Agricultural Focus

DRIVING LIFELONG PROSPERITY

Spring 2023

SPOTLIGHT ON INCORPORATION

INSIDE

HAZLEWOODS

DRIVING LIFELONG PROSPERITY

Is incorporation still worth it?

Incorporation of all, or part of a profitable farming business is regularly used as part of a strategic tax planning exercise when considering the overall business structure. Proposed changes to the filing requirements, and the corporation tax rate suggest the incorporation position should be carefully reviewed.

CHANGES TO FILING REQUIREMENTS

The Government is in the process of implementing a reform to increase the financial information available to the public. A profit and loss account will be required in the annual accounts filed at Companies House for all companies. In addition, a statement from the directors confirming the company meets the qualifying criteria to claim the audit exemption will be required.

The rationale behind the changes is to improve transparency, allow third parties, such as creditors and consumers to make better informed decisions, and make it easier to spot fraud. It will, of course, also allow competitors and nosy neighbours to access financial information such as turnover, gross margin percentage and profitability.

CHANGING OF TAX RATES

From 1 April 2023, the main rate of corporation tax increases to 25%. This increase raises the question of how beneficial using a company to shelter profits from higher rates will become.

Typically, many businesses commence trading as an unincorporated entity. This works well where there is a significant investment being made in plant, machinery, and equipment, especially where 100% capital allowances are available. The capital allowances tend to keep the taxable profit below the higher rates of income tax, or even produce a taxable loss which can be used to reduce other taxable income.

A significant tax increase arises where the business starts to make considerable profits at a time where capital investment in machinery and equipment reduces. As a result, these unincorporated businesses can start to hit marginal tax rates of up to 62%, making corporation tax rates at 25% still seem quite attractive.

WHAT ARE YOU GOING TO DO WITH THOSE PROFITS?

It is relatively easy to transfer a profitable income stream into a company; the important question you need to consider is what will you do with the profits once they are in the company?

Generally, for an incorporation to work well, the company needs to be able to:

- Grow the business more quickly, this can be done net of corporation tax at 25% as opposed to income tax at up to 62%. Growth being either repayment of debt, or continued expansion. There just needs to be a use for the cash within the company.
- Extract cash from the company for personal use without having to declare dividends at higher rates of tax.

WHAT HAPPENS ON INCORPORATION?

Often assets are transferred into the company at market value; as the company has no cash, the value is left as a loan from the owners. When doing this, it is important to understand and minimise the tax consequences. The owners are free to draw the loan back tax free from future profits of the company.

The types of assets which work particularly well include:

- A dairy herd held under a herd election.
- Plant and machinery subject to capital allowances.

The transfer of the land and buildings, and related borrowing is also an option, but the tax implications are complicated and should be fully understood before proceeding.

In summary, even with increasing corporation tax rates, there is still a role for incorporation to play. When considering incorporating, it is important to understand the tax implications, and also have a plan for the utilisation of the cash generated from a profitable income stream.

Electric vehicles

As electric vehicles, or EVs, are becoming an ever-increasing sight on our roads, more and more people are considering whether an EV is right for them, or indeed their business.

Below are some of the differences to consider.

Availability

There are still significantly fewer EV options available on the market. Land Rover do offer a hybrid option, but the range is currently only 27 miles.

Purchase Price

A new diesel Land Rover Defender 90 starts at £62,000. The hybrid electric counterpart, Land Rover Defender P400 PHEV starts at £65,000.

As a comparison, the BMW iX is fully electric. The price starts at £68,000 though you may have concerns over its suitability to be a working farm vehicle.

In most cases, EVs have a higher residual value than their non-electric counterparts.

Running costs

Compared to the Land Rover Defender, a pure EV would save in the region of £1,500 for every 10,000 miles driven.

EVs are currently exempt from road tax, however the annual tax for the diesel Defender would be between £165 and £520.

Capital allowances

For non-electric cars (not commercial vehicles) the annual tax relief available on purchases is limited to 6% or 18% of the purchase price of the asset, on a reducing balance basis.

For EVs a first-year allowance can be claimed. This is 100% of the cost of the car in the year of purchase.

Leased cars

Vehicles with CO2g/km emissions of 50 or higher, suffer a tax restriction of 15% to the allowable costs.

Private use of cars

For sole trades and partnerships, any private use by the partners would restrict the running costs and capital allowances which can be claimed.

If an employer provides a car to a director/employee which can be used for personal journeys, this will represent a taxable benefit in kind for the employee.

The benefit in kind charges range from 2% of the list price for pure electric cars, or the best performing hybrid cars, to 37% for the higher emitting cars.

IN SUMMARY

If you are looking to purchase a new car, certainly EV, or hybrid is likely to come with a significant upfront cash flow advantage in the form of 100% capital allowances; however, this is only a timing difference. When the vehicle is eventually sold, there will be an adjustment to ensure that the capital allowances claimed match the actual depreciation (loss) on the vehicle. For an EV this would likely mean there would be a charge to income in the year of sale.

If you are looking to change a business car, start with the commercial aspects, which vehicle best suits your needs. If you find an EV is a viable option, understanding your tax position will assist you in determining the best time to purchase.

Basis period reform

For a number of years sole traders and partnerships have reported their taxable profits to HMRC based on the profits in the accounting period ending in the tax year. It is quite common for arable farmers to have a business year end of 30 September to tie in with the harvest year. The accounting period ending 30 September 2022 being taxable in the tax year ending 5 April 2023. This is known as the 'basis period'.

HMRC is now changing the basis period so that, regardless of your business year end, all sole traders and partnerships must report and pay tax on the profits arising in the tax year, so from 6 April to 5 April. This will begin from 5 April 2024 and the 2023/2024 tax year will be a transitional year.

Any sole trade or partnership with a year end of 31 March or 5 April will not be affected by this change in reporting requirements.

For those who are affected, action may need to be taken by the business owners. There are some factors to consider when assessing how this change in legislation affects your rural business, such as:

- Should you change your year end to 31 March or 5 April? There are pros and cons to changing a business year end and factors such as involvement with other trading entities may have a bearing.
- If changing your year end is the best way forward, when is the right time to make the change? You need to understand the tax implications and whether you can meet the criteria to allow additional profits made in the transitional year to be spread over a five-year period.
- Is your business likely to make a profit or loss in the transitional year and how to best utilise any loss?
- How do the transitional rules work with farmers averaging?

When changing your year end it is important to consider if you have any overlap profits which would have arisen when you started the business, or possibly if you have already changed the year end. Overlap profits will need to be identified and used to reduce the total profits in the transitional year.

Some businesses may choose to incorporate and become a limited company. There is a lot to consider when deciding if this is the right path for your business. For many rural businesses this is unlikely to be the preferred option when considering all the taxes at stake.

If you continue with a non-31 March/5 April accounting period end, the profits taxable in a tax year will need to be based on a proportion of more than one year. For example, a 30 September 2026 year end will be split, profits between 1 October 2025 and 5 April 2026 being taxed in 2025/26 and the remaining six months to 30 September 2026 taxed in 2026/27. As the self-assessment tax return filing deadline for 2025/26 is 31 January 2027, there is only four months after the year end to complete the year end accounts. Alternatively, businesses and individuals can file estimated tax returns and amend these once the accounts have been finalised, this will lead to duplication of some work and, inevitably, increased accountancy fees!

In summary, if your sole trade or partnership has a year-end other than 31 March or 5 April there will be action required to adjust to the new basis period. Hazlewoods can evaluate the options and identify the right path forward for your business.

Beware of the new VAT penalty regime

Most farming businesses are VAT registered; many receive regular VAT repayments and as such have not had to pay any penalties for submitting returns late as penalties have previously only been payable when VAT due is paid late. For VAT periods starting on or after 1 January 2023 the penalty regime is changing.

The penalty systems for late returns and late payments are very separate. So, a business should always submit its returns on time, even if it cannot fully pay the tax that is owed by the due date.

There is no financial penalty for the first late submission, but a late filing will lead to HMRC issuing a penalty point notice. The number of points which can be accumulated before a financial penalty is levied will depend on the frequency that returns are submitted. These are as follows:

- **Monthly returns** – threshold is five
- **Quarterly returns** – threshold is four
- **Annual returns** – threshold is two

The thresholds mean that the earliest date for any late return penalty will be 7 July 2023. This will be issued to a business that submits late monthly returns from January to May 2023 reaching its threshold of five the latter period having a submission date of 7 July.

For a business submitting quarterly returns, the earliest penalty date will be 7 February 2024, when four calendar quarter returns in 2023 have all been submitted late; 7 February 2024 is the due date for the December 2023 return.

After the threshold has been reached, the business will incur a £200 penalty for each late return. There is also no relief for dormant entities, therefore, it will be necessary for nil returns to also be submitted on time.

Once a business has reached the threshold it will be possible to return to zero points provided two conditions are met:

1. All returns for the previous 24 months have been filed (although not necessarily on time); and
2. The business must have submitted all returns on time for a set period after reaching the relevant points threshold. The period is:
   a. 6 months for monthly returns.
   b. 12 months for quarterly returns.
   c. 24 months for annual returns.

The new regime is set to penalise the persistent offender, rather than those making the occasional late submission. Plan ahead, and make sure your business is not subjected to unwanted penalty charges.

Meet our team

A Q&A with Tax Manager in the Farms and Estates team, Victoria Thomas.

WHAT IS IT LIKE BEING AN ACCOUNTANT IN THE AGRICULTURAL SECTOR RIGHT NOW?

Our sector is always interesting! It's funny because we have a lot of constants and many concerns remain the same year on year. The political environment, however, is always a challenge, it affects everyone and can sometimes be quite dramatic.

Nothing is really a great surprise for us; working in a sector means we have in-depth knowledge and understanding of client needs and can usually adapt to changes pretty quickly.

WHAT DREW YOU TO WORKING IN THE AGRICULTURAL SECTOR?

I'm a bit of an anomaly in our team! I actually don't have an agricultural background, so I'm one of very few who has never really been that close to a cow!

Having said that, I've worked in the team for so many years now and I've learnt so much about the sector, I feel very at home. I really love the people and businesses we work with.

The general tax work that we do is pretty straightforward and process driven, but the advisory work is what really interests me. Advising families on inheritance tax, for example, you get to know the individuals really well. The work might take a bit longer, but you come out of it feeling like you've really achieved something for the family. I get very excited when a new piece of advisory work comes my way.

WHY HAZLEWOODS?

I'm approaching 10 years at Hazlewoods this year, which is such an achievement and really says a lot about how much I love it here. I started as an AAT trainee in the old Gloucester office in 2013 and have since qualified as AAT, ACA, CTA.

The support has made me stay; I have such great levels of support from all levels around me, all the way to Partner. We also have a fantastic trainee programme and the ability to impart knowledge to newcomers to the team is something I really enjoy too.

It obviously helps that we have such great people and a lovely working environment. In 2015, I moved to our Staverton office when the extension opened and you really couldn't ask for more beautiful surroundings to work in.

TELL US SOMETHING THAT WE MIGHT NOT KNOW ABOUT YOU?

I've lived in five different countries; I was born in England, moved to Wales, Switzerland, Australia and then America. I still travel a lot now, although I prefer short city breaks and staying a bit closer to home.

For me, the best way to relax is to go on a long walk, climbing hills and making the most of the countryside we live in. In 2019, we celebrated the Hazlewoods centenary by visiting 100 clients in a day; I walked 50,000 steps that day – I loved it, not only for the walking, but because we got out to see so many clients who were all so welcoming and supportive. It's such a lovely sector, everyone has common goal and works together really well.

MEET THE TEAM

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