Agricultural Focus

DRIVING LIFELONG PROSPERITY

Autumn 2019

SPOTLIGHT ON BUSINESS FORECASTS

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HAZLEWOODS DRIVING LIFELONG PROSPERITY

BUDGETS AND CASHFLOW FORECASTS – LOOKING FORWARD

You may have updated your accounts software or even moved to digital accounts software for the first time in order to be compliant for making VAT digital (MVD), but do you realise how much you can get from your software for relatively little extra effort?

Accounting software allows data to be used to produce regular management accounts which can provide a platform for making critical business decisions. This information has never been so readily available and can make a real difference to the way you run your business.

Historically many farming businesses produced year end accounts in order to comply with income tax requirements. These have often been prepared by accountants 6 –12 months after the year end, with any meeting focusing on what happened almost 12 months ago.

IT IS TIME FOR THIS TO CHANGE

Understanding your farm's profitability and cash requirements is becoming increasingly important for agricultural businesses.

Uncertainty is a key risk for business. With the uncertainty over Brexit and the threat of a 'no deal' there has never been a more opportune time to look at the financial health of the farming business.

Many farmers are looking to either expand their existing business or consider new ventures to bring in extra income. Major business decisions need to be considered carefully, and financial information is a key factor in the decision-making process.

Quite often a decision to spend can be led by the tax implications. Whilst tax is an important factor to consider, it should not override the commercial decision-making process. Sitting down at the beginning of the financial year and considering the timing of annual spend will highlight any pinch points and will enable you to provide essential information to your lender if additional borrowing is required.

UTILISE THE INFORMATION AVAILABLE

Producing monthly or quarterly VAT returns digitally means that the bank account has been reconciled, all costs and receipts have been analysed to the appropriate nominal code and the information is there for you to use.

Most software packages have the capability of holding fixed asset registers, so depreciation can be calculated and a budgeting tool, so the previous year's data can be used as a starting point for your budget.

Sit down and go through the expected profit and loss for each enterprise. Think about expected yields, prices and input costs. This is the important starting point for the basis of a budget; software packages will then allow you to consider the timing of expenses and receipts to convert this to a cash flow forecast.

Discuss plant and machinery requirements, and opportunities to share or pool machinery with neighbours. Understanding the useful life of your assets will ensure the appropriate depreciation rate is used and aid the production of useful meaningful management information.

Think about stock movements and incorporate that into your budget, in order for a true profit forecast to be reflected.

Rolling forecasts over several years will highlight the risk of loss of BPS from 2021, and provide reassurance or push the decision to change things if the outlook is not looking profitable. Farm businesses should be aware of the impact of no subsidy and be in a position to plan well in advance.

Revisit your budget throughout the year.

SENSITIVITY ANALYSIS

Incorporating sensitivity analysis into the budgeting model will also help you to predict changes and their impact on cash flow. How will a 1ppl variance in milk price, a 0.5T wheat yield or a reduced occupancy rate on your furnished holiday let affect your projected profit and cash flow?

A sensitivity analysis for new projects will enable you to look at the break-even point and how sensitive a fall in price or yield is, and if the risk of fluctuation in this makes the project unviable

SHARING INFORMATION

With up to date real time information, cash flow can be monitored and compared to budgets. Sitting down round the table once a quarter will give you the opportunity to review spend to date and make decisions regarding the next quarter. It is also a great time to discuss what went well and where changes need to be made.

Collaborating with professionals will be key and keeping in regular contact with accountants, consultants and bank managers enables you to make informed decisions in a timely and efficient manner.

Up to date information means profit forecasts can be prepared before the year end. This enables tax estimates to be prepared for the following January and July and give the opportunity to consider the timing of machinery purchase, whether additional pension contributions should be made and the timing of selling crops in store.

CONCLUSION

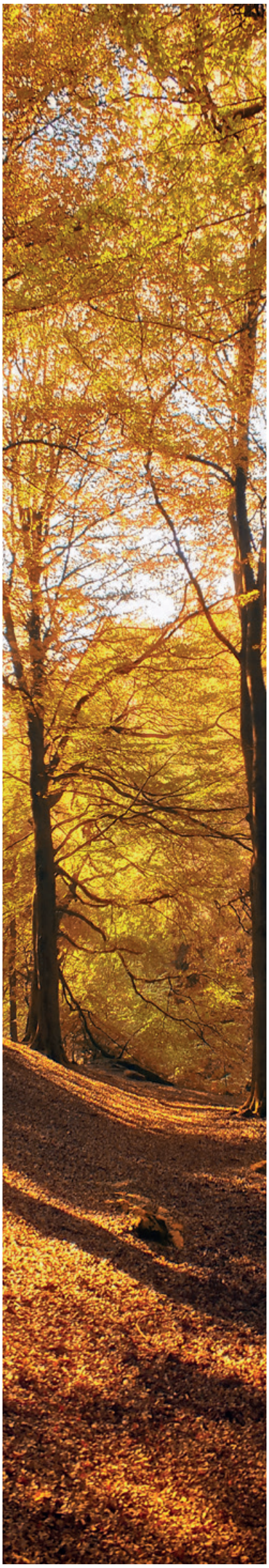
Every business needs to plan ahead and assess profitability and cash requirements. It is never too late to start preparing budgets and cash flows. Regularly monitoring the actual numbers compared with expectations will assist with ongoing planning and decision making.

Embrace change and use the information you have. If the numbers do not add up then it may be a time to look at a diversification project, or stop an enterprise that is not making money. These are tough decisions to make, but in a time of uncertainty being able to make a quick well-informed decision is paramount to running a successful farming business.

Please contact Lisa Oliver on 01242 680000, lisa.oliver@hazlewoods.co.uk or your usual contact if you would like to discuss budgets and cashflow forecasts.

Can you see the wood for the trees?

With increasing demand for trees, both for timber and carbon sequestration, the tax implications for woodland and forestry are becoming more important.



WHAT TYPES OF WOODLAND ARE THERE?

Amenity woodland is typically small areas of woodland, such as shelter belts and game cover, not managed as either commercial woodland or short rotation coppice. When occupied as part of a wider farming business the woodland is treated as being agricultural.

Commercial woodland is woodland managed on a commercial basis and with a view to the realisation of profits. The commerciality of woodland should be evident from the way the woodland is managed e.g. a woodland management plan etc

Short rotation coppice is a perennial crop of tree which is regularly harvested. For tax purposes it is treated as farming.

WHAT IS THE TAX POSITION OF WOODLAND?

Income tax

Commercial woodland is specifically outside the scope of income and corporation tax. There is no tax payable on the proceeds of timber sales and no relief for the costs of managing the woodland.

The sale of felled timber from amenity woodland on the farm should be included within the farming accounts. Grants have to be looked at on a case by case basis, with some being taxable and others not.

If the woodland is let, either in its entirety or for activities such as paint balling, the rent received will be subject to income tax. The same will apply if sporting rights are let.

Capital gains tax (CGT)

For commercial woodland the sale of trees, whether standing or felled, is exempt from capital gains tax. When the woodland is sold standing, the sale price must be split on a just and reasonable basis between the value of the trees and of the underlying land. A taxable gain or loss will arise on the land. Roll over relief is available if the qualifying conditions are met.

For the sale of woodland or timber where it is not managed commercially the trees are treated as a chattel. There will only be CGT if the proceeds for each tree sold exceeds £6,000.

Holdover relief is available on the gift of commercial woodlands or woodland qualifying for Agricultural Property Relief.

Inheritance tax

Commercial woodland should qualify for Business Property Relief (BPR), giving 100% relief from inheritance tax (IHT), providing it has been owned for at least two years. Agricultural Property Relief (APR) is available on amenity woodland if it is occupied with agricultural land or pasture.

For woodlands that do not qualify for either BPR or APR, woodlands relief is available providing it has been owned for at least five years prior to death. This allows the IHT on death that is due on the value of the growing timber to be deferred until such time as the trees are sold. The value of the underlying land is subject to IHT on death.

VAT

Providing there is an intention to make taxable supplies the woodland business will be included within the farming business for VAT or it can be registered as a separate business.

CONCLUSION

The tax reliefs on woodlands are potentially generous. For commercial woodlands having a woodland management plan and records to demonstrate implementation is key. As the carbon market grows this could become a valuable source of income.

LITIGATION SUPPORT AND FORENSIC ACCOUNTING IN THE FARMS AND ESTATES SECTOR

It feels as though as quickly as the value of farmland and property has risen over the last decade, the number of claimants seeking redress in the courts has increased even faster. The four most common areas of litigation seem to be:

- Matrimonial disputes;
- Agricultural Holdings Act succession cases;
- Valuation of a farming business; and
- Commercial disputes.

Ruth Dooley heads up Hazlewoods growing Forensic Accounting and Litigation Support Team. Ruth's litigation support expertise allied with Hazlewoods agricultural sector expertise has led to a number of appointments over the last couple of years. A flavour of the sort of case where Hazlewoods has advised is set out below.

1. Matrimonial. Hazlewoods valued the farming partnership the husband carried on with his brother and the husband's interest in that partnership. Hazlewoods also assessed the ability of the partnership to borrow to fund a settlement, the husband's maintainable earnings, the potential to dispose of any assets and the extent of any capital gains tax arising from the sale of any part of the husband's business or land.
2. AHA succession. Hazlewoods expert was asked to set out their expert opinion on whether or not an applicant satisfied the livelihood condition and then to reach an agreed position with the other party's expert.
3. Valuation of a farming business. Hazlewoods accepted instructions to act as a single joint expert to report on the value of a farming business as a going concern. In this case the family had been trading in partnership until relations between father and son broke down. When the son brought a claim against his parents under the doctrine of proprietary estoppel, Hazlewoods delivered a comprehensive report on the value of the farming business.
4. Commercial. The expert report produced was to quantify business losses incurred by a farming business where it was alleged equipment failed to operate as reasonably expected.

Clearly in the agricultural sector much of the value of someone's business interest reflects the value of the underlying property. Agents will be pleased to hear that Hazlewoods experts are not holding themselves out as property valuers(!), but we do understand farm accounts, partnerships, maintainable earnings, enterprise profitability, borrowing capacity and tax. If we can help in this area then please feel free to contact Ruth at ruth.dooley@hazlewoods.co.uk.

The Farms & Estates team has played a full part in a number of contentious cases. Nick Dee who heads up the Farms & Estates team makes five suggestions that will help you not to be involved in another...

1. Have a written partnership agreement which makes it clear what is and is not a partnership asset and who holds a beneficial interest in that property.
2. Have an up to date will and a letter of wishes that explains what you want to achieve and why.
3. Do not let tax planning override common sense, you need to hold some assets in your later years to provide a roof over your head and to safeguard an income.
4. Speak to the next generation so that they know where they stand and bear in mind they may have slightly different priorities to you, that does not make them wrong.
5. Think carefully before tying property up in trust or leaving assets jointly to the next generation, simplicity is often the best policy.

VAT RATES

When entering data into software packages, in order to ensure that all income and expenditure is recorded correctly on the submitted VAT returns, it is important that the correct VAT coding is used in your software package. The codes used vary for each software package, and the table below provides a brief summary to assist with the entries.

If using software to record data for partial exemption calculations, then further analysis will be required. Hazlewoods can always assist to ensure the correct codes have been set up in your dataset.

			SOFTWARE CODES				
VAT rates		Examples	Farmplan	Key Prime	Sum-it	Xero	Sage
Standard rate	20%	Most goods and services. E.g. fertiliser, sprays, professional fees, vet fees.	S	S	N1 (if entering Net amount)	20% (VAT on expenses)	T1
					G1 (if entering Gross amounts)	20% (VAT on income)	
Reduced rate	5%	Home energy	R	S5	N2 (if entering Net amount)	5% (VAT on expenses)	T5
					G2 (if entering Gross amounts)	5% (VAT on income)	
Zero rate	0%	Milk, livestock, crop sales (if used for human or animal consumption), seed, feed, water, grass keep.	Z	Z	VZ	0% (VAT on expenses)	T0
						0% (VAT on income)	
Exempt		Rental income (land that has not been opted to tax and property let on AST's), DIY livery, insurance and finance charges.	E	E	VE	Exempt expense	T2
Outside scope		Basic payment, council tax, MOT certificates, wages and drawings.	N	O	VO	Exempt income	T9

Sales and purchases exempt from VAT are included in the total sales (box 6) and purchases (box 7). Items outside the scope of VAT do not appear on the VAT return.

If you are using the flat rate scheme, exempt sales are included in the flat rate turnover, but sales that are outside the scope of VAT are not.

If you have any queries regarding the appropriate rate of VAT to use, please do not hesitate to contact the Farms and Estates team.

ATED UPDATE

The annual tax on enveloped dwellings (ATED) tax legislation covering residential properties owned by limited companies became effective from 1 April 2013. Since its introduction a number of changes have been made, so where are we now and what to watch out for?

THE CURRENT POSITION:

- ATED chargeable periods are the 12 months from 1 April to 31 March.
- ATED affects companies (and partnerships with corporate partners) that hold residential property with a value over £500,000.
- The ATED annual charges for 2019/20 based on the value at 1 April 2017 (or date of later purchase) are as follows:

PROPERTY VALUE (Million)	ANNUAL CHARGE
£0.5 – £1	£3,650
£1 – £2	£7,400
£2 – £5	£24,800
£5 – £20	£57,900
£10 – £20	£116,100
Over £20	£232,350

- The next valuation date is 1 April 2022 and will be used for returns for the five years commencing 2022/23.
- For existing properties, the filing deadline is 30 April following the end of the tax year.
- For new properties purchased, the filing deadline is 30 days from the date the property is acquired.
- Where the property is a newly constructed dwelling, or a new dwelling produced from other dwellings the filing deadline is extended to 90 days from the earlier of occupation or deemed completion.

Some reliefs are available from the annual charge. Examples where relief might be available for farming businesses are:

- farmhouses;
- rental property; and
- if occupied by certain employees.

Where applicable, ATED forms still need to be completed and the reliefs claimed.

One positive change which took effect from 1 April 2019 is ATED-related CGT payable at 28% has been abolished. Companies are now liable to corporation tax on any ATED property gains with the benefit of indexation allowance up to 31 December 2017.

Please contact Lucie Hammond on 01242 680000, lucie.hammond@hazlewoods.co.uk or your usual contact if you would like to discuss budgets and cashflow forecasts.

INHERITANCE TAX RELIEFS. WHAT DOES THE FUTURE HOLD?

Farming is currently a very tax efficient activity in terms of inheritance tax (IHT). It is possible for a sole trader farmer or a partner in a farming partnership to structure their affairs so that no IHT is payable on death on assets owned and used in the business.

The availability of business property relief (BPR) and agricultural property relief (APR) at 100% means that there is a tax incentive to hold assets until death. In addition, on death there will be a capital gains tax (CGT) free uplift to market value. This means that assets can pass to the next generation with no IHT and potentially no CGT on a future sale.

A recent report by the Office of Tax Simplification (OTS) has recommended various changes to the IHT legislation which, if implemented, could affect the planning farmers put in place to minimise their future IHT.

RELEVANT RECOMMENDATIONS INCLUDE:

- Lifetime gifts could become IHT free after five years. This is a reduction from the current seven years. However taper relief, which reduces the tax rate on gifts made three to seven years before death, would be abolished.
- The CGT uplift to market value would be removed where the asset benefited from an IHT relief or exemption on death. This would mean that the gain on a future sale would be calculated by reference to the original cost, or the value at March 1982 if later.
- To qualify for BPR a business must be 'wholly or mainly' trading i.e. greater than 50% trading. For CGT purposes the business must be substantially a trading business, which is widely seen as 80% trading. The report recommends aligning the two tests and it is likely that the IHT test would be moved to the CGT test.

Where families are planning to hold farmland for many generations, the removal of the CGT uplift on death may not be regarded as an issue. Indeed, it may encourage the passing on of assets during lifetime as hoped. However, the change to the qualifying criteria for BPR could have wider implications, particularly for those businesses with let property, such as cottages, running alongside the farming activities.

We are in a climate of political uncertainty at the moment, and whether the changes recommended by the OTS get taken forward by the government, remains to be seen. A change of government could lead to a more radical overhaul of the tax system, and for many this may be seen as a greater risk than the OTS proposals.

GOING FORWARD

The current favourable capital taxes environment that exists for farming business may not exist in the long term. Therefore, families may wish to consider how they could be affected by possible future changes and review current strategies. Please contact Nicholas Smail on 01242 680000, nicholas.smail@hazlewoods.co.uk or your usual contact, if you would like to discuss inheritance tax planning.

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