Summer 2015 Edition

Agri Matters

Farming is our field

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Welcome...

Sitting here this afternoon writing this it's hard not to be distracted by the glorious warm sunshine streaming in through the window. Lambing looks to have gone well for many clients although a bit more warmth to go with the spell of dry weather would help both first cut silage and arable crops would not go amiss.

At the time of writing we are getting to the end of the General Election campaign. By the time you read this article we should know who is going to form the next government. Agriculture has barely received a mention during the campaign so it is tempting to think that whatever the colour of the government it will have little impact on the farming industry.

There was little of particular interest to farmers in the March 2015 Budget. The proposal to extend the averaging rules for farmers is interesting, although details are pretty scarce at the time of writing. Depending upon the result of the election and how long any subsequent negotiations take, we can expect a further Budget, probably in June or early July.

Arla's announcement of an increase in their price effective at the end of March provided a small ray of hope in what is otherwise still a fairly bleak outlook for dairy farmers. The GDT index had strayed temporarily into positive territory before falling back again and of course the ongoing saga at First Milk is a real worry and continues to cause horrendous cashflow problems for many farmers.

Turning to things European, the strength of sterling against the Euro has certainly become a focus point with Sterling having strengthened against the Euro by 10% or so in the last 12 months. This will impact on BPS payments later in the year which won't help already stretched cashflows.

Perhaps of greater concern though are the problems caused by CAP reform on both sides of the border. In Scotland, delays in agreeing the new rules with the EU and in communicating them to farmers mean there is an incredibly tight timescale if farmers are to receive their Basic Payment Scheme money in December. In England the position should have been more straightforward as the new system is very similar to the old one. However the farcical problems with the RPA IT systems mean there are real fears that payments will also be late.

In this edition of Agri Matters, as well as looking at the recent Budget, we cover the changes in property taxation in Scotland with an article comparing Land Buildings Transaction Tax with Stamp Duty Land Tax; we catch up with Inheritance Tax and look at the changes to State Pensions.

On a personal note, recent months have seen me saying goodbye to friends, colleagues and clients in South Cumbria in readiness for my move to our Rosehill office in Carlisle. Whilst it was not easy to say goodbye after 15 years in Kendal, I have every confidence that my clients will be well looked after by Rodger Hill – see our People Page for more on Rodger. Having returned to my North Cumbria roots I am looking forward to getting to know my new clients, particularly those who were dealt with by the late and much missed Grahame Sewell.

We hope you enjoy this issue of Agri Matters and, as always, we are very happy to receive your feedback so please e-mail any comments you may have to agrimatters@armstrongwatson.co.uk.

David Threlkeld

Farming Structures

What's best for your business?

In these pages twelve months ago we gave details of changes that were being introduced in April 2014 in respect of partnership taxation. In particular we explained the restrictions being placed on profit allocations where a partnership includes a company as a partner. The conclusion was that there was no "one size fits all" solution – in some cases a traditional partnership will be best, in others the entire business can be operated by a company, while for some a hybrid solution is necessary to obtain the optimal outcome. In this article we will look at ten factors to be taken into consideration when determining the best structure for your business:

1. Minimising Tax on Profits

A partner in a farming partnership pays income tax on their profit share regardless of whether that profit is withdrawn from the business and spent or is reinvested in the business. This can mean a partner paying 40% income tax and 9% national insurance on part of the profit share. In contrast a company is not liable for national insurance and pays 20% corporation tax on profits. There can however be additional tax payable by shareholders when money is taken out of the company.

2. Tenancies and Incorporation

An Agricultural Holdings Act tenant who operates his business via a company could be deemed to be subletting and hence have breached his tenancy agreement.

3. Information on Public Record

A limited company has to put certain information on public record – details of shareholders and directors and abbreviated annual accounts for example. It is possible to have an unlimited company which has the same tax advantages as a limited company but without limited liability – see below.

4. Treatment of Bank Loans

On fully incorporating a business, a lender will normally seek to renegotiate the terms of a loan if it is transferred to a company. Loans can be kept in personal names but a rent will need to be charged in order to obtain tax relief on the interest. See below for possible Capital Gains Tax consequence of paying rent.

5. Inheritance Tax – Treatment of Director's Loan Accounts

Money owed to a director by a company does not attract any Inheritance Tax relief. In contrast a capital account in a partnership will normally qualify for 100% relief.

6. Effect on Tax Credits and Universal Credit

Tax Credits are largely based on income subject to income tax so there can be an advantage in using a company. When Universal Credit is fully implemented it is unlikely that most farming families will qualify for them whether farming in partnership or via a company.

7. Capital Gains Tax – Rent Charged to Company

The payment of rent by a company for the occupation of land can adversely affect the amount of tax paid on a subsequent sale of the land. Without careful planning this can be 28% rather than 10%.

8. The Benefit of Limited Liability

Limited liability means that a director or shareholder cannot normally be held liable for the debts of the company. However, where the farm is owned outside the company, a lender is likely to ask the landowner to give the property as security for the loan or to give a personal guarantee.

9. Inheritance Tax – Property Held Outside Company

This issue is covered in the Inheritance Tax article in this newsletter. If land which is owned by individuals and farmed by a company has non-agricultural value, then part of that value will be chargeable to Inheritance Tax. With careful planning, land farmed by a partnership can qualify for 100% relief.

10. Expansion – How to Purchase Additional Land

There are long-term disadvantages in owning land within a company. When a successful company wishes to purchase extra land it has a dilemma – either to pay income tax to distribute funds so that the individuals can purchase the land or to purchase the land in the company's name.

Industry News...

The recent Budget did not contain many tax changes but there were a handful of measures of interest to farmers. In this article we explain these together with other topical issues.

Changes to Farmers' Averaging Rules

Unusually the farming industry was mentioned in the budget with the Chancellor expressing sympathy with "the challenge our farmers face from volatile markets". As a result the government has agreed with a proposal from the NFU to allow individuals to average their profits over a five year period rather than the current two.

This measure is not being implemented until 6 April 2016 and we will have to await a consultation document later in the year to find out exactly how the new rules will work.

Capital Allowances – Annual Investment Allowance to Change Again

The Annual Investment Allowance (AIA) allows businesses to claim 100% of the cost of plant and machinery in the year of purchase up to an annual limit. This is currently set at £500,000 but is due to drop back to £25,000 on 1 January 2016.

The Chancellor stated that he will increase the AIA for 2016 from £25,000 to a "much more generous rate" in his Autumn Statement. There are two problems with this situation – firstly we don't know if the current Chancellor will still be in a job after the General Election and secondly we don't know what he considers to be "much more generous".

Thus anyone who is planning capital expenditure should consider completing the project prior to 31 December 2015 to take advantage of the current limit.

Abolition of Class 2 National Insurance

Class 2 National Insurance is paid by self employed individuals at a rate of £2.80 per week for the 2015/16 tax year. A consultation document will be issued later in the year with a view to abolishing class 2 contributions and reforming class 4 contributions some time in the next Parliament.

This change is linked to the reform of State Pensions – see separate article. At present employed individuals pay higher rates of National Insurance than the self employed and generally receive higher State Pensions. From 2016 there will be a flat rate State Pension regardless of the type of National Insurance a person has paid. Currently an employed person pays 12% National Insurance on the bulk of his earnings whereas a self employed person only pays 9%.

It would be reasonable to assume that self employed contributions will increase and that most self employed farmers will be paying more National Insurance in the future.

Capital Gains Tax – Changes to Entrepreneurs' Relief

Entrepreneurs' Relief (ER) is of huge importance to farmers as it can reduce the rate of Capital Gains Tax (CGT) on the sale of land from 28% to 10%. However, ER is one of the most complicated pieces of legislation and the Chancellor has announced further technical changes which I will not detail here.

There are several different ways of obtaining ER and it is crucial that advice is taken prior to the disposal of the land to ensure that it qualifies for the 10% rate under at least one section of the legislation.

Inheritance Tax – The Importance of Keeping Your Will Up To Date

Despite rumours of radical changes to Agricultural Property Relief in the weeks leading up to the Budget, there were no major changes announced. There is however to be a review into the use of Deeds of Variation but it is not clear if this is a serious proposal or merely a means of scoring political points against Ed Miliband.

A Deed of Variation is a way of effectively rewriting a person's Will after their death in order to either make it more tax efficient or to pass assets to different beneficiaries. It has been widely reported that the Miliband family entered into a Deed of Variation on the death of their father.

It is never a good idea to rely on the use of Deeds of Variation as it requires all of the beneficiaries to agree on the change. If their use is to be restricted, it is even more important that Wills are regularly reviewed and updated.

Income Tax Rates and Allowances

There were no changes to Income Tax rates and only modest changes in personal allowances and basic rate tax bands. Of more interest is the Chancellor's commitment to introduce significant increases by the end of the next Parliament in 2020.

In 2015/16 the personal allowance is £10,600 and the basic rate band is £31,785, meaning a person starts to pay 40% tax on income over £42,385. The Chancellor is aiming to increase these figures to £12,500 and £50,000 respectively, meaning that 40% tax will only be paid on income over £62,500 by 2020.

The End of Tax Returns?

The Government is planning to create digital tax accounts for individuals and small businesses which will remove the need to complete annual tax returns. The digital tax account will automatically receive data from third parties and check that the correct amount of tax has been deducted from salaries, pensions, etc. and calculate the tax due on business profits.

It is difficult to see how this will easily work for farmers and other small businesses, particularly by the stated start date of 2020.

Is a Land Rover a Car?

Elsewhere in this newsletter there is an article about VAT which explains how to distinguish between a car and a commercial vehicle. This is important as it is not possible to reclaim VAT on the purchase of a car. There is a similar issue for Capital Allowances purposes in that Annual Investment Allowance – see above – can be claimed on commercial vehicles but not on cars. The definition of a car for capital allowances is different to the definition for VAT purposes, which is not helpful. If a vehicle is "primarily suited for the conveyance of goods" it is a commercial vehicle. Conversely if a vehicle is more suited to carrying passengers then it is a car.

This point is illustrated by a recent "discussion" we had in respect of a client who had purchased a Land Rover Defender. The tax inspector denied our claim for AIA on the basis that the vehicle was suitable for transporting people as well as livestock, sheepdogs, fencing materials etc. We stood our ground and asked that a different inspector review the decision and said we would take the case to an independent tribunal if necessary.

Fortunately HMRC reconsidered their decision and accepted that a Land Rover Defender is a commercial vehicle.

Basic Payment Scheme and Short-Term Rental of Land

Probably the biggest challenge faced by politicians and civil servants when drafting the rules for both Single Farm Payment (SFP) and Basic Payment Scheme (BPS) is to ensure that payments are made only to active farmers.

This is particularly the case in Scotland where so-called "slipper farmers" receive huge amounts of bad press. Under BPS there is a fear that landowners who have previously been happy to rent their land out, will now try to be seen as active farmers so they can claim the money themselves.

The Scottish Government has declared that BPS will only be paid to farmers that meet "minimum activity requirements". However, in practice it may be difficult to identify these non-active farmers, particularly in upland areas where genuine farmers have very low stocking densities and the land generally requires little in the way of active husbandry.

Only time will tell as to whether the regulations will be able to distinguish between active farmers and slipper farmers.

Common VAT issues for Farmers

VAT for most farming businesses is quite straight forward – the main sources of farming income are zero rated which means no VAT is payable on monies received but VAT on expenses can be reclaimed – hence regular repayments of VAT being received.

However, there are some more complicated scenarios where either VAT on expenses cannot be reclaimed or VAT has to be paid on certain types of income:

VAT on Let Property

As mentioned above, VAT relating to zero rated sales such as livestock and crops can be reclaimed in full. Similarly VAT on expenses relating to standard rated income such as contracting income is also recoverable. In contrast VAT relating to exempt income such as cottage rents or land let out on Farm Business Tenancies is usually not reclaimable.

A business which has both taxable and exempt sources of income is partially exempt and special rules apply to determine how much VAT can be reclaimed on expenses. This involves splitting the VAT incurred into three parts – that attributed to taxable supplies, that attributed to exempt supplies, and that which relates to the business as a whole, which has to be apportioned.

The general rule that VAT relating to exempt sources of income cannot be reclaimed is relaxed where the exempt VAT falls below de-minimis limits. This is a complex calculation which is beyond the scope of this article.

Farmhouse Expenses

A common query that we come across is how much input VAT can be recovered on expenditure within the farmhouse. Clearly, some of this expenditure will have a private element and part of the input VAT is non-recoverable. This split of farmhouse expenditure is almost impossible to quantify, but fortunately HMRC agreed standard apportionments with the NFU many years ago.

The percentage recoverable is based on whether or not you are a full time working farmer. For a full time working farmer HMRC will allow between 40% and 70% recovery of the input VAT, whereas for a part time farmer this is limited to a maximum of 40%.

Is it a car or a commercial vehicle?

For VAT purposes there is a significant difference between a car and a commercial vehicle. Input VAT incurred on a car cannot be recovered, whereas input VAT incurred on a commercial vehicle can be recovered,

It is important to distinguish between the two so that the input VAT reclaimed is correct. For example, broadly speaking a Land Rover Discovery is classified as a car and the input VAT wouldn't be recoverable, whereas a Land Rover Defender is seen as a commercial vehicle and input VAT recovery is possible. If the vehicle has windows or seats to the rear of the driver's seat it is normally classed as a car.

The exception to this rule relates to double cab pickups – as these have two rows of seats you might expect them to be classed as a car – they are considered to be commercial vehicles as long as they have a payload of at least a tonne.

B&B's / Holiday Letting

A common diversification to the normal farming trade is to run a B&B or holiday letting business. It is important to understand that the resulting income is standard rated and VAT will need to be paid to HMRC if it is part of the farming business.

It is possible to undertake these diversifications in a separate business so that VAT does not need to be paid over. However, HMRC will look closely to check that the two businesses are genuinely separate. Thus all record keeping and marketing activities need to be kept totally separate.

Introduction of Land & Buildings Transaction Tax in Scotland and Changes to SDLT in England

How do the rules compare and contrast on each side of the border, and between residential property and agricultural property?

In our last newsletter we mentioned the forthcoming introduction in Scotland of the new Land & Buildings Transaction Tax (LBTT) with effect from 1 April 2015. Since then we have had changes to both LBTT and Stamp Duty Land Tax (SDLT) in England.

What Has Changed?

Prior to the announcement in last year's Autumn Statement, SDLT was calculated using the "slab system", which meant that the whole price was charged at a single rate of SDLT. This resulted in the situation where a small increase in price resulted in a large increase in SDLT – for example a house costing £250,000 incurred SDLT of £2,500 whereas one costing £255,000 resulted in a charge of £7,650.

The Scottish government had already announced that LBTT would be calculated using a band system, e.g. a residential property costing £250,000 would incur LBTT of £2,100 (being £145,000 at 0% plus £105,000 at 2%)

The announcement in the Autumn Statement was that SDLT on residential property would move to the band system while non-residential property would remain on the slab system. The Scottish government then announced changes to the LBTT bands but these remain different to those in England.

Rates for Residential Transactions

Rate of tax applied to portion of consideration	LBTT	SDLT
0%	Up tp £145,000	Up to £125,000
2%	£145,001 to £250,000	£125,001 to £250,000
5%	£250,001 to £325,000	£250,001 to £925,000
10%	£325,001 to £750,000	£925,001 to £1,500,000
12%	£750,001+	£1,500,000+

Example One:

Purchase of residential property for £350,000:

- SDLT paid prior to December 2014 - £10,500
- SDLT paid since December 2014 - £7,500
- LBTT paid since April 2015 - £7,100

Rates for Non Residential Transactions

	Rate of tax applied to portion of consideration LBTT	Rate of tax applied to total consideration SDLT
0%	Up to £150,000	Up to £150,000
1%	-	£150,001 to £250,000
3%	£150,001 to £350,000	£250,001 to £500,000
4%	-	£500,001+
4.5%	£350,001+	-

Example Two:

Purchase of agricultural land for £260,000:

- SDLT payable in England £7,800
- LBTT payable in Scotland £3,300

Leases

It is easy to forget that SDLT and LBTT can be charged on the tenant of agricultural land, usually on the granting of a tenancy. This is a complex area and a lack of space prevents us from covering it in detail. By way of example a tenant signing up for a 20 year tenancy at a rent of £20,000 would have a charge of £1,342 in both England and Scotland.

Farm Purchases – Multiple dwellings

Where a farm is purchased that includes several houses or cottages, a claim can be made to reduce the amount of SDLT/LBTT payable. In effect the tax on the residential properties is calculated as if they are being purchased separately, with SDLT/LBTT payable as normal on the balance of the cost.

Beware Inheritance Tax Pitfalls

Many farmers consider that Inheritance Tax (IHT) is not a problem for them as they are entitled to 100% relief on all farming assets. Whilst Agricultural Property Relief (APR) is a valuable relief and will apply to most farm property, there are exceptions!

In this article we will look at four circumstances which could, without careful planning, result in IHT being payable.

1) Non-Farming Activities

As the name suggests, APR applies to agricultural property. Thus where a farming business has diversified away from the growing of crops or keeping of livestock there will be some land or buildings that is not being occupied for the purposes of agriculture. Examples include:

- Renting out former farmworkers cottages
- Renting out surplus buildings for storage
- Running a furnished holiday letting business
- A horse livery business

Land or buildings not used for agricultural purposes will not be eligible for APR but in some circumstances will qualify for Business Property Relief (BPR). In a previous edition of this newsletter we explained how BPR could be at either 50% or 100% depending on whether the property is owned by the partnership or company which is carrying out the farming business or is owned by an individual partner or shareholder.

2) Non-Agricultural Value

APR is restricted to the "agricultural value" of an asset. This is defined as the value of the asset in question if it could only ever be used for agricultural purposes. For example a traditional farm building might have little agricultural value due to not being able to access it with modern machinery, but have alternative uses such as conversion to residential use which increases its value.

Fortunately BPR can be claimed on this non-agricultural value but as stated above this may only be at 50%. Whether the farmer has any intention to use the building for non-agricultural purposes is deemed to be irrelevant. All that matters is that it could be put to other uses.

3) Farmhouses

APR can be claimed on farmhouses but there are several obstacles to negotiate:

- **Is the house lived in by a working farmer?**

This is defined as someone who "works the land on a day-to-day basis" so HMRC may query whether an elderly farmer is sufficiently involved in the farming business.

- **Is the house of a "character appropriate" to the land being farmed?**

This is a subjective test but can mean that APR on a house can be lost if land is either rented out or sold. HMRC lost a tribunal case a few years ago in respect of a 17 acre farm but the house in question was in a very poor state of repair and generally much more land is required.

- **APR is restricted to the agricultural value of the house**

This is on the same principle as mentioned above, ie that a house may be worth less if it can only be lived in by a farmer. It is therefore more of an issue for houses in commuter belts and possibly some houses located in picturesque locations. HMRC did win a tribunal case some years ago which decided that agricultural value was 30% less than market value but this should not be accepted as the norm.

If a business receives a significant proportion of its income from rents, HMRC may argue that the business is one of "wholly or mainly holding investments" which means that BPR is not available. Similarly if a grassletting business is deemed to be non-trading there is no chance of claiming APR on the farmhouse.

Hopefully this article has emphasized that IHT for farmers is not always straightforward. Fortunately in most cases the tax bill can be reduced or eliminated with careful planning.

What do you need to know about State Pension changes?

In this article we will look at the changes being made to the State Pension system and how this will affect farmers retiring in the coming years. As with most changes there are winners and losers.

Major changes to the State Pension system are taking place which will fundamentally change both the amount of pension receivable and when it will be paid. In this article we look at these changes and how farmers reaching retirement age in the coming years will be affected. As with most changes there will be winners and losers.

Is the State Pension Age Changing?

Yes, due to increased life expectancy the age at which State Pension can be claimed is being increased:

- Women who have traditionally claimed state pension at 60 are now having their state pension age increased and by 2018 it will have increased to 65.
- Both men and women born between 6 April 1960 and 5 April 1961 will have a state pension age between 66 and 67
- Anyone born between 6 April 1961 and 5 April 1969 will have a state pension age of 67
- This will then raise to 68 sometime in the 2030's and to 69 in the 2040's
- It will then be automatically reviewed in line with increased life expectancy.

What About the new Flat-Rate Pension?

This will be introduced in April 2016 and its main features are as follows:

- The current basic state pension and second state pension will be replaced by a single flat rate pension.
- It will be higher than the current basic state pension – at least £148.40 per week.
- To receive the full pension a person will need 35 years of national insurance contributions or credits.
- It will be necessary to have 10 years of contributions to get any pension and between 10 and 34 years will result in a proportionate pension.
- In general a person will only be able to get a pension based on their own contributions rather than based on current or former spouses as at present.

Will Any of These Changes Affect People Already Receiving Their State Pension?

No – only women born on or after 6 April 1953 and men born on or after 6 April 1951 are affected. Anyone who reaches state pension age before 6 April 2016 will stay on the current system.

Is it Possible to Defer Receiving State Pension in Order to Claim under the new System?

Unfortunately not – it is the date that you reach state pension age that is crucial, not when you elect to claim it. It will still be possible to defer receipt of your state pension under the new system but there are a couple of important changes:

- The rate that the state pension will increase for each year that its receipt is deferred will reduce from 10.4% to 5.8%. This means that a person will have to live for about 19 years to benefit from the decision.
- It will no longer be possible to receive a lump sum in lieu of the deferred pension.

How Are Married Women Affected by the Changes?

Historically many married women elected to pay reduced rates of national insurance and claimed a state pension based on their husband's contributions – known as a category B pension - instead. It is no longer possible to start to pay reduced rate contributions but many women nearing state pension age may have made an election many years ago which means they have not paid enough contributions to get a full state pension.

A category B pension is 60% of the pension received by the spouse but it will no longer be possible to claim this under the new system. There are however transitional arrangements which may help some people who lose out as a result of the changes. We are awaiting final details of how these will work.

Join us this summer...

We would be delighted if you would join us for free hospitality at our stand this summer!

NSA North Sheep	3 June
Cumberland Show	6 June
North Yorkshire County Show	21 June
Penrith Show	25 July
Dumfries Show	1 August
Cockermouth Show	1 August
Gosforth Show	15 August
Kilnsey Show	1 September
Westmorland County Show	10 September

We look forward to welcoming you and catching up!

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.

Welcome to Rodger Hill

Rodger joined Armstrong Watson at our Kendal office on 1 April 2015 as Director, having spent the previous 20 years working for Moore & Smalley advising and helping a variety of businesses, but specifically those in the farming sector. Rodger enjoys getting to know his clients, building good working relationships with them and becoming the first point of contact for any business issues. You'll often find Rodger at our meeting rooms at the Junction 36 Rural Auction Centre in Kendal, Ulverston or High Bentham.

Coming to an auction mart near you

We're delighted to be opening two new auction mart offices in quick succession; Wigton and Gisburn. We've had a presence in Wigton for many years, but our new office in the auction mart is an exciting development and will allow Louise Utting to meet with clients and contacts in the privacy of our modern office space.

Our farming clients from the Gisburn area have previously been looked after by our Skipton office, but due to growing demand we've decided to establish a more convenient point of contact within the auction mart. Our office will be headed up by Jonathan York, who will be around on sale days.

We look forward to welcoming you to our new premises!

Many of our staff are not afraid to get their hands dirty. Here we have a selection of pictures from lambing time. From left to right, Janet Kidd (Penrith office), Jonathan York (Skipton office) and Murdo Laurie (Hexham office, assisted by Laddie).

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We hope you've enjoyed this edition of our 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. This map shows just some of the main points of contact for our agriculture team.

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