Agri Matters

Autumn 2019

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News –

- Sale of residential properties – earlier payment of tax
- Labour Party Tax proposals
- Self employed farm contractors
- SDLT and LBTT confusion with mixed purchases

- Where next for Inheritance Tax?
- Understand your accounts and cashflow
- CGT and compulsory purchase payments

Plus...

Guest Article from Neil Wilson of SAB Advisory Ltd

FARMING IS OUR FIELD

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Welcome

It is early October as I write this article and it feels like some things never change. The weather is playing havoc with autumn farming plans and we still have no idea what Brexit will look like for the UK and the Farming Industry in particular.

I am very passionate and positive about the agricultural industry, but I also have to be realistic and I have some real concerns for UK Farming over the coming years and we will have to be strong and resilient.

What are my concerns? Well I was at a meeting with a Senior Defra official from London last night, and his message was there will be no support in the form of BPS etc. by 2027. Farmers must prepare themselves for this as there won't be a magic payment that comes along to replace BPS. Yes there will be the new Environmental Land Management Scheme (ELMS) but it will be paid to farmers for doing 'public good' and nowhere is food mentioned in this.

When Brexit does happen - or may have already happened by the time you read this - the trade deal or lack of a deal could be crucial to UK Farming. If there is no deal we will go onto World Trade Organisation import and export Tariffs.

Revised versions of these were announced this week and there is no protection against cheap food imports coming in and the tariffs for getting our products into the EU are penal in some cases which means in my view reduced demand will result in lower selling prices.

What we are busy with is helping our clients plan for challenges ahead. It is about helping them know their business inside out, unit cost of production, asset ownership, cash and tax management, ensuring the business is in the right structure for the future, including succession and exit planning.

Andrew Robinson
Head of Agriculture

Whilst I am concerned about some big challenges ahead, if we all work together and are prepared to react, those that want to will succeed. Burying heads in the sand and hoping it goes away won't work because this is real.

In light of the above, we have a relevant guest article from Neil Wilson, former Head of Agriculture at HSBC, with his tips on how to deal with lenders in these challenging times.

We also include articles on potential Inheritance Tax changes, tax issues to be aware of if land is subject to Compulsory Purchase, and advice on how to understand your cashflow.

Our news pages have items on earlier payment dates for Capital Gains Tax, SDLT and LBTT payable when purchasing residential properties, tax issues when engaging farm contractors, and a look at possible tax changes if we have a change of government.

Our Agricultural Tax Director takes a look at some recent VAT tribunal decisions which show that VAT is not a simple tax!

As always we welcome feedback on the articles in Agrimatters, and I hope that my next editorial is more upbeat.

Andrew Robinson

Guest article

Neil Wilson - SAB Advisory Ltd

Neil Wilson is Director of SAB Advisory Ltd which provides strategic advice to progressive and growing agribusinesses. He is former Head of Agriculture at HSBC UK Bank plc and is a partner in his family farm in South West Scotland.

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Strategic AgriBusiness advice in a changing world.

Times are tough in farming just now. Weakening commodity prices allied with inflating input costs are seeing margins tighten, and that is before we get to the current political turmoil and longer-term trade uncertainty. A lot of farming units are feeling the pressure on cash flow, which leads to concerns about paying bills as we head into winter. So, what do business owners need to think about when cash is tight?

Firstly, you really need to understand the cause. Is there a longer-term problem underlying the business such as poor profitability or high cost? Or is the business fundamentally sound and is suffering from a blip? Using experienced, professional help to assess this can be a real positive step and help take pressure off you to make well informed decisions.

Secondly, how will any cash shortfall be funded? Most will go straight to the bank manager to ask for support, and in the 'good old days' this would have been a fairly straightforward process. This is not the case now. You will need to be prepared with a compelling case about why more funds are required and how they are to be paid back. It is now about much more than how much security the Bank hold.

Different banks will approach this in different ways but here are some general tips about how to approach this:

1. This seems basic, but make sure you really understand what your business does and what its competitive position is.
2. Be clear and informed about why you need more money. Maybe draw up a short explanation and plan to share with the Banker.
3. Presentation of management information on current and forecast technical and financial performance will really help with any request.

Seeking early help from a financial professional will pay dividends as they can guide and challenge the proposals making sure they will pass robust inspection from the Bank. Using them for joint meetings with the Bank may also be beneficial, but you are the business owner so do not defer to the advisor during the meeting. Take control yourself.

Once you have agreed your additional funding please then check the terms carefully. Recent changes to be aware of may be the introduction of conditions relating to debt servicing cover or interest cover and by breaching these may allow the Bank to review the borrowing early.

One significant change to be aware of is many Banks now offering loans repayable over a longer term, of say 15 to 20 years, but only committing them to the farm business for 5 years. It is easy to think they will just be automatically renewed at that point, but these clauses allow the Bank to review the full facility and they may remove it at short notice asking for their money back. If it is renewed then they may charge an additional fee, change the terms and/or increase the interest rate. In short, this should be viewed as a refinancing exercise which can be an expensive process to carry out every 5 years. Care and diligence is required by every business.

Neil Wilson
Director,
SAB Advisory Ltd

Keith's briefing

As I have said in previous editions of Agrimatters, a review of tax tribunal cases can provide practical guidance, particularly on avoiding problems and pitfalls. In this article I will look at three recent cases involving VAT which illustrate key points for farming businesses.

Frank Smart – key point – in order to reclaim VAT on expenses there must be a link to taxable supplies.

The background to this case was that an Aberdeenshire farming business reclaimed VAT on the purchase of a large number of SFP Entitlements. No farming took place on the land rented for the purpose of claiming SFP.

In order for VAT to be reclaimed on any expenditure a business must show that there is a direct link to "taxable supplies" made by the business. Taxable supplies cover most sales made by a farming business, e.g. livestock, crops, machinery sales, etc. but crucially not subsidy income which is classed as "outside the scope" of VAT. The farming business was able to demonstrate to the court that its intention at the outset was to increase farming activities by investing in the SFP entitlements. Thus the business got to keep the VAT.

Babylon Farms – key point – in order to be VAT registered there must be a business activity.

This case involved a business that had farmed actively in the past but activities had dwindled over the years. VAT returns continued to be submitted and reclaimed on expenses, including the cost of a new building. The only income was £440 of hay sales to a connected business.

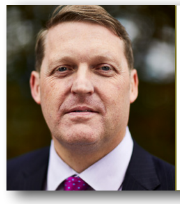
HMRC argued that the business was not being carried out on a commercial basis and the business should be deregistered. The tribunal agreed with HMRC and the business had to repay £19,720 of VAT.

A related point here is that the receipt of rent is an exempt supply for VAT, which means a business that only receives rent cannot ordinarily be registered for VAT.

Caton – key point – whether HMRC can treat separate businesses run by husband and wife as a single business for VAT purposes.

This case does not involve a farming business, instead concerned a husband and wife who ran a restaurant and café in adjoining properties. HMRC argued that because Mr Caton helped his wife – for example the cafe alcohol licence was in his name, the leases of both properties were in his name, and both bank accounts were in his name - that they be treated as a single business. This would have meant that VAT would have had to be paid over on all sales.

Mr Caton was perhaps fortunate that the tribunal accepted that the assistance he provided was in the capacity of husband rather than business partner. In a farming context a similar situation can arise with a B&B or holiday letting business. The income of both these businesses are standard rated, meaning if they are run as part of the VAT registered farming business, that 20% VAT has to be paid over. If however these ventures are kept totally separate from the farm business and turnover is less than the registration threshold of £85,000 then no VAT is due.



Keith Johnston
Agricultural Tax Director

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Where next for Inheritance Tax?

There have been two important announcements recently which could adversely affect farmers and other rural businesses in the coming years.

Firstly, a report issued by the Office of Tax Simplification (OTS) and secondly a report that the Labour Party are in favour of replacing IHT with a Lifetime Gifts Tax.

The OTS is an independent body tasked with making recommendations to government as to how tax legislation can be simplified. Not an easy task given our hideously complicated system! In January 2018 The Chancellor of the Exchequer asked them to look at "administrative and technical aspects of Inheritance Tax". They issued a report into administration aspects in November 2018 and have now published a 107 page report into technical aspects of the tax.

OTS key recommendations

Reduce the seven year "clock" to five years. This would mean only gifts made in the five years before death would be taken into account for IHT.

Simplify the system relating to small gifts.

To extend Business Property Relief (BPR) to furnished holiday letting properties. HMRC currently treat these as investment assets.

Recommend that HMRC take a more sympathetic approach when a farmer is forced to leave his farmhouse due to ill health. At present HMRC often deny Agricultural Property Relief (APR) where a property is unoccupied.

For diversified businesses to qualify for BPR they will need to show a minimum of 80% trading activities rather than the current 51%.

When a person inherits assets qualifying for APR and BPR, they should take over the original cost for Capital Gains Tax rather than getting a "tax-free uplift".

What happens next?

At the time of writing, Brexit is still unresolved and tax policy is not a priority for any politician. There is therefore no certainty that any or all of the above recommendations will be implemented.

Labour Party Policy?

Recent reports suggest Labour are considering more radical policy changes by replacing IHT with a Lifetime Gift Tax (LGT):

- LGT would be payable by the person receiving the asset, during lifetime or on death, rather than by the person making the gift.
- Tax would be payable if a person receives more than £125,000 over a lifetime, and would be calculated at a person's marginal rate of Income Tax.
- There would be "conditional exemption" for agricultural and business assets, but this relief would be clawed back on a subsequent sale of the asset.
- A separate report suggested that APR be restricted to a maximum area of land (perhaps 100 hectares) or to a monetary amount.

If we have a change of government and Labour comes to office, this is likely to be much more of a priority. It's safe to say that the IHT system is likely to be radically different in a few years' time, regardless of which political party is in power. This gives farmers the chance to take action now to protect their businesses.

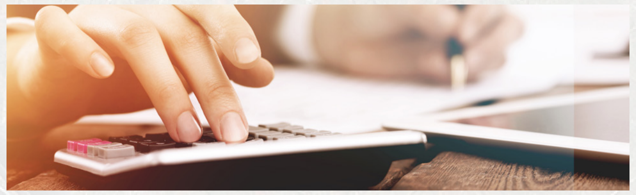
Susannah French
Accounting Senior Manager

Understand your accounts and cashflow

Cash is king as the saying goes. By understanding your cashflow, if something changes in your business you can quickly assess the impact on your cash. Speaking to the bank manager in advance is a much easier conversation to have, rather than trying to deal as it happens, whatever the reason might be.

Making Tax Digital for VAT means that many more businesses now have up-to-date digital information which can help make cash management less challenging. MTD is an opportunity to take control of your financial information and use it to your advantage. Businesses usually get into difficulties because of a lack of cash rather than a lack of profit. Causes of this can include:

- Overtrading. You are profitable and your business is growing and you need to spend more money buying new equipment, increasing stock levels and perhaps increasing your workforce. The costs usually come before the profit on increased sales is realised which can lead to cash shortages and in acute cases, failure of the business.
- Increased stock numbers and values. A business with an extra 100 sheep at the end of the year will have purchased them or spent money rearing them. This does not affect the accounting profit, but will impact on your cashflow.
- Machinery and buildings. Capital expenditure is depreciated and written off against profit over several years. Ideally repayments on finance to fund expenditure should be matched to the period over which the asset will produce income.
- Private drawings from a partnership are not deducted from the profit and loss account. If your drawings regularly exceed the profits being made, your cashflow will be squeezed.



- A business not generating sufficient cash to cover loan repayments, drawings, and increased working capital will experience cashflow problems. It is tempting to try to repay a bank loan over as short a period as possible, but you have to be realistic.

Fluctuating tax bills are another factor that can impact upon cashflow. Depending on the level of capital expenditure, taxable profit can be totally different to accounting profit:

- A new tractor purchased in one year could mean that there is no tax to pay thanks to Annual Investment Allowances.
- The following year, if there is less capital expenditure, tax bills can be significantly higher and any HP repayments are still being made.

Company tax bills are a single payment nine months after the end of the accounting period. Furthermore, a company pays tax at a single rate so tends to fluctuate less than for an individual.

An individual's tax bill consists of two payments on account followed by a balancing payment. An increased taxable profit can also push an individual into a higher rate of tax. Payments on account can be adjusted so it's important to plan ahead and be aware of the issues.

Steven Brown
Accounting Senior Manager

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Compulsory purchase of land and Capital Gains Tax

Whenever new road schemes and other infrastructure projects are planned, land is likely to be acquired under Compulsory Purchase Orders (CPO). This leads to Capital Gains Tax (CGT) on the proceeds received.

I am not covering the legal or valuation issues arising, other than to say that separate specialist advice needs to be taken. One important point to note is that payment may be received for a reduction in value of property retained as well as for assets sold.

Ordinarily, the sale of land is voluntary and the tax consequences can be taken into account before the transaction is entered into. However, with land sold under a Compulsory Purchase Order, a sale may be involuntary and this is recognised by the tax system. This is by way of a form of rollover relief, which is similar but crucially different to that available to all trading businesses. This means that a farmer in receipt of money for land sold under a CPO has two different ways of deferring the CGT payable. We will first look at the normal rules, then highlight the differences applying to compulsory purchase.

Normal Rollover Relief rules for sale of land

- Only available for assets used in a trading business, although partial relief is due where an asset is partly used for trading purposes.
- Only available where both the asset sold and purchased are on the list of qualifying assets. In a farming context these are land, buildings, fixed plant and machinery, and BPS entitlements.
- The date of sale for CGT purposes is when an unconditional contract is signed.
- The deadline for reinvesting the proceeds is three years after the date of disposal. It is also possible to rollover capital gains against assets acquired in the year before the old asset is sold. It is possible to extend the time limits where it was not possible to acquire assets within the normal limits.
- HMRC accept that purchasing a further share in an asset, or expenditure on improving an asset qualifies for Rollover. Thus constructing buildings on land already owned can qualify for relief.
- The capital gain is deducted from the cost of the new asset. This means more CGT is payable when the replacement asset is sold.

Rollover Relief rules for Compulsory Purchase

- Available where land is sold under a CPO or to a body holding CPO powers.
- Proceeds have to be reinvested in "new land". This means that improvements to existing land or buildings do not qualify under this part of the legislation.
- The date of disposal is when the amount of compensation is agreed.
- The new asset does not have to be used for business purposes.
- A dwelling house can qualify for relief but not if it becomes a person's dwelling at any time during the next six years.
- The landowner must not have taken any steps to dispose of the land, or made their willingness to sell known to the authority with CPO powers.

David Threlkeld
Accounting Partner

News

Sale of residential properties – earlier payment of tax

From 6th April 2020 anybody selling a residential property needs to be aware that:

- A new online return needs to be filed with HMRC within 30 days of the date of completion.
- If applicable, any Capital Gains Tax (CGT) is also paid within 30 days.

The new rules apply even when a person is required to complete a Self assessment Tax Return (SATR) each year. Under the current system CGT is paid on 31st January following the end of the tax system, which is up to 22 months later than the new system. The same gain will also be entered onto the SATR to check that the correct amount of tax has been paid.

The first problem with the new system is to obtain all the information to calculate the gain accurately. If you are selling a single buy to let property, this should not be too difficult, but the sale of a cottage originally purchased with the farm will be more problematic. Similarly, where a barn has been converted on the farm, an apportionment of the original cost will be necessary.

The second problem is how to calculate the correct amount of CGT to pay. The rate of tax paid on a residential property is either 18% or 28% depending on the level of a person's other taxable income. In most cases this will not be known when the in-year return is being submitted, so a reasonable estimate will be required.

Labour Party Tax proposals

With the possibility of an imminent general election, what might we expect in the way of tax policy from Mr Corbyn if Labour takes office?

Commitments outlined so far include:

- A pledge to reverse the Conservative Party reduction in Capital Gains Tax Rates. This would see the main rate restored to at least 18% (Currently 10%) for basic rate taxpayers and 28% (currently 18%) for higher rate tax payers. The existing 8% surcharge for residential property that does not qualify for main residence relief would be applied on top.
- Corporation Tax rate increased from 19% to 26% over a 3 year period but with a small profits rate of 21% for those companies with profits of less than £300,000. The rate of Corporation Tax is due to decrease from 19% to 17% in April 2020.
- The Inheritance Tax nil rate band which is currently £325,000 would be abolished. Instead, tax would be paid on all capital gifts at a flat rate of 40% subject to a lifetime allowance of £125,000. The current spouse exemption would remain. Agricultural and Business Property Relief would remain, but would become a deferral of tax, with relief clawed back on an eventual sale. There is also a suggestion that Agricultural Property Relief be restricted by applying either a monetary limit or maximum acreage. A figure of 250 acres was suggested in a recent report.

As accountants we do not take a political view, but are merely making clients aware of potential changes.

Self employed farm contractors

This is an area that HMRC continue to take a close interest in, and farmers need to be careful they are dealing correctly with payments to contractors.

Even where both parties agree that payments be treated as a self employed relationship, HMRC can overrule and insist that the worker is an employee and be subject to PAYE. Whether a worker is self employed or employed has important tax and legal consequences:

- For tax purposes, both the farmer and the worker pay less national insurance if the worker is properly self employed.
- A self employed person is not entitled to sick pay, holiday pay, redundancy pay, etc but should ask for a higher hourly rate of pay to compensate.
- Most employees earning £10,000 per year are entitled to be enrolled into a workplace pension scheme. This increases both the cost and administrative burden of employing staff.

The key issues to determine whether a worker is employed or self employed are:

- Is there any mutuality of obligation? If the worker can (and does) turn down offers of work, it is easier to argue self employment.
- Is there a right of substitution? If the worker has the right to send along a suitably qualified alternative, this is an indication of self assessment.
- Does the worker have an opportunity to profit? If the payment is per task or per unit, rather than per hour, this is also an indication of self employment.
- Does the worker provide equipment?
- What level of control does the farmer exercise over the worker?

SDLT and LBTT confusion with mixed purchases

As most readers will know, the rates of Stamp Duty Land Tax (SDLT) in England and Land and Buildings Transaction Tax (LBTT) in Scotland have increased in recent years. For the large part, the rules for both duties are very similar, even if the rates and bands are subtly different.

One area that is different is when a mixed purchase, i.e. both land and residential property takes place. The reason for this is the additional charge if the purchaser already owns a residential property. This additional rate of 3% in England and 4% in Scotland can obviously make a big difference to the amount of duty paid.

In England, the additional SDLT is only paid if the entire purchase is residential property. Thus where a commercial farm is purchased, the SDLT is calculated using the mixed use rates. The problem arises when a house with a small area of land is purchased. HMRC may argue that the land is part of the "grounds" of the residential building, with 3% extra SDLT payable on the whole price if the purchaser already owns another residential property.

In Scotland, the position is clearer in that the purchase price is always split on a "just and reasonable basis". Again, if the purchaser already owns another residential property, an additional 4% is added on the deemed purchase price of houses and cottages.

People News – Nicki Hutchinson

Nicki Hutchinson joined the Northallerton office as Accounting Senior Manager in July 2019. Nicki will play an important role in the development of Armstrong Watson's services to agricultural and owner managed business throughout North Yorkshire and the Tees Valley.

Peter Molyneux welcoming Nicki Hutchinson to the team

Nicki has extensive experience across the industry, qualifying as a Chartered Accountant in 1992 and then working as an audit manager before moving into general practice at the same time as becoming a Chartered Tax Advisor in 2011.

With such a broad ranging, cross service knowledge, Nicki is able to offer advice and support to clients in both their accountancy and tax affairs. Her experience spans across a wide variety of sectors but with a particular focus on small landed estates and agricultural business.

Nicki is looking forward to helping Peter Molyneux and the rest of the agricultural team in Northallerton providing both existing and new clients with the quality of advice and support they deserve, helping them to grow and prosper.

Armstrong Watson Financial Planning – *focus on protection*

As Chartered Financial Planners, many clients think that all our time is spent managing pensions or investments in order to help individuals plan for their retirement and ultimately, their succession plans.

While this is important, one area that provides the cornerstone of financial planning is protection - life insurance, critical illness cover and protecting income in case of a long term illness.

The life stages which affect all of us tend to start with that of buying your first home, raising a family, helping children achieve their potential with further education, or helping them into farming so they can start their own business. The potential spanner in the works would be illness, or worse still, premature death, which would affect not only your loved ones, but your home, farm or succession plans.

Statistically, you are considerably more likely to suffer from a critical or long term illness earlier in life than you are to die prematurely, but far too few people arrange adequate protection for themselves and their family, despite the cost of this kind of insurance being relatively low due to increased life expectancy.

Tobacco smokers or vapers will pay more in premiums, reflecting their higher risks, but typically the cost of insuring a 40 year old non-smoker until age 60 for £500,000 life cover only could cost in the region of £20 per month. Adding on Critical illness cover or taking out a long term sickness policy would naturally cost more.

Our clients' wellbeing is important to us, so to help ensure you and your loved ones are adequately protected please contact me to arrange a review. An initial meeting is with our compliments.

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Summer Shows

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AGRICULTURAL SHOWS 2019

Congratulations to this year's competition winner!

Alistair Coe – Cockermouth Show

who won £250 worth of vouchers for a local retailer!

Serving farmers across the country for over 150 years

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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