

# Agricultural Focus

Sowing the seeds for future prosperity

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## Business structures

**Many farming businesses still operate through the traditional structure of a partnership, although there have been many incorporations of farming businesses in recent years. Some of these have involved the transfer of the whole business to a limited company, while some have involved the transfer of only part of the business to a company, with a partnership continuing to exist alongside.**

### Goodwill

Changes announced in the Autumn Statement mean that entrepreneurs' relief is no longer available on goodwill upon the transfer of a partnership business to a company owned by the same individuals. This means that the capital gains tax (CGT) liability on the value of goodwill in such circumstances will be at 28%, not 10%.

This is unlikely to affect the decision to incorporate many farming businesses, as HM Revenue & Customs (HMRC) normally argues that there is no goodwill attached to a farming business. However, the existence of valuable contracts can mean that goodwill does exist in a farming business, and we have dealt with incorporations of farming businesses where a

goodwill value has been agreed with HMRC, for example in the soft fruit industry.

Even where significant goodwill does exist, this may not affect the decision to incorporate and crystallise a CGT liability at 28%, as this will offer an opportunity to extract funds at a rate of 28% instead of 42% or 47%. Alternatively, it is possible to hold over any capital gain on the value of goodwill to ensure that a tax liability at 28% is not crystallised.

### Other issues

There are often other reasons to incorporate the farming business that can still offer tax advantages. Where a business is looking to expand and incur significant borrowings, carrying out such activity through a limited company

instead of a partnership enables debt to be repaid out of profits that are taxed at 20%, instead of 42% or 47%, allowing the debt to be repaid quicker.

Additionally, where all the profits being made by the business are not being extracted, running the business through a limited company and not a partnership means that tax is only paid on profits at a rate of 20%, not 42% and 47%, until profits are actually extracted from the business.

A limited company can also offer a structure where the individuals owning assets are 'separated' from the individuals running the business.

Therefore, there may still be good reasons for a farming partnership to consider the use of a company structure.

# Capital allowances

## Reduction in Annual Investment Allowance

The Annual Investment Allowance (AIA) available on expenditure eligible for capital allowances is currently £500,000 per annum. This is proposed to be reduced to £25,000 per annum from 1 January 2016. Therefore, businesses planning to incur expenditure to

make use of the current level of the AIA need to ensure that the date of expenditure will qualify for the increased allowance.

For a business with a year end of 31 March, for the year ended 31 March 2016 the total AIA available will be £381,250. However, if no expenditure is incurred before 31 December 2015 then the maximum available AIA will be £25,000.

To make use of the £375,000 available of the current AIA of £500,000 the expenditure will need to be incurred before 31 December 2015.

If expenditure is being made using hire purchase, the relevant assets would need to be in use before 31 December 2015.

## Ensure that available capital allowances are maximised

In the last few years there has been significant expenditure by farming businesses that is potentially eligible for capital allowances. The recent high level of the Annual Investment Allowance (AIA) for capital allowances has meant that a large proportion of the expenditure can be available as a 100% tax deduction.

Anaerobic digesters and the expansion of poultry businesses have been areas of significant expenditure. Detailed documentation to support expenditure will ensure that capital allowance claims are maximised.

### Anaerobic digesters

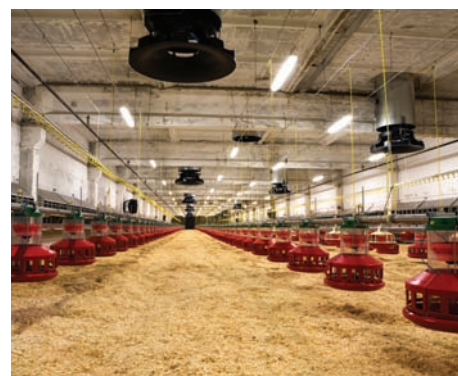
The majority of the expenditure in respect of Anaerobic Digesters (ADs) will be eligible for capital allowances, including the planning fees incurred. Where a new access road is required for an AD plant to function, it can be possible

to obtain capital allowances on the cost of the road.

### Poultry housing

Following the abolition of agricultural buildings allowances, a revenue tax deduction will only be available in respect of the cost of poultry housing through capital allowances. The 'shell' of any building will not be eligible for capital allowances.

However, it is possible that the same contractor could be constructing the shell of the building as is actually fitting out the building. Therefore, invoices need to confirm which costs relate to the shell of the building and which costs represent expenditure to fit out the building, such as ventilation equipment and electricity and lighting systems. It is much easier to obtain the necessary detailed analysis for a capital allowances claim before the building is completed.



## 55% pension "death tax" to be abolished

**What is changing** - currently, it is normally only possible to pass a pension on as a tax free lump sum if you die before the age of 75 and you have not taken any tax free cash or income. Otherwise, any lump sum paid from the fund is subject to a 55% tax charge. From April 2015 this will change, and this automatic tax charge will be abolished. The tax treatment of any pension you pass on will depend on your age when you die.

**If you die before age 75** your beneficiaries can take the whole pension fund as a tax-free lump sum or draw an income from it, also tax-free, either by using income drawdown or by choosing to buy an annuity.

**If you die after age 75** your beneficiaries have three options:

1. Take the whole fund as cash in one go: the pension fund will be subject to 45% tax. However, it has been proposed that this should be changed from 2016/17 to the beneficiary's or beneficiaries' marginal rate of income tax.
2. Take a regular income through an annuity or income drawdown: the income will be subject to income tax at your beneficiary's or beneficiaries' marginal rate.
3. Take periodical lump sums through income drawdown: the lump-sum payments will be treated as income, so subject to income tax at your beneficiary's or beneficiaries' marginal rate.

**Who will be affected** - anybody who has a defined contribution pension, e.g.

individual or group personal or stakeholder pensions, Self Invested Personal Pensions, and Additional Voluntary Contribution schemes will be affected.

**What we say** - the good news on pensions just keeps on coming. The abolition of the draconian 55% pension death tax, together with flexible access to pensions from age 55, means that rigid pensions are a thing of the past.

There are a number of changes being introduced from April 2015 and, with the right preparation, pension planning can be beneficial to you and your beneficiaries.

Pension funds can now offer possibilities to grow a fund in a tax free environment, having obtained a 40% tax deduction on the contributions and being taxed at only 20% on withdrawal.

Our in-house Financial Planning department can provide independent financial advice. If you have any questions about pensions please contact Gary Cook at Hazlewoods Financial Planning on 01242 680 000.

# Agricultural Property Relief

## Will a farmhouse claim withstand scrutiny?

In recent years Agricultural Property Relief (APR) claims in relation to farmhouses have received greater scrutiny by HM Revenue & Customs (HMRC) with several high-profile tax cases.

Where additional Inheritance Tax (IHT) becomes due as a result of HMRC being successful in refusing an APR claim, whether in part or completely, HMRC may also charge a penalty based on the additional tax due. We are aware of cases where this penalty has been as high as 30% of the additional tax due.

When making a claim for APR it should therefore be ensured that the claim will withstand scrutiny by HMRC, and relevant documentation such as contract farming agreements or grazing licences are correctly drafted and reflect what is actually happening.

Failure to do so could result in a penalty, meaning that the effective rate of IHT is higher than 40%.

## Use of grazing licenses and contract farming arrangements

Many farmers use grazing licences, share farming and contract farming arrangements to farm their land. One of the main uses of such arrangements is to protect the farming status of the landowner.

## Tax advantages

Securing treatment of the income as farming income gives several tax advantages. These will include the treatment of the income as earned income, allowing the landowner to deduct various expenses against the income, and to reclaim input VAT. The farm should qualify for capital gains tax rollover, holdover and entrepreneurs' relief, and for IHT purposes the owner may still be in agricultural occupation of the farmhouse. Business property relief from IHT should be available for any non-agricultural value from farmland and buildings.

Whether income arising under these arrangements is treated as rental income from property ownership or a farming trade is often a grey area. This grey area is being used by HMRC to attack such arrangements and to deny the reliefs mentioned above.

## Activities required

To qualify for the favourable treatment attention needs to be paid to the legal agreement and the activities the landowner performs. As the landowner, to be farming, you must be in occupation of the land and your occupation must be for the purposes of husbandry. The approach by the courts is to determine the primary use of the land and then to ascertain the identity of the person who had that use. In case law, the courts have been prepared to accept the landowner as the person with the primary use provided he conducts some activities which are husbandry.

For example, a grazing license should provide that the landowner is responsible for growing the crop of grass and actively performs some activity on the land. This would include mowing, fertilising, seeding, and controlling weeds on the land. Mere acts of maintenance, such as hedge cutting, would not be treated as husbandry. Similar clauses will be required in share farming and contract farming agreements to ensure the landowner is responsible for acts of husbandry to protect their farming status.

## Business risk

It is also important that there is always some business risk for the landowner. A guaranteed income every year would not give such risk. Case law has shown that not only is the agreement important but the actions of the parties in performing the agreement is vital. HMRC will put the agreement aside and consider the facts in each individual case to establish whether a farming activity is taking place and it is being carried out by the landowner.

## Going forward

In essence, if you wish to protect your farming status and you are relying on such arrangements you should take advice now. Your agreements should be reviewed and the relationship between the landowner and the licensee, share farmer or contractor should be considered to establish the one with the principal use of the land and plan for any changes required now.



# VAT on Property Conversions

The introduction of Permitted Development Rights in England in April 2014 means that it can be possible to convert agricultural buildings into residential dwellings without the need to apply for planning permission. However if the property is in a National Park or Area of Outstanding National Beauty then planning permission will still be required.

The VAT position on building new residential properties and converting commercial buildings into residential use has always been extremely complicated. The new legislation mentioned above has added to the complication and confusion.

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.
- Standard rate - i.e. 20% - on everything else.

One of the key factors in determining which rate of VAT to apply is whether planning permission has been obtained and whether the development has been in accordance with it. The new legislation led to fears that in the case of a barn conversion VAT would now be charged at 20% rather than the previous 5% because planning permission had not been obtained.

Clearly this point had not been considered before Permitted Development Rights were introduced. It was only in July 2014, after

representations to HMRC from the National Farmers Union, that HMRC appeared to have conceded that they would accept that planning consent had been obtained in cases where it is no longer necessary to apply for planning permission! This means that most barn conversions should still qualify for 5% VAT and repayments of VAT should be claimable under the DIY self-build scheme. However, we understand that HMRC are still considering various issues, and so have yet to issue definitive guidance.

A further point regarding VAT and planning permission is to ensure that there are no clauses restricting the separate occupation and disposal of the property:

- If the property can only be occupied by a family member or by an employee of a

particular business, or

- The property can never be sold separately to another property,

Then the construction work will not qualify for either zero rating or reduced rating.

In addition, where such planning restrictions exist, VAT incurred on a self-build project will not qualify for repayment under the DIY housebuilders scheme. Fortunately an agricultural occupancy clause restricting occupation to someone currently or last working in agriculture should not create a VAT problem.

It is crucial that advice is sought at an early stage to ensure both that the correct rate of VAT is applied and any VAT recovery by the farming business is maximised.



## Year-end planning

### Ensure full use is made of annual tax allowances and reliefs

There is still an opportunity for individuals to review matters and ensure full use is made of annual tax allowances and reliefs for the year to 5 April 2015.

#### 1. Married couples should use both personal allowances and basic rate tax bands

For the year ended 5 April 2015, each individual has a tax free personal allowance of at least £10,000 and a 20% tax band of £31,865. Income between £41,865 and £150,000 is charged to tax at 40%. Where an individual has taxable income over £100,000 they will lose some or all of their personal allowance, giving an effective tax rate of 60% on income between £100,000 and £120,000. Income tax is charged at 45% on income exceeding £150,000.

Possible planning could include varying profit shares in a partnership or ensuring that

dividends paid from a company are paid to the spouse with the lowest tax rate.

#### 2. Child benefit

Child benefit will be restricted where one individual in a household has an income over £50,000. Where possible, income should be equalised between husband and wife and "partners", to ensure that the child benefit restriction is minimised.

#### 3. Pension contributions should be considered, particularly where tax relief at 40%, 45% or even 60% is available

The rules relating to tax relief on pension contributions now allow an individual to contribute up to 100% of earned income (for example, salary or partnership profit) subject to an annual limit of £40,000. However, any unused relief can be carried forward for up to three years. Pension contributions can therefore be a useful tool in reducing the amount of income suffering higher rates of tax.



#### 4. Capital Gains Tax annual exemption

Each individual currently has an annual exemption of £11,000, which means that the first £11,000 of capital gains is tax free.

Spouses should therefore consider transferring assets to each other before disposal to ensure their annual exemptions are utilised, which could save tax at 28%.

It may also be more tax efficient to crystallise a capital loss in the year before making a capital gain than in the same year as the gain, as a brought forward loss is only set against gains after the annual exemption has been utilised.



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