS: THE VAT IMPLICATIONS

Converting agricultural buildings for residential use or constructing new dwellings to rent out on assured shorthold tenancies (AST) or as furnished holiday lets (FHL) is an option to utilise farm buildings and increase farm income.

The VAT position on building new residential properties and converting agricultural buildings into residential use can be complicated and it is important the invoices raised are appropriate for the work being done.

A builder carrying out the construction work will have three choices as to the rate of VAT to charge:

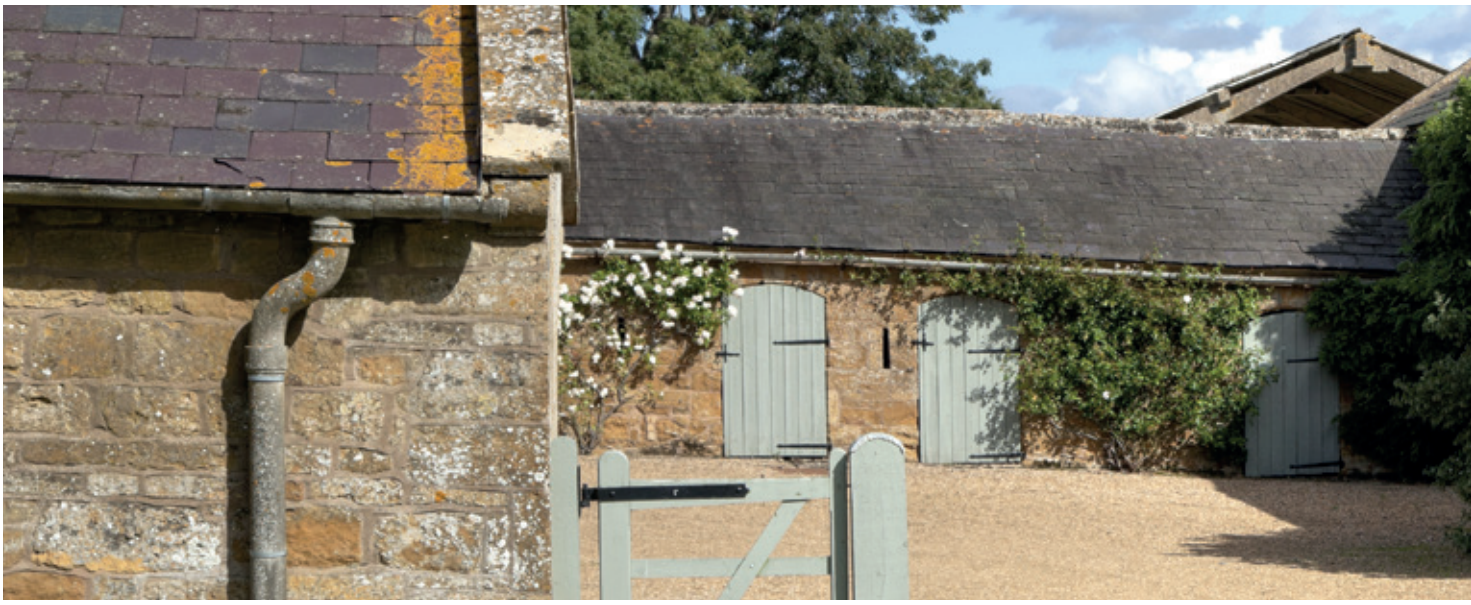
- Zero rate - i.e. 0%
  - on the construction of new dwellings
- Reduced rate - i.e. 5%
  - on qualifying conversions of non-residential dwellings into residential use
  - residential property that has been unoccupied for more than two years
  - where the number of dwellings in a property changes
- Standard rate - i.e. 20%
  - on everything else

It is always important to check the planning permission granted in relation to the new build or conversion to ensure there are no clauses restricting the separate occupation or disposal of the property. If either of the following are stipulated in the planning then the construction work will not qualify for either zero rating or reduced rating:

- if the property can only be used as 'ancillary accommodation' to another dwelling; or
- the property can never be sold separately to another property.

Fortunately, an agricultural occupancy clause restricting occupation to someone currently or last working in agriculture should not create a VAT problem.

Whether the input VAT on the cost of the build or conversion can be recovered will depend on how the property is intended to be rented out; i.e. an AST or as a FHL.



ASSURED SHORTHOLD TENANCY (AST)

Rental income from residential properties is an exempt supply for VAT purposes.

Input VAT can generally only be recovered where an entity is making a taxable supply (standard or zero-rated).

Renting out the properties on an AST would mean the business would become partially exempt, and consideration would need to be given to whether any of the input VAT on any of the repair costs was recoverable under the deminimis rules.

The basic rule is that input VAT on expenditure to generate exempt supplies cannot be recovered unless the total amount of exempt input VAT is below the partial exemption limits. Broadly, a VAT registered business can recover up to £7,500 of exempt input VAT in any one VAT year as long as the amount of the exempt input tax is less than the taxable input VAT for the business. If the exempt input tax incurred exceeds £7,00 in the VAT year, then none of it is recoverable.

Given this, where a property is going to give rise to exempt supplies it is particularly important to minimise the input VAT cost.

Any repairs would qualify as a deduction for income tax. Any improvements to the properties will be capital expenditure and, unfortunately, will not qualify for income tax relief.

FURNISHED HOLIDAY LET (FHL)

FHL rental income is a standard rated supply for VAT purposes. If the property renovation was to be undertaken within the VAT registered farm business all input VAT would be recoverable. As with the AST, repairs would be tax deductible and any improvements would be treated as capital expenditure, although capital allowances may be available on any furniture, white goods and integral features e.g. electrical installation.

The farming business would have to charge output VAT on the furnished holiday let income and this would be a cost to customers as they will be unable to recover the VAT.

If the FHL business was run separately to the farm partnership, then provided the new FHL business is not VAT registered and does not breach the annual VAT registration turnover threshold of £85,000, output VAT would not have to be charged to the customers, although no input VAT would be recoverable on the repairs and renovations.

The property could be rented on an AST to the separate FHL business (e.g. family member sole trade) and provided there are no planning regulations that stipulate the properties must be used as a FHL then the farming business would not have to charge output VAT on the rental to the FHL business. The input VAT recoverable on the renovations would then be on the same basis as if it were an AST.

If you have any queries on the VAT implications of converting farm buildings, please contact **Lisa Oliver** on **01242 680000** or **lisa.oliver@hazlewoods.co.uk**.

FARM DIVERSIFICATION

HOLIDAY LETTINGS

Diversification can be a great way to boost income and increase the profitability of the farm with holiday letting a popular activity. This can take a variety of forms such as yurts, shepherd's huts or lodges. Whatever type of accommodation is used, it is very important that the correct business structure is in place from the outset.

INCLUDE IN THE CURRENT FARMING BUSINESS

The simplest approach would be to include the activity within the current farming business. The main advantage of this structure is simplicity as all income and expenses will go through the existing farming partnership under one VAT registration with no need for a further set of accounts.

Once each individual's income exceeds £50,000, higher rate tax at 40% will be payable. If the inclusion of the holiday enterprise means profits are likely to exceed this level there may be the opportunity to include other family members in the partnership in order to utilise their basic rate tax bands.

The initial cost of purchasing any movable plant and machinery for the enterprise, such as a shepherd's hut will qualify for capital allowances. The current annual investment allowance (AIA) of £1,000,000 may be large enough to ensure 100% tax relief is available on all equipment purchases. However, where a permanent structure such as a lodge is constructed, only certain fit out costs will be eligible for capital allowances, such as electric, water and heating systems.

As the farming business will be VAT registered, all input VAT on the set up and running costs will be recoverable, although the main disadvantage of this structure is that, regardless of the turnover relating to the holiday accommodation, output VAT will need to be charged at 20% on the letting income. This will be an added cost to customers given that the majority of customers will not be able to recover this VAT.

SET UP AS A SEPARATE ENTITY

If it is expected that the initial turnover of the holiday letting is likely to be below the compulsory VAT registration threshold of £85,000 per annum, it may be beneficial to set up as a separate trading entity. If this entity is not VAT registered then output VAT will not have to be charged on the letting income, meaning that the cost is likely to be cheaper for most 'customers'.

The separate entity could be a sole trader, partnership or a limited company depending on the taxable income of the existing farm partners, the anticipated profit of the holiday enterprise and the amount of capital tied up in the business.

Provided certain criteria are met then an additional AIA may be available for the new entity, which may be beneficial if the current farming partnership is likely to utilise its AIA.

A separate entity would provide the opportunity for other family members or third parties to be involved in the business and give them the opportunity of running their own business separately from the family farm.

If all farm partners are higher rate tax payers and the profits from the holiday letting are likely to be reinvested in the business rather than being drawn out by the owners, then it may be beneficial for the holiday letting to trade as a limited company. All profits would be taxable at 19% and there would be no national insurance costs.

A further advantage of a limited company is that it provides protection for the owners, which may be highly desirable.

The disadvantages of setting up a separate non-VAT registered entity would be the extra administration including separate accounting records, a different bank account and an additional set of accounts, plus the input VAT would not be recoverable on the initial set up costs and running costs.

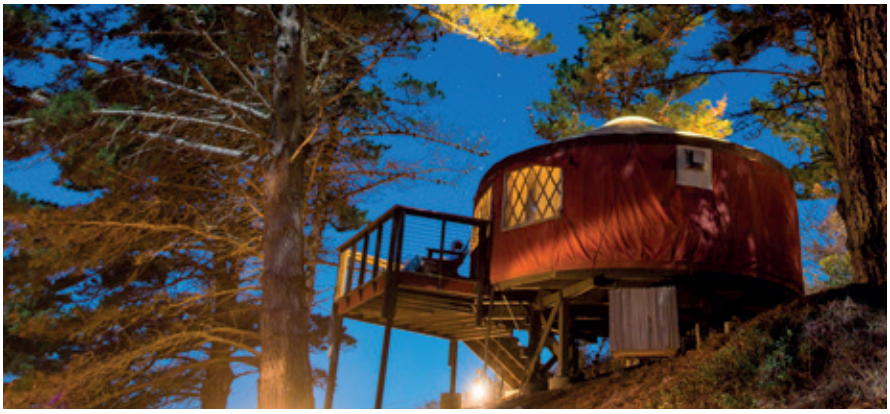
INHERITANCE TAX RELIEF

Furnished holiday lettings using lodges is an eligible activity for rollover relief for capital gains. In principle, the activity can also qualify for business property relief (BPR) for inheritance tax (IHT). However, HM Revenue & Customs will normally attempt to resist such a claim and only where it is shown that the services provided with the letting are substantial will a successful BPR claim be made. Therefore, carrying out the activity outside of an existing trading partnership may mean that the value of the assets are potentially chargeable to IHT.

If the holiday letting enterprise is to involve significant expenditure with the construction of permanent lodges then there may be an IHT advantage to keep the activity as part of an existing farming partnership.

If the farming income continues to be more than 50% of total income, and there are significant farming assets, then the value of the lodges is likely to qualify for IHT relief as part of the overall trading business.

Please contact **Peter Griffiths** on **01224 680000** or **peter.griffiths@hazlewoods.co.uk** if you would like to discuss farm diversification opportunities.



CAPITAL ALLOWANCES: WHAT IS A SILO?

As a rule, if you purchase a new silo for your business which is used for drying grain, you would expect to be able to claim capital allowances on the cost of purchase and installation on the basis that it is classed as plant and equipment used in the business. However, if you erect a new farm building to store grain, then until the new 'structures and buildings allowance' (SBA) was introduced from budget day last October, no tax relief would be due.

An exception to the rule could be when a building is considered a silo. Unlikely you might think, but in the recent first tier tribunal tax case of May V HMRC, this is exactly what the tribunal judges have concluded. The decision made in January 2019 was to allow a capital allowance claim on the entire cost of a new building on the basis that the building can be classed as a silo used for drying grain.

Looking at the facts particular to this case:

- Mr & Mrs May farm 900 acres in Devon. 700 acres are used for grain production for the sale to local farms and feed mills.
- The business needed a facility for drying and conditioning the grain after harvesting and for storing it until sold. The grain is sold between September and May, with about 80% being sold between January and March when the best price is received.
- The Mays engaged the services of a farm consultant who was involved in the design of the facility. They came up with a 'horizontal silo' where the drying mechanism is a set of grain pedestals on which each has a fan that draws up air through the grain to remove the moisture.
- The whole facility is one structure with partitioning sections for different types of grain.
- Mr & Mrs May claimed capital allowances on the whole structure not just the drying equipment within it. HMRC sorts to disallow the claim on the basis that part was a 'building' and therefore no claim is available. The tax years in question were 2011/12 to 2013/14.

What were the key points of the decision:

- The definition of a silo. This does not exclude a structure which is not either underground or cylindrical. HMRC was not able to produce evidence that a silo has a more specific meaning that would exclude a building used for storage of grain.
- To qualify for capital allowance the silo must be used for temporary storage, which it is.
- Whether the facility is plant and machinery. The walls were thicker than a normal agricultural structure and the structure was not one that could be used for another purpose as the walls, very smooth floor and airspace are suitable for grain but not for livestock or machinery or forage storage. The whole structure forms part of the drying and storing facility.
- The facility performs one particular function of the business, the drying and conditioning of the grain.

Unfortunately, this case will not open up a claim for every new farm building, but it certainly gives food for thought and proves that a detailed plan and well executed argument can prove invaluable.

If you are not able to argue that the total cost of a new structure should qualify as plant and machinery, provided you have sufficient detailed breakdown of the costs you should be able to claim capital allowances on integral features including lighting, heating and plumbing as well as any specific equipment within the building.

The new SBA mentioned above will now provide some relief on the construction of new farm buildings commenced after 29 October 2018. The claim is 2% per annum and where a claim is made the cost is excluded from inclusion as a cost for capital gains tax purposes.

CHANGES AHEAD FOR HOMEOWNERS

From April 2020, changes will be made to reliefs available when disposing of your main residence, which could result in a significantly increased capital gains tax (CGT) bill.

A disposal of your main home is generally exempt from CGT where it has been your only or main residence throughout the entire period you have owned it; this is known as principal private residence (PPR) relief. Partial relief for PPR may also be available in some circumstances.

Below we have identified four key changes with the new rules.

1. Letting out a property which was previously your main residence

The consultation proposes that lettings relief will only be available for disposals post 5 April 2020 in periods where the owner is in shared occupancy with the tenant. This measure will effectively abolish lettings relief for most people who have let out their home after moving out. This could result in up to £22,400 of additional tax.

2. Recently moved out of/will soon be moving out of your main residence

Homeowners currently have a final period exemption for PPR relief of the last 18 months of ownership regardless of whether they are in occupation at that time.

For someone that moved out of their house at the beginning of March 2019, their final period exemption will be effectively reduced to a maximum of 13 months if they sell by 5 April 2020 with a 'cliff-edge' drop to just nine months if they sell after this time.

3. Transfer of property to a spouse

The consultation also includes proposals to change the rules on inter-spouse transfers. Currently, the receiving spouse is deemed to acquire the property on the date of the gift, but only inherits the prior ownership period for PPR relief if it is the main residence at the time of the transfer. The proposal put forward is for the receiving spouse to always inherit the transferring spouse's PPR history.

4. Disposal of property post April 2020 – tax payment date

From April 2020, CGT will be payable on disposals of residential property within 30 days of the sale. Currently, this would be payable by 31 January following the end of the year in which the gain arose.

ACTION TO TAKE

Although these changes alone may not compel you to sell your property now, if you are thinking of selling in the near future there could be significant advantages of doing so prior to the rules change in April 2020. The same could be true if you are thinking of gifting to the next generation as part of succession planning Please get in touch for further advice.

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