# Agricultural Focus

**DRIVING LIFELONG PROSPERITY**

Autumn 2020

## SPOTLIGHT ON TAX

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# Tax Changes

## PASSING ASSETS ON - IS NOW THE TIME TO ACT?

**As the cost of government support for the coronavirus spirals ever upwards, it seems inevitable that taxes will have to rise to pay for it. While the November budget has been cancelled, delaying any immediate changes, the timeframe to take advantage of current rates may be limited.**

For many in the farming sector, the inclination is to hold onto assets due to the potential inheritance tax reliefs on death and rebasing for capital gains tax. But what are the risks and opportunities?

### INHERITANCE TAX

In July 2019 the office for tax simplification (OTS), published its second report into IHT. The report made several recommendations including:

- Remove the capital gains tax (CGT) base cost uplift that arises on death where an asset passes under an exemption e.g. inter spouse or subject to a relief e.g. business property relief (BPR) or agricultural property relief (APR)
- Aligning the trading test for BPR, currently wholly or mainly i.e. more than 50%, with CGT which is substantially, widely seen as 80:20

In January 2020 the all-party parliamentary group for inheritance and intergenerational fairness published its report, 'The Reform of Inheritance Tax'. The main recommendation from this report was to replace the current IHT regime with a tax on lifetime and death transfers of wealth, with very few reliefs and a low flat rate, likely between 10% and 20%. The CGT tax-free death uplift would be abolished.

The common theme from both is the removal of the CGT rebasing on death and at best reform and worst abolishing APR and BPR. While both these reports are a long way from becoming law, they highlight the potential direction of travel if IHT is reformed. For landowners and farming businesses the position would undoubtably be worse if these changes were implemented.

## CAPITAL GAINS TAX

Capital gains tax applies if assets are gifted or sold. For assets qualifying for APR or BPR it may be possible to holdover the capital gain, deferring any tax until the recipient of the gift sells it. However, for assets such as let cottages this will not be possible.

The current rate of CGT for residential property is 28% and 20% for all other assets. (18%/10% for any part of the gain falling in the basic rate band). There is talk of these rates rising to the same level as income tax, so possibly up to 45%, making current rates look very favourable. If residential property is gifted and tax is payable, the gain must be reported to HMRC and the tax paid within 30 days. Prior planning is essential to meet this deadline.

The lifetime limit on gains qualifying for business asset disposal relief (BADR), formerly known as entrepreneurs' relief, and a 10% tax rate dropped from £10 million to £1 million in March 2020. This limit could be dropped further, or the relief abolished altogether. It may be beneficial to bring qualifying disposals forward or pass assets on to the next generation to take advantage of the relief. The March 2020 changes were accompanied by anti-forestalling legislation to catch transactions which were done purely to capture the higher levels of the relief, and there is always a risk that the government could implement something similar with future changes.

## STAMP DUTY LAND TAX (SDLT)

To encourage movement in the housing market SDLT on the first £500,000 of consideration has been reduced to nil, subject to the 3% higher rate for additional properties applying, up until 31 March 2021. This can give rise to a saving of up to £15,000 per property and may tip the balance in favour proceeding now.

## CONCLUSION

The current CGT rates could be at an all-time low and generous IHT reliefs may be at risk. Whilst the tax tail should not wag the dog, if you are thinking of passing assets on, now may be the time to act.

# Trusts

**Trusts are a valuable planning and asset protection tool and are frequently used by farming and landowning families when looking to pass wealth down the generations. There are a number of different types of trust but the most commonly used include bare, interest in possession and discretionary trusts. They can be set up during lifetime or on death and the tax treatment of each differs. This article considers two areas currently affecting trusts.**

## TRUST REGISTRATION SERVICE (TRS)

The TRS was introduced with effect from the 2016/17 tax year and is a HMRC online register used to record detailed information on trusts including the settlor, trustees, beneficiaries and assets within the trust.

Currently any trust, excluding a bare trust, must complete the register where it is subject to income tax, capital gains tax, inheritance tax (IHT), stamp duty land tax or stamp duty reserve tax.

With effect from the 2019/20 tax year, there is an annual requirement to update the information on the TRS. If there are no changes, the trustees are required to confirm this on the TRS. This must be completed before the self-assessment tax return can be submitted and means that for all trusts previously registered, the first deadline is 31 January 2021.

It is possible for accountants acting as agents to complete the update on behalf of trustees but only after the trustees have set up a government gateway organisation account for each trust and 'claimed' the trust.

Going forward, all trusts, regardless of whether they have a tax liability, will need to register. The deadline for registering any existing trusts is 10 March 2022. After that, all trusts will need to register within 30 days of being set up.

## DISCRETIONARY TRUSTS - PLANNING AHEAD OF 10 YEAR CHARGES

A discretionary trust is subject to IHT 10 year anniversary charges. The charge is a maximum of 6% and is based on the value of the assets in the trust less any reliefs such as business property relief (BPR) or agricultural property relief (APR) and any nil rate band available.

It is important for the trustees to understand the trust's IHT position and potential liabilities, and by timely planning, it may be possible to reduce the tax charge. The qualifying periods for BPR and APR are a minimum of two years, so forward planning is essential.

Possible actions which can be implemented to reduce the liability includes:

- Distributing some or all of the assets ahead of the 10 year anniversary. Providing there was no IHT when the trust was set up or at the last 10 year anniversary, this should not give rise to an IHT charge.
- Distributing income to beneficiaries – any income which has been accumulated for over five years is deemed to be capital for the purposes of calculating the anniversary charge.
- Reviewing assets to maximise the availability of BPR or APR. This may involve the trustees farming themselves or the assets being used in the trade of a beneficiary.
- APR is restricted to 50% for land subject to an agricultural holdings act (AHA) tenancy, unless vacant possession is available within the next 12 months. Negotiating with the tenant to convert this to a farm business tenancy (FBT) can increase the IHT relief to 100%.
- Review the position of any loans in the trust to ensure they are secured against assets in the most advantageous way to maximise APR or BPR.
- Using funds available within the trust to invest in assets which qualify for BPR or APR such as AIM listed shares, unquoted trading companies or more land. If existing investments need to be realised, consideration should be given to the potential CGT liabilities on any gains.

In addition to the tax consequences of any planning, the trustees also need to consider the wishes of the settlor, which are hopefully set out in a letter of wishes, and the personal circumstances of the beneficiaries.

Although trusts can be complicated, they remain a useful planning tool and allow assets to be protected for the long term. Once in place, a trust should be reviewed regularly with a specialist trust advisor. If you would like any assistance with the TRS, planning for an existing trust or are considering creating a new trust, please contact one of our team.

# Farmhouse repairs

**Farmhouses typically perform a dual function, acting as a home and also a place of business. This mix of business and private use has implications for the VAT recoverability and the tax deductibility of expenditure, including repairs and improvements.**

## REPAIR VERSUS CAPITAL

Capital expenditure constitutes a significant improvement such as an extension, conservatory or reconfiguring internal layouts to add an extra bathroom. This type of expenditure does not generally qualify for a deduction against income tax. In some instances, it is possible to claim a proportion of items which qualify as integral fixtures for capital allowance purposes. In either case, these costs can reduce the taxable capital gain on the sale of the property.

Repair and maintenance costs are those that restore the property to its original condition. Technology has changed over time so in some cases what may seem like an improvement such as replacing single glazed windows for double glazing is merely a repair using industry norm materials.

## VAT RECOVERABILITY ON REPAIRS

Some years ago, the NFU agreed standard apportionments with HMRC. In cases where the building is a typical working farmhouse and the business is a full-time farming activity then 70% of the VAT incurred on repairs can be claimed.

HMRC may allow up to 40% of the VAT to be claimed if the above conditions are not met dependent on the facts of the case.

## TAX DEDUCTIBILITY AGAINST INCOME TAX

When calculating the taxable profits of the farming business only a proportion of the farmhouse running costs, including repairs, can be deducted. Unlike the guidance for VAT there is no agreed percentage and each farmhouse is viewed on its own merits. When determining the allowable percentage of costs, the existence of a farm office outside the farmhouse and the number of rooms in the house should be taken into account as well as the actual business use of each.

## TIME TO REVIEW?

Over time farming businesses change and a review of how the farmhouse is being used and treated for tax purposes should be discussed regularly with changes being implemented when necessary.

# Plan ahead for cash squeeze

**The 2020 harvest year is one that many arable farmers would like to consign to history as soon as possible, but they still must manage their cashflow over the coming months. There has been a welcome rise in the price of wheat, but this may not help those with little crop in the barn or those who sold early.**

On the plus side, planting conditions for the 2021 harvest look encouraging and the lower oil and fertiliser prices should help the cost of production. However, the looming changes to basic payment in 2021 raise question marks over future profitability.

A business receiving £70,000 of basic payment in December 2020 will see that fall by just over 10% in 2021 to £62,500.

Changes to basic payment for 2021

| Direct payment band | Reduction percentage |
|---|---|
| Up to £30,000 | 5% |
| £30,000 to £50,000 | 10% |
| £50,000 to £150,000 | 20% |
| £150,000 or more | 25% |

Add in the uncertainty over Brexit negotiations and planning ahead to manage profitability and cash is challenging to say the least but has never been more important.

Steps to consider:

1. Delayed self-assessment tax for sole traders and partners is currently interest free but will be due to be paid by 31 January 2021. Where the liability is no more than £30,000, it may be possible to agree a time to pay arrangement over the following 12 months.
2. Delayed VAT payments are interest free but are due to be paid by 31 March 2021. Where a payment has been deferred, you should be able to opt-in to make 11 equal interest-free instalments over the 2021/22 tax year instead.
3. Will you be able to make use of the new coronavirus job support scheme which is due to start on 1 November 2020?
4. If your business continues to suffer from the impact of coronavirus, you may be eligible to claim under the extended self-employed income support scheme (SEISS), covering the period from November 2020 to January 2021.
5. Bounce back loans (BBL) - anecdotally more than 50% of farms have drawn down a BBL of up to £50,000. With an interest rate of 2.5%, 12 months interest free and repayment over the following five years (to be extended to 10 years), then this is very useful and cost-effective funding.
6. Bank borrowing - speak to your bank early about funding requirements. The margins charged on bank lending have nudged down over the last 12 months as banks rediscover an appetite to lend to the agricultural sector.

It is impossible to cover every eventuality but understanding and planning for the most likely outcome will put you and your business on the front foot.

# Research and Development tax reliefs: Could you make a claim?

**Research and Development (R&D) tax reliefs provide an opportunity for companies to claim additional corporation tax relief for certain costs in order to reduce taxable profits and their corporation tax liability. The relief is only available to companies.**

R&D comes in many forms and can include expenditure such as costs incurred on activities that are designed to increase yields, profitability and improve the quality of land. It is possible that a company is already undertaking activities that qualify for relief or it may be possible to structure future activities such that relief can be claimed.

The relief works by increasing eligible expenditure of say £100,000, which already receives 100% corporation tax relief by a further 130% of this amount (£130,000). The company therefore reduces the profits chargeable to corporation tax by £230,000. With a tax rate of 19% the tax reduction is £43,700, rather than £19,000 on the £100,000 spent.

In the above example the cash benefit in a profitable company is 24.7% of the amount of R&D spend. If the company is loss making, the R&D eligible costs can be surrendered for a cash payment. In this case, if there is a taxable loss of at least £230,000 and the full amount is surrendered, then a cash payment of 14.5% (£33,350) can be claimed.

**Eligible activities relevant to a farming company could include studying the effects of:**

- introducing different feed or different antibiotics to livestock
- growing different varieties of soft fruit in a particular soil or climate
- introducing different methods of pest control

Most claims include a significant element of staff costs that relate to the proportion of time spent by employees on qualifying activities together with 'consumable' costs, such as feed, seed, fertiliser, water, fuel and power, that can also be attributed to relevant activities.

To support a claim for the enhanced tax relief, records should be kept of the activities undertaken as well as the results of the project. It does not matter if the outcome of the project means that the activities are not implemented in the future.

If you have any questions or would like to discuss R&D tax reliefs, please contact Peter Griffiths on **01242 680000** or email **peter.griffiths@hazlewoods.co.uk.**

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