Armstrong Watson's Newsletter for Rural Businesses

Farming Matters

Autumn 2013 Edition

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Accountants & Financial Advisers

Welcome...

Welcome to the first edition of our Farming Matters newsletter. The challenges and opportunities that farming businesses and the wider rural community face are unique and ever changing. We thought it would be useful to discuss some of these issues in this publication.

For many businesses the biggest challenge of the last 18 months has been provided by the weather. Hopefully the good summer and autumn we are having will go some way to repairing the damage of last year. The reduction in grain prices as a result of good world harvests once again highlights the volatile world farmers are now operating in. Whether this is good or bad news for you will of course depend on the farming sector you are in. There is an article on the tax consequences of volatile profits on page seven which readers may find useful.

A significant part of the work we do is to minimise your tax bill. For the last 12 years we have been bringing companies into partnership to take advantage of the 20% tax rate a company pays, while maintaining all the flexibility and Inheritance Tax benefits of a partnership structure. In May of this year the government launched a discussion document which could severely restrict the tax advantage gained by this structure from 6th April next year. We will await the draft legislation later in the year but rest assured we are already looking at alternative ways to keep tax bills to a minimum.

On a lighter note we have again been supporting numerous local agricultural shows. Some pictures and reports from these shows can be found on page ten.

I hope you enjoy this edition of Farming Matters. We would welcome any feedback and if you would like to discuss any of the issues raised in the articles please give us a call or email us at farmingmatters@armstrongwatson.co.uk.

Paul Benson.

VAT ON STORAGE INCOME - Do you know the rules?

Farmers who rent out buildings need to be aware that new VAT rules have made a huge difference both to whether VAT needs to be charged on the rent and whether VAT can be reclaimed on related costs.

The changes which were announced in the 2012 Budget received little publicity compared to other VAT measures such as whether VAT should be charged on hot pies. The lack of publicity was partly due to the fact that HMRC stated that the changes would only affect approximately 250 businesses renting out "self-storage" units. However, once the legislation was published it became apparent that many more businesses were going to be affected, including farmers renting out surplus buildings.

Going back to basics, where there is a supply of rights over a defined area of land (for example the charging of rent) this is an exempt supply for VAT purposes. This means that output VAT is not charged on the income and generally input VAT cannot be reclaimed on related expenses. As is often the case with VAT, a general rule is followed by a list of exceptions to that rule. Amongst these exceptions are accommodation in a hotel or similar establishment and car parking, and from 1st October 2012 the grant of facilities for the self-storage of goods was added to the list.

The new rules apply to any situation where a VAT registered business allows another person to self-store their goods. It does not apply where the storage of goods is ancillary to the main use of the building.

> 'One of the main problems caused by these rules is that a landlord now needs to know exactly what his tenant is using the property for in order to apply the correct VAT treatment of the rent.'

To illustrate the issues we will look at a few examples:

- A farmer rents out an old byre to a firm of solicitors who use it to store old files and papers. This scenario is squarely caught by the new rules and VAT should be charged on the rents.

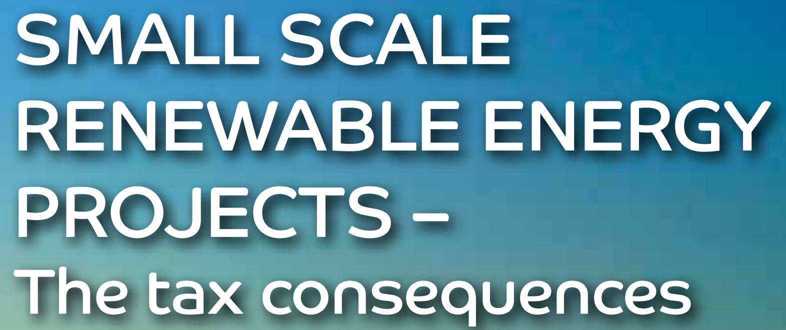
- The same farmer also rents a barn to a mechanic. Part of the building is used to work on vehicles while the rest is used to store car parts, tyres, etc. As the storage is ancillary to the vehicle repair business, it is not caught by the new rules and no VAT has to be charged on any of the rent.

- Staying with the example above, our mechanic is successful and his business expands. He rents a second property down the road from a different landlord but continues to rent the barn, which is now used solely for storing vehicles and spare parts. The VAT liability has now changed and VAT has to be added to the rents. Landlords need to have a clause in their agreements with tenants obliging them to be notified when the use of the building changes.

As well as considering whether VAT needs to be charged on rents, businesses should consider whether the new rules impact on the amount of VAT that can be recovered on related expenditure. Where VAT is charged on rents, any VAT incurred on repairs and other costs should now be fully recoverable.

Where a business makes both taxable sales (ie zero rated sales of livestock and crops as well as standard rated sales) and has exempt income from rents, there are complex rules governing the amount of VAT that can be reclaimed on expenses.

As we have seen, this area of VAT has become even more complicated and great care needs to be taken to ensure that the rules are complied with and a business maximises the recovery of VAT on expenses.



SMALL SCALE RENEWABLE ENERGY PROJECTS – The tax consequences

Renewable energy has received a huge amount of publicity in the last couple of years. The UK Government has committed to a large reduction in carbon emissions and an expansion of renewable energy production is seen as a key part of meeting this target.

The economics of many renewable energy projects have traditionally been poor, with low returns and long payback periods.

The availability of Feed-in tariffs (FITs) and Renewable Heat Incentive (RHI), both of which guarantee payments to the producer of the energy for a minimum of 20 years, has resulted in a large increase in the number of small scale energy projects, particularly PV panels, wind turbines, and increasingly biomass boilers.

The receipt of FITs or RHI has transformed the returns available from projects and made them extremely attractive for many farming businesses.

In this article we will look at some of the tax consequences of undertaking similar projects.

Are Feed–in Tariffs and Renewable Heat Incentive payments taxable?

There has been considerable confusion on this topic with many newspaper advertisements implying that they are tax free. Exemption from tax is only available where the system is installed at or near domestic premises and at least 80% of the energy generated is consumed in those premises.

This means that where the system is installed on farm buildings or where more than 20% of the energy is used in the farming business, then at least part of the receipt will be taxable.

What Tax Relief is Available on the cost of the Equipment?

These rules have changed several times in recent years and the current position is as follows:

- Until April 2012 certain renewable energy equipment qualified for 100% Enhanced Capital Allowances. However, where the equipment qualifies for either FITs or RHI, 100% ECAs are no longer available.
The only exception to this is in respect of combined heat and power equipment which qualify until April 2014.

- 100% Annual Investment Allowance (AIA) – see separate article for further details – can be claimed on renewable energy equipment. As the AIA is currently £250,000 per year until December 2014, there is an opportunity to get 100% allowances on the purchase of equipment.

- If it is not possible to claim AIA, then writing down allowance (WDA) is available. The main rate of WDA is 18% but since April 2012 expenditure on solar panels is classed as "special rate expenditure" which only qualifies for 8% WDA.

What is the VAT position?

If the renewable energy project is a business activity then VAT can be reclaimed on the cost of equipment in the normal way. If part of the energy generated is used in the farmhouse or other property lived in by a member of the family then the position is more complicated and the VAT reclaimed will normally be restricted.

Where energy is sold either to a neighbouring property or into the national grid then output VAT has to be charged and paid over. This will either be at 5% or 20% depending on the quantity of energy provided.

In conclusion, renewable energy does offer opportunities for farming businesses to both reduce their energy costs and provide a useful additional source of income, but as we have seen there are tax issues that need to be considered.

TAX TRIBUNAL DECISION AFFECTS HOLIDAY COTTAGE OWNERS - Beware of big tax bills

A recent Upper Tax Tribunal decision in the case of Pawson v HMRC has left the family of the late Mrs Pawson facing an Inheritance Tax (IHT) charge potentially running into tens of thousands of pounds.

What is the Issue?

IHT is generally charged at a rate of 40% on that part of a person's estate which exceeds £325,000. However, there are reliefs available for business and agricultural assets of either 50% or 100% which in many cases serve to reduce or eliminate the tax bill.

Most people running a holiday cottage will be adamant that they are running a business and will find it difficult to understand why they are not entitled to Business Property Relief (BPR). The answer lies in part of the IHT legislation which states that if a business consists wholly or mainly of holding investments then BPR is not due. Thus it is possible to be running a business which is deemed to be an investment business rather than a trading business, and no BPR is due.

In most cases it is obvious whether a business is a trading business or an investment business – the proprietor of a livestock farm or a hotel is clearly running a trading business whereas the owner of an office building who rents it out is running an investment business.

For many years HMRC seemed happy that holiday cottages qualified for BPR. However in 2007 they announced that they had changed their mind and that in future it would depend on the level and type of services provided to guests. There was no change in the IHT legislation - it was merely HMRC's interpretation that had changed. It is ultimately up to the courts to decide whether HMRC's view is correct or not, and the case concerning the late Mrs Pawson was the first one to be heard on this point.

The Pawson Case

Mrs Pawson owned a share in a holiday cottage on the Suffolk coast. The services provided were fairly basic – weekly linen change, television, telephone, etc.

The First Tier Tax Tribunal ruled in favour of the taxpayer. The judge considered that a 'reasonably intelligent person' would consider the letting of the cottage to be a business not an investment. This was because the letting of a holiday cottage involved far more time and input from the owners than the normal letting of property.

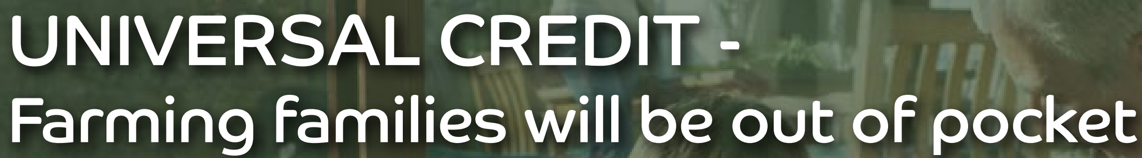
HMRC appealed against this decision and the case was heard by the Upper Tier Tribunal (UTT) who unfortunately ruled in favour of HMRC. The judge stated that obtaining income from land is generally regarded as investment activity.

The existence of active management of a property does not mean that the property loses its investment status. In addition, the UTT concluded that a large part of the 'services' provided (such as collecting rents, finding occupants, maintaining and up-keeping the garden and house) were actually inherent with investment activity. The additional services of changing bed linen, providing utilities and cleaning services, were business activities but were not sufficient to tip the balance and make it a trading business.

So where does that leave holiday property owners?

It may still be possible to get BPR but the level of services provided will need to be more like those in a hotel – daily cleaning, provision of meals, etc. However, even then there is no guarantee that a claim for BPR will be accepted by HMRC. Thus all holiday property owners need to review their IHT position as a result of this case.

It is always sensible to regularly review your IHT position together with the terms of your will to ensure that you do not leave your family with an unwelcome tax bill after your death.



UNIVERSAL CREDIT - Farming families will be out of pocket

Farming families on low incomes who have relied on the Tax Credit system over the last ten years may find that they do not qualify for Universal Credit when it is introduced. Furthermore, those that do qualify face more paperwork in order to receive their money.

Universal Credit is an ambitious project to reform the whole welfare system. All the existing welfare benefits (eg jobseekers allowance, income support, housing benefit, tax credits, etc.) will be scrapped and replaced with a single set of rules and a single payment. Universal Credit is currently being trialled in a handful of areas but only for people claiming jobseekers allowance at present. Progress to extend it across the country has been slow due to computer problems. Existing benefits claimants will be transferred across to Universal Credit between 2014 and 2017.

> 'As with all radical reforms of this nature it is inevitable that there will be winners and losers and unfortunately it looks as if the self-employed and those running their own companies will be among the big losers.'

A key aim of the new system is that it should be based on actual income figures rather than the income of the previous year. To ensure that the Department of Works and Pensions (DWP) have this information, a new system known as Real Time Information (RTI) has being introduced. This requires all employers to submit details of wages paid to their employees every time a payment is made.

This in itself is a hugely complicated task – one that has not gone entirely smoothly – which leaves the self-employed in a difficult position as there is no practical way of calculating profit figures on a monthly basis. Despite this, the DWP are proposing that self-employed claimants will have to make a monthly return of their business receipts and payments.

Furthermore, the rules proposed by DWP for calculating receipts and payments are different to Income Tax rules so two sets of records will have to be kept. The typical farming business will inevitably make losses in some months and profits in other months, but bizarrely the draft rules do not allow losses to be offset against profits made in later periods.

In addition there are other proposals which will also adversely affect farmers and other people running their own businesses:

- Any money withdrawn from a limited company is likely to be treated as income for Universal Credit purposes. This will include repayments of loans.

- Claimants will have to prove that they are in gainful self-employment and could be asked to attend an interview with the DWP.

- The government is also considering introducing a rule which will deem that a self-employed person earns the national minimum wage, currently £6.31 per hour, for every hour worked.

- If a claimant has savings or other capital of £16,000 or more, they will not be eligible for Universal Credit. Capital for this purpose will include almost all investments, including those which are exempt from Income Tax and directors' loans to limited companies.

Representation has been made by various representative bodies in an attempt to make the Universal Credit system fairer and easier to claim but at present these efforts seem to have fallen on deaf ears. Thus self-employed claimants are going to be extremely hard hit by these proposals and many farming families who currently claim will find themselves out of pocket when they are unable to claim Universal Credit.

PROTECT WHAT YOU'VE GOT -

The importance of life cover

The subject of life assurance is never going to be a "fun" topic of conversation and is therefore often avoided. However, when you sit down with someone who has your best interests in mind, you may find that life assurance is something you not only need, but truly want — to protect your family, dependents, business and legacy.

Why, you may ask. Well firstly, you never know. Dying suddenly, in an accident, as a result of an unexpected illness, or even of natural causes can happen at any time. Life insurance helps your loved ones pay the mortgage, bills and even education costs after you're gone.

This can be paid either as a tax free lump sum or income and can also provide funds to pay any potential Inheritance Tax bill. Nothing can replace you in their hearts, but planning ahead with life insurance can make things easier for those you leave behind.

You work hard to make sure your spouse, partner, children and family members are taken care of, but it's just as important to consider providing financial support for their future living costs should you die. After all, they will have to go on without you, so make sure they're protected too.

Life insurance can help your dependents cover any financial responsibilities that are left after your death. Debt can be a tremendous burden, on top of the emotional toll your absence already creates in their lives, so death shouldn't mean debt.

Life insurance isn't just for individuals though. It can protect a business from financial loss, liabilities or instability upon the death of a business owner/ partner.

> 'Whether providing necessary short-term cash, or keeping operations going until things settle, life cover can be invaluable in maintaining the business you've worked so hard to build.'

Whilst death can have major repercussions, a major health crisis such as cancer or a heart attack affects one in four people in the UK between the ages of 30 and 70 (Source: Legal & General website). If this affected you how would you meet the additional expenses, such as home help, childcare, transport if you can't drive and home modifications if you become disabled? Critical illness plans pay out a tax free lump sum if you suffer from one of the wide range of illnesses covered.

An area that is frequently overlooked is making sure that protection plans are set up correctly and, if relevant, are placed under an appropriate trust. All too often plans are set up for the right reasons, but will not pay the proceeds to the intended individual(s) or as efficiently as intended, because they have not been set up using the correct trust, which would ensure that the proceeds are paid out swiftly, to the right people.

The common thread is "peace of mind", plain and simple. No amount of money can ever replace a person, but more than anything, life insurance and critical illness cover can help provide protection for the uncertainties in life.

GET THE BEST TAX OUTCOME FROM AWFUL WEATHER CONDITIONS

Fortunately the weather this summer has been a vast improvement on the past two years. However, high feed prices for livestock farmers and less than ideal sowing conditions for arable farmers earlier this year mean that profits for many farming businesses are likely to remain lower than they were in 2012..

The obvious consequence of falling profits is that tax bills will eventually be reduced. The year end date that a farming business prepares its accounts to will determine how quickly tax bills fall. An accounting date early in the tax year such as 30th April or 31st May can mean waiting an extra year to benefit from lower tax bills.

In this article we will look at several issues that affect the payment of tax and which farmers need to be aware of when considering their cashflow over the coming year.

Payments on Account

When HMRC calculate provisional payments of tax they automatically assume that profits and tax bills are going to be the same as the previous year. However, if a person is certain that his taxable income is lower than the previous year then a claim can be made to reduce the amounts payable. Care has to be taken not to reduce the payments too far as interest and penalties will be charged if the eventual tax bill turns out to be higher.

All sources of income need to be taken into account when deciding if a claim can be made, eg rental income, employment income, rather than just farming profits.

Capital Allowances

The availability of 100% Annual Investment Allowance (AIA) on the purchase of new or second machinery is covered elsewhere in this newsletter. The consequence of being able to claim the full cost of machinery against profits in the year of purchase is very useful and many farming businesses have taken full advantage.

Full tax relief is available even when the machine is subject to a hire purchase agreement. This means that in later years there is no tax relief to be claimed but repayments are still due to the finance company.

The logical reaction to a reduction in profits and a tightening of cashflows is to defer or reduce spending on machinery. However this may result in an unexpected outcome for tax purposes in that the tax payable may be higher than expected due to the lack of AIA on machinery purchases. We have seen cases where tax payable is higher than the previous year even though accounts profits are significantly reduced.

Averaging

A further consideration is that where profits have fallen significantly a Farmers Averaging claim can be made. Where an individual's share of profits have fallen by at least 25% an overall saving can be achieved by moving income into a lower tax rate or by ensuring that personal allowances are fully utilised.

The decision whether to make an averaging claim is not always straight forward as it is made on an individual basis rather than by the business as a whole.

Payments to HMRC should be lower for most farming businesses over the next year or so. It is however equally important to keep an eye on tax bills when profits improve so that nasty shocks are avoided in the future.

ANOTHER CHANGE IN TAX RELIEF ON EQUIPMENT PURCHASES

The tax treatment of expenditure on machinery and other equipment used in farming businesses has changed several times in recent years. The rate of tax relief can vary from 100% down to nil so it is crucial to take a bit of care when planning expenditure. We look at some of the common issues and pitfalls relating to the maximisation of capital allowances.

100% Annual Investment Allowance (AIA)

This allows expenditure up to a specified limit to be fully written off in the year of purchase. The limit has been changed four times in five years – most recently it went up from £25,000 to £250,000 from 1st January 2013. Furthermore the £250,000 limit is only in place until 31st December 2014.

Writing Down Allowances (WDA)

Where expenditure in a period exceeds the AIA limit, relief on the balance is given at a rate of either 8% or 18% depending on the nature of the expenditure. Among the items only qualifying for 8% WDA are certain features within a building (electrical wiring, ventilation costs, cold water systems, etc) and since April 2012 expenditure on solar panels.

Can I claim the full £250,000 in this year's accounts?

The full £250,000 will not be due until accounting periods ending on or after 31st December 2013. Until then the amount of AIA depends on the accounting year end and the date equipment is purchased.

For example a business with a 31st March year end will have an AIA of approximately £81,000 available in its 2013 accounts. However, only £25,000 of this can be claimed on expenditure before 31st December 2012.

Relevant date of purchase of equipment for capital allowances.

If an asset is being purchased outright, with no finance, the acquisition date for tax purposes is normally the date that the invoice is issued.

However, rules are in place to prevent extended payment terms being negotiated to bring forward the date of purchase. If there is a gap of more than four months between the invoice date and the date on which payment is required to be made, the expenditure is not incurred until the date on which payment is required to be made.

What about assets on Hire Purchase?

If an asset is being acquired with hire purchase, the acquisition date for tax purposes is the date that the asset is brought into use. Thus care must be taken when purchasing harvest or other seasonal machinery as capital allowances may not be due until the following year. Where an asset is taken in part exchange or a deposit is paid in the year, this part of the cost is eligible for capital allowances.

What about Equipment within a Building?

Since 2011 there is no tax relief whatsoever on the cost of a basic agricultural building so it is necessary to identify those parts of a building which qualify for capital allowances in their own right.

This is a complex area but among the items that qualify are:

- Slurry storage and handling facilities.
- Silage clamps.
- Grain drying and handling equipment.
- Milking parlour machinery and equipment.
- Livestock handling equipment.
- Moveable buildings – but only where there is a genuine intention to move them!

OUR NEWS
Your rural business specialists

In order to be able to advise farming businesses, it helps to be able to 'talk your language'.
We have always made sure that the vast majority of our farming team are from farming backgrounds and have a detailed knowledge of the farming industry. Meet two recent arrivals in our Penrith and Skipton offices and find out about Lindsay's promotion.

Welcome to...

STEVEN BROWN
Farm Accounts Manager, Penrith

Steven joined Armstrong Watson in 2012 following our merger with O'Reilly's Penrith office. For the last 10 years he was manager of Agricultural Services for O'Reilly and is responsible for looking after farming businesses of all shapes and sizes.
Steven has lived in Cumbria since 1996 and is a member of the Association of Chartered Certified Accountants and is also a Chartered Tax Advisor. This enables him to give advice on all areas of farming businesses. Away from work Steven enjoys playing squash and generally keeping fit.

JONATHAN YORK
Tax Manager, Skipton

Jonathan joined Armstrong Watson in January 2013 following our merger with Robertshaw Myers in Skipton. Following Richard Watson's retirement, Jonathan has taken over responsibility for all the agricultural clients in Skipton.
Jonathan has over 20 years experience in accounts and tax, firstly in his native Leicestershire and latterly with Robertshaw Myers following his move north in 2006. He has a strong interest in agriculture having spent a lot of time on farms when he was growing up.Outside work Jonathan enjoys walking with his family and supporting Leicester Tigers Rugby Union Club.

On the up...

LINDSAY MARRS
Business Services Director, Carlisle

Lindsay started working for Armstrong Watson when she was 16 years old and has gained experience and qualifications through the Armstrong Watson training scheme. She qualified as a chartered accountant in 2004, and has recently moved up the ranks to director. Her hard work and farming background means that she's well placed to support farming clients, helping them to meet the challenges of running a farming business.

OUR SUMMER EVENTS

As usual this year, we've had a summer packed full of farming events. This year, we attended ten agricultural shows throughout the north of England. We hope you got the chance to visit us...

Skipton Auction Mart

Kilnsey Show

Penrith Show

Our next upcoming date:

1 Nov Borderway Agri-Expo 2013, Rosehill Carlisle

We'll look forward to seeing you there!

We hope you've enjoyed this first edition of our new newsletter for rural businesses. Please don't hesitate to get in touch with us if you have any questions about any of the issues covered in this newsletter, or if there are any subjects you'd like us to cover in future editions. The map on the back page shows just some of the main points of contact for our agriculture team.

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