

Agriculture Matters

Sowing the seeds for future prosperity

Tax Tips for Agribusinesses

The taxation policy and spending plans of the Government continues to feature regularly in the News. Some commentators predict that the top rate of income tax of 50%, introduced in 2010/11, will be abolished in the not too distant future. However, there has not been any firm commitment from the Government to abolish this rate, therefore any future planning should assume that the 50% rate will be with us for the foreseeable future.

With many businesses having a December or March year end, October can be an appropriate point in time to review matters in advance of the year end, consider whether the business structure is tax efficient, and profits are extracted in a tax efficient manner. In this issue we highlight tax matters that should be considered in any such review.

Business structure

The main choice of business structure is between an unincorporated business, a sole trader or partnership, and incorporated business; a limited company. General business

considerations may determine the choice of business structure. For example in certain industries it is almost "expected" that a business will be conducted through a limited company. The current tax legislation can make it tax efficient for a business to be conducted through a limited company, because profits are only taxed on the owners when extracted from the business, and dividends can be a tax efficient method of extracting profits.

Whereas, with a partnership or sole trader business, all profits are taxed on the individual owners irrespective of whether the profits are actually extracted from the business.

Therefore, where profits are in excess of £150,000, an individual could be suffering tax at a marginal rate of 52% (including National Insurance) but they may be only extracting a small proportion of this amount to fund their normal personal spending requirements.

Where the individual owners do not require all of the annual profits to be extracted from a business, a limited company can allow undrawn profits from the company to be taxed at a rate as low as 20%, until the profits are withdrawn. Therefore, with the top rate of income tax 50%, and the possibility of this rate being abolished in the future, this can allow profits to be retained in the company and potentially withdrawn in the future when the top rate of income tax is possibly lower. The current taxation of dividends received by individuals can allow a husband and wife to receive a combined annual total income of approximately £84,000 and pay no income tax or National Insurance, where both are shareholders in a company.

Where a business is investing for the future, and is financed through loans which will need to be repaid, a limited company can allow capital to be repaid from profits that only suffer tax at 20%, but would suffer tax at potentially 50% if the business was conducted as a partnership or sole trader. Therefore, an unincorporated business structure would have significantly less after tax profits available to repay debt capital.

However, a business structure is not a "one size fits all" scenario with all factors particular to each situation needing to be considered, including profit extraction, succession planning and exit strategy of the owners, when deciding on the correct structure. Businesses that currently operate as a sole trader or partnership can "convert" to a limited company by incorporating which can offer possible tax planning opportunities, through the sale of the Goodwill of the business. Alternatively, a Corporate partner can be introduced to an unincorporated business which can be tax efficient.

Therefore, the owners of an unincorporated business should consider whether it would be tax efficient to incorporate, or introduce a

Continued overleaf...



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Corporate partner: The owners of a limited company should consider whether the current profit extraction structure is tax efficient and full use is being made of the 20% and 40% tax bands of spouses.

Holding business assets personally

It is common for the owners of a business to personally acquire premises to be used by the business. This may be done in order to provide a future retirement income. If shares in an unquoted trading company, or a trading partnership share, are owned by an individual, it is likely that the market value of the business interest will not suffer Inheritance Tax (IHT) on the death of the individual, because of the availability of Business Property Relief.

Any business premises owned by the business, and used in the business, would also be covered by the relief as the value of the premises would be included in the value of the shares or partnership share. However, any business premises owned personally by a partner or shareholder and used in their business, would only attract Business Property Relief at a rate of 50%. Additionally, a shareholder will only qualify for this level of relief if they hold at least 51% of the shares in the company.

Therefore, the fact that business premises owned personally will not be wholly relieved from IHT needs to be taken account of in future planning. If future generations of the same family intend to continue a business in the future, it may need to be ensured that other assets are available to fund any IHT liabilities, to ensure that the business premises

remain available for the business and do not have to be sold on a death.

Additionally, if shares in a company are to be transferred to the next generation during the lifetime of the current shareholder; reducing a controlling shareholding to below 51% may mean that an increased IHT liability will arise in the future in respect of business premises held by the current shareholder.

Succession planning and exit strategy

Holding an interest in a business until death will often maximise available tax reliefs, as Business Property Relief should be available on the value of the business, meaning that no IHT is due, and the business interest is passed to beneficiaries at current market value, with no Capital Gains Tax (CGT) being due on death. Therefore, if the beneficiaries sell the business interest shortly after, they are unlikely to suffer any tax liability. However, if an individual sold a business interest before death, they would be likely to suffer a CGT liability at a minimum rate of 10%, and then suffer IHT at death at 40% on the proceeds still held.

However, if the owners of a business retain their full ownership until death this is unlikely to provide an incentive for individuals to enter the business and continue the development. Whether this is members of the same family, or unconnected individuals. Succession planning and a possible future exit strategy need to be considered well in advance, and will involve planning for both CGT and IHT. In addition, income requirements in retirement

need to be considered, as well as the ability to provide for all beneficiaries on death, without having to sell an interest in a business which is to be continued by another family member.

If an exit strategy involves the likely future sale of a business, whether to other owners of the business or an external party, the eligibility for Entrepreneurs Relief should be regularly reviewed to ensure that any CGT liability will be minimised. The relief will reduce the CGT liability on the sale of shares in a qualifying trading company, or an interest in an unincorporated business, to a tax rate of 10%. However, there is a qualifying period of 12 months, and eligibility criteria needs to be met for at least 12 months. For example, where shares in a company are being sold, a minimum holding of 5% is required, and the vendor must be an employee or director.

Therefore, a possible situation could arise where the original founders of a business are no longer employees or directors but still have shareholdings considerably larger than 5%. On a sale of the business these individuals would not qualify for Entrepreneurs Relief and would suffer CGT at a minimum rate of 18%, and a likely rate of 28%. Therefore, future plans for the business and the owners should be reviewed regularly to ensure that CGT and IHT reliefs are maximised.

Please contact our Agribusiness Team if you would like to discuss any of the issues included in this release, or any other issues connected with your business.

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