Agri Matters

Farming is our field

Summer 2017

Natural Capital - how's your balance sheet?

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Accountants, Business & Financial Advisers

Welcome

Welcome to our latest edition of Armstrong Watson's agricultural newsletter.

As I sit writing this, we are experiencing a prolonged dry spell of weather. In Hexham we haven't had any real rain since the end of March and dare I say it, we could all do with a drop of rain to keep the crops growing.

We are all very much aware that the Farming Industry is very volatile in terms of commodity prices. After several months of milk price rises and a little bit of confidence returning, we are now seeing the major players cutting prices again which is very disappointing. Lamb and Beef remain relatively stable at present and the exchange rate continues to help cereal prices somewhat.

Throw in an early General Election and Brexit, and I believe we have some very uncertain and interesting years ahead of us. It is impossible to plan for what we don't know, and the longer it takes for any concrete facts to emerge re Brexit, the harder it gets.

We are working with our clients on how to prepare their businesses for the future post-Brexit. These discussions vary greatly but our belief is that farming businesses should try and structure themselves so they could manage with less than 50% of current support levels. That way if the worst does happen they are prepared and if support continues they are in a good place.

I am always reminded of a saying I was taught the first day I started training as an accountant 'fail to prepare then prepare to fail' and think this sums up where we are at in agriculture now.

In a departure to our normal newsletter content we welcome a guest article from Robert Craig who discusses the challenges facing farmers in maximising productivity and profitability while at the same time preserving the "natural capital" of their farm.

The proposed increase in Class 4 National Insurance contributions which was announced in the March 2017 Budget was hastily scrapped.

There is however a change to the way the self employed qualify for a state pension which is definitely being introduced in April 2018. We explain how this change could adversely affect some farmers.

George Osborne when announcing the introduction of the Residence Nil Rate Band for Inheritance Tax purposes in 2015 stated that hard-working families would have an exemption from tax on £1 million of assets. We explain why some farmers need to plan carefully in order to take advantage of this change which took effect on 6th April 2017.

We also have articles on whether expenditure on farm buildings will qualify for tax relief, and the impact that changes to accounting standards rules may have on the content of limited company accounts.

Finally, our agricultural tax director Keith Johnston comments on increased complexity when calculating capital gains on sale of property, and also a further court case concerning whether land belongs to individuals or the partnership.

I hope everyone has a successful summer season and Mother Nature plays ball and I hope to see you at one of the agricultural shows we will be attending.

Andrew Robinson

Natural Capital -
How's your balance sheet?

Natural Capital can be defined as the world's stocks of natural assets which include geology, soil, air, water and all living things.

Not so very long ago very few farmers or even consumers for that matter would have known the meaning of the term "Natural Capital" and even fewer being able to access, quantify or even attempt a simple valuation. Modern post war agriculture has delivered an abundance of food to a world of excessive consumption and wastefulness, with little regard being given to the depleting state of our natural assets.

As a direct result of economics, intensive agriculture is approaching what could be the most challenging period it has ever had to endure. Put simply, the business case before the farm gate is completely at odds with the business case beyond. The endless pursuit of cheap valueless food - which is also arguably increasingly less nutritious, has been at the expense of the ecosystems which we've taken for granted.

As farming businesses have restructured by simplifying and specialising our production system to remain efficient, we've unintentionally ignored the harmful effects this industrialisation of agriculture has had on the natural environment and the very eco-systems we rely and depend upon. So how do we as UK farmers change direction towards a more secure long term, sustainable yet productive agriculture?

International commodity markets are becoming increasingly aware of the limitations of our unsustainable global food system. Climate change and extreme weather events have highlighted the precarious nature of our ability to sustain production levels.

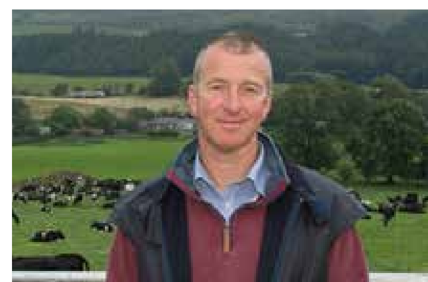
There's been a distinct change in direction in just the past few years as we're now seeing a growing number of the largest food companies realising both their responsibility and their ability to drive change by creating primary production incentives which reward sound environmental practice.

Along with the markets changing it's becoming increasingly important that governments develop farming and food policy in line with the emerging new reality. In a post BREXIT world, we in the UK will find ourselves in the unique position of being able to construct domestic agricultural policy that has the flexibility to both reward biodiversity and natural capital enhancement. At the same time investment in scientific development should deliver the efficiency gains needed for us to remain global leaders in agricultural productivity.

High quality food and nutrition is central to the health and wellbeing of our society. It is essential we become better at educating consumers about the nutritional quality of the food they consume while also better understanding the intrinsic link between farming system and consumer health.

Many of the funding challenges our National Health Service faces are due to the exponential growth in obesity and other non communicable diseases such as heart disease and type two diabetes, all of which can be directly linked to lifestyle, diet and poor nutrition and are also largely avoidable. Consumer education and communicating the link between healthy soil biology and the nutritional density of food will drive an awareness that will shape the future system changes in farming.

We're beginning a new chapter of food production and farming practice that could see the Natural Capital balance sheet as important as the monetary one.



Written by Robert Craig
Eden Valley dairy farmer and Nuffield Scholar.

Reduced Inheritance Tax bills – but not for all!

We mentioned the introduction of the Residence Nil Rate Band (RNRB) in our Autumn 2015 edition of Agrimatters. This had been an election pledge in the 2015 General election campaign when George Osborne promised that hard working families would only pay Inheritance Tax (IHT) if their estates exceeded £1 million.

This measure only affects the IHT calculations of those people who die on or after 6th April 2017, but as we will see it will not benefit everyone, and in particular some farmers will not be eligible to claim.

A Reminder of the Basics

- Inheritance Tax is payable at a rate of 40% if a person's chargeable estate exceeds £325,000.
- It is payable on assets held at the date of death and assets given away in the preceding seven years.
- Assets left to a surviving spouse are exempt from IHT and any unused nil rate band can pass to the survivor.
- There are exemptions for most agricultural and business assets, but care needs to be taken to ensure relief is available.
- Relief can also be claimed on farmhouses but only where they are occupied by a "working farmer". Also HMRC will often argue that part of the value of some farmhouses does not qualify for relief as it is "non-agricultural".

How does the RNRB work?

- A person receives an additional nil rate band of up to £175,000. This gives an individual a possible £500,000 of IHT exemption, and a married couple a maximum of £1 million.
- The new allowance is being phased in – it is currently £100,000 and will increase by £25,000 per year until it reaches £175,000 in April 2020.
- The RNRB can only be claimed where an interest in a residential property, which has been occupied as their main residence at some point, is left to a child or grandchild. It cannot be claimed where a property is left to a sibling or a niece or nephew.
- The main drawback of the RNRB is that it is restricted if a person's total estate is more than £2 million. This is even the case where the bulk of the estate consists of agricultural or business property qualifying for 100% IHT exemption. Technically the restriction is calculated by withdrawing the RNRB by £1 for every £2 that a person's estate exceeds £2 million.

Planning Points

- In recent years, many married couples left their assets to each other on the first death and on to their children on the second death. This was generally effective in minimising the IHT liability as the survivor had two nil rate bands. In order to maximise a claim for RNRB, consideration needs to be given to passing some assets on the first death.
- Care needs to be taken that the residential property that could qualify for RNRB is left to a child or grandchild. There is no requirement for them to live in the property or even retain ownership.
- Consideration should be given to making lifetime gifts to bring the total value of a person's assets to below £2 million in order to qualify for RNRB.
- Where an interest in a residential property is to be left to children via a trust, care needs to be taken. Whether the RNRB is available will depend on the type of trust used.

National Insurance changes could hit farming families

When planning for retirement the importance of the state pension is often overlooked. Whilst it is true that few people could live on the state pension alone – the basic pension will increase to £159.55 per week in April 2017 – the cost of providing a similar level of income from alternative sources is extremely high. In this article, we will explain the different ways in which a person can qualify for a state pension and also look at changes being introduced in 2018 which will make the position more complicated.

The current state pension system

- The age at which we receive the state pension is being raised. By the end of next year both men and women will receive the state pension at age 65. This then increases so that by 2028 it will be 67.
- A person needs to pay national insurance or have received credits for 35 years in order to qualify for a full state pension.
- There are a number of different ways of obtaining a qualifying year:
    - By paying class 2 National Insurance contributions (NIC's) as a self-employed person, which are currently £145.60 per year. A self employed person can also pay class 4 NIC's on their profits but these do not entitle the payer to any state benefits.
    - By paying class 1 NIC's as an employee. To obtain a qualifying year, a person needs wages of at least £112 per week.
    - By paying voluntary class 3 NIC's at a cost of £733 per year.
    - By receiving a NIC credit if you are in receipt of certain state benefits, including jobseekers allowance, carer's allowance, and child benefit for a child aged under 12.

So what is changing?

From 5th April 2018 class 2 NIC's will cease to exist and a self employed person's entitlement to state pension (and other state benefits) will be based on class 4 NIC's.

Using the 2017/18 national insurance thresholds the position would be as follows:

- A person has taxable profits of less than £5,876 – no liability to pay class 4 NIC and no qualifying year.
- A taxable profit between £5876 and £8,164 – this will be known as the small profits limit and will result in a qualifying year even though no class 4 contributions are payable.
- Profits in excess of £8,164 will result in a 9% class 4 NIC's charge and a qualifying year will be received.

A self employed person with profits of less than £5876 will no longer be building up entitlement to state pension. However a person needs 35 qualifying years out of a working life of approximately 50 years so missing out on a small number of qualifying years due to low profits may not matter too much.

It is important that everyone knows how many qualifying years they have already got so that they can make an informed decision as to whether they should pay the more expensive class 3 contributions. A cost of over £700 per year may seem high but the cost can be recouped in less than 4 years once a person starts to receive their state pension.

KEITH'S BRIEFING

Our Agricultural Tax director comments on a recent court case concerning a family dispute and further complexity with Capital Gains Tax.

Partnership disputes

We have mentioned the case of Ham v Ham in previous newsletters and stressed the importance of having a properly documented partnership agreement. The case concerned a successful Somerset farming business where purchased land was shown on the partnership balance sheet and their son was later made a partner in the business.

Years later the son decided he wanted to leave the partnership and asked for his capital to be repaid including a share of the increase in value of the purchased farms. There then followed a protracted dispute, culminating in a High Court hearing, to determine whether the parties intended the property to belong to the partnership or if it remained in the ownership of Mr and Mrs Ham senior. The court decided that the property had been shown on the partnership balance sheet by mistake and that the son could not claim a share of the increase in value.

It is sometimes the case that there is a benefit in treating property as belonging to a partnership, particularly for Inheritance Tax purposes. However, legal paperwork needs to be in place to confirm this and both the partnership agreement and Wills need to be consistent with the annual accounts.

Capital Gains Tax complexity

Politicians frequently promise to simplify the tax system but often end up doing the opposite. If we take a look at the current Capital Gains Tax (CGT) system we can agree that it is far from simple!

The then Chancellor of the Exchequer, George Osborne, announced changes to Capital gains Tax in the Spring 2016 Budget reducing the top rate of tax from 28% to 20%. In recent years there have been several measures introduced to discourage people from owning more than one residential property. Thus it was not much of a surprise when the Chancellor stated that these reduced CGT rates would not apply to the sale of residential property.

We now have a situation where the following rates of CGT can apply on the sale of a farm:

- Residential property – lower rate of 18% and higher rate of 28%. A person's main residence can however qualify for full exemption and no tax is payable.
- Land and non-residential buildings – lower rate of 10% higher rate of 20%.

The lower rate of tax (i.e. 18% for residential property and 10% for other assets) only applies where a person's combined taxable income and taxable capital gains are within the income tax basic rate band. For the current tax year this is £33,500.

There is then a different 10% rate – Entrepreneurs' Relief – which can apply to certain disposals of business assets.

You will be pleased to hear that a lack of space prevents me from going into this in detail – suffice to say that it is extremely complicated.

So when a farm property is sold that consists of both land and residential property, the rate of tax payable could be 0%, 10%, 18%, 20% or 28% - or a combination of all of them!

A further complication arises when a barn is converted into a residential property, as part of the gain on a future sale is taxed as a commercial building and part as a residential property, based on a time apportionment.

Keith Johnston

What is a repair?

This is a question that has caused much debate over the years and no doubt will continue to do so. It can be highly subjective and, in many cases, has been the subject of examination by the courts where HMRC and the taxpayer have disagreed over the accounting and taxation treatment of particular expenses. Usually it is the case that the taxpayer considers an expense to be a repair (and so eligible for relief against profit) and HMRC as a capital item and an asset thereby restricting or completely denying tax relief depending upon the nature of the expenses concerned.

Sometimes it can be a matter of common sense. Consider storm damage to a shed roof for example. If it is reinstated on a like for like basis using similar materials or as near the modern equivalent as possible, there should not be an issue. It is not cost sensitive – it may cost £5,000 or £25,000, it is the substance of the transaction that matters not the amount spent.

What about work on a farm lane?

Consider this case that went before the tribunal back in 2010. HMRC wanted to treat the expenditure of circa £23,000 for repairing an existing farm lane as capital. This amendment increased the partnership income tax profit on the basis that it related to costs which were capital in nature, and therefore not allowable as a deduction in the accounts.

The First-tier Tribunal agreed with the taxpayers that the work on the farm drive consisted of a concrete surface being placed over the existing one and was a repair to an existing asset and therefore allowable for income tax. The appeal was allowed by the Tribunal.

The key point in this case is that there was an existing concrete track and there was no change to the width or load bearing capacity.

Had there been no pre existing track, HMRC would have had a much stronger argument. It is therefore essential that all farm improvements and repairs should be fully reviewed, and preferably before the expenditure is incurred. Relying on invoices alone will not always be sufficient and it can be a very useful investment of time to take photographs of the building before and after the work.

Are drainage costs a repair?

For many years Tax Inspectors argued that the use of more modern building materials constituted an improvement. An example was the use of double glazing in a commercial building to replace single glazed windows. This was even the case where the supposed improvement was cheaper or where it was not possible to find a tradesman to undertake a like-for-like repair.

However since then there have been a number of tax tribunals on the question of what constitutes a repair which resulted in HMRC relaxing their approach where modern materials are used.

Getting back to drainage work, way back in 1981 the Inland Revenue as they were then published a statement saying that the replacement of tile drains with mole drains was an improvement and not a repair, and this can still be found on the HMRC website. However, as a result of the tribunal decisions mentioned above, our view is that provided a field has previously been drained, the replacement of old drains in most cases will be a repair.

NEWS NEWS NEWS

Making Tax Digital

We mentioned the introduction of Making Tax digital (MTD) in our last newsletter and described it as the biggest upheaval since the introduction of VAT in 1973. The key issue for farming businesses is the requirement to file information about income and expenses every three months.

The major concern from the accountancy profession and other bodies was the unrealistic timescale for introduction of the scheme, which was originally 2018 for many businesses. In the spring 2017 Budget it was announced that the start date for most businesses would now be delayed until 2019. However, given that testing of the system has just started and software companies have a lot of work to do to upgrade their programmes to cope with MTD, the deadline is still challenging.

A further point is that due to the early dissolution of Parliament caused by the General Election, the legislation to implement MTD has not yet been enacted. We will have to see whether the legislation is reintroduced later in the year and whether the start date is pushed back further.

Scottish Income Tax

We have also talked on these pages in the past about the Scottish Government having the power to alter income tax rates but leaving them the same as the rest of the UK. However, in February 2017 the Scottish parliament voted to freeze the higher rate threshold for income tax. This means that for the 2017/18 tax year the UK higher rate threshold is £45,000 but in Scotland it remains at £43,000.

This will only make a modest difference in tax liability – no more than £400 per individual – but the differences could of course widen in future. The main complication is that the Scottish Government only has power to tax certain sources of income – essentially earned income such as business profits and wages, and property income – while savings income and dividends remain subject to UK rates and thresholds.

Farmers Averaging

Another topic covered regularly in these pages has been the changes to farmers averaging rules. The first tax year that the new five year averaging legislation applies to is the year ended 5th April 2017 so claims can now be made.

As always with farmers averaging – whether it is the traditional two year claim or the new five year claims – there is only a benefit if a personal allowance has been wasted or higher rates of tax has been paid in at least one year.

Thus while the new rules will produce some tax repayments for some farmers, they are unlikely to be significant in most cases and the calculations will be complex.

Stamp Duty Land Tax

We have regularly covered SDLT changes on these pages in recent editions. This time we are highlighting how farmers may face an additional 3% SDLT charge when they purchase a residential property. This measure was introduced to discourage buy-to-let investors from buying additional properties, but can affect ordinary farmers.

If at the time a person buys a residential property, they already own a share in another property, an additional 3% is added to the SDLT charge. For example on the purchase of a property for £200,000 the SDLT increases from £1,500 to £7,500.

In farming families the property including farmhouses and cottages is often part owned by several family members. Thus a person can own part of a house that they don't live in, which means they are liable to pay the higher rate of SDLT when they buy an additional property.

Business Rates

Agricultural land and buildings have historically been exempt from business rates but there are occasions when landowners can be liable.

The first of these is when buildings cease to be used for agricultural purposes, such as holiday letting and other commercial purposes. It should be noted that England and Scotland operate their own business rates schemes which are similar but have important differences.

Business rates are calculated using the Rateable Value (RV) of a property which is set by the District Valuer in England and Local Assessor in Scotland. The liability to business rates is calculated by applying a multiplier (currently 46.6 pence in the pound for most businesses) to the RV. The RV is periodically reassessed and this has just been done in England with some businesses, including several livestock auctions, facing significant increases.

Businesses which only occupy a single building with a low RV may qualify for a reduction of up to 100%. This is known as Small Business Rate relief in England and Small Business Bonus Scheme in Scotland. In England, 100% relief is due if the RV is £12,000 or less, and relief is tapered on RV's between £12,001 and £15,000.

Finally, a worrying change to business rates has just been introduced in Scotland. Business rates on shooting estates were abolished in 1995 but have been reintroduced from April 2017. Many smaller estates and shoots will be able to claim exemption under the Small Business Bonus Scheme mentioned above but larger estates will have a liability to business rates. It is to be hoped that further reforms are not made to extend liability to all agricultural property.

Tax on Accommodation for Farmworkers

The Office of Tax Simplification (OTS) has been looking at how employer provided accommodation is taxed on an employee and has said that it is outdated and in need of updating.

Accommodation provided to farm employees (except for company directors) has historically been treated typically as a tax free benefit. This is based on 40 year old legislation which allows exemption because the accommodation is either necessary for them to do their job or it is customary to be provided with accommodation.

If the accommodation does not meet these exemptions, or is provided to a company director, the amount of the taxable benefit depends on whether the property is owned or rented, and when it was purchased.

For example:

- If the director/employee has lived in the house since the business purchased it in 2011, when it cost £190,000 and the gross rateable value is £568, the taxable value will be £4,018.
- If the director/employee has lived in the house since the business purchased it at the beginning of 1980, when it cost £25,862, the taxable value will be £568.
- If the director/employee has lived in the house since 2012 when the market value of the house was £185,581 and the business purchased it at the beginning of 1980, when it cost £25,862, the taxable benefit will be £3,885.
- If the business rents the accommodation for £750pcm the taxable value will be £9,000.

It is clear that the current system is in need of simplification, but it is to be hoped that any changes do not result in additional costs for the employee and employer.

Northern Farming Conference 2016

The seventh annual Northern Farming Conference was held at Hexham Auction Mart on 9 November 2016.

Following an interview on BBC Radio Cumbria, Andrew Robinson, Chairman of the conference, welcomed an increased attendance of over 200 farmers and professionals including David Threlkeld, Keith Johnston, Peter Molyneux and Murdo Laurie from Armstrong Watson.

The conference is a joint venture between the CLA, Strutt & Parker, Bond Dickinson, Armstrong Watson, Catchment Sensitive Farming, Gibson & Co Solicitors and Hexham and Northern Marts.

Cockermouth Mart

Armstrong Watson are delighted to announce that we now have a booth at Mitchell's Auction, Cockermouth. Look out for Mary Bragg, Kerryl Steel or Steve Pinguey in booth 12 opposite the café or around the ring.

They will be happy to help with any queries or collect paperwork and records from you and deliver them to any of our offices.

There might even be a biscuit for you!

SUMMER SHOWS

We'd love you to join us for hospitality at our upcoming summer agricultual shows:

Cumberland Show - 17 June

Penrith Show - 22 July

Cockermouth Show - 29 July

Dumfries Show - 5 August

Westmorland Show - 14 September

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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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