

# Agri Matters

Farming is our field

Winter 2017

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# Welcome

As I sit here writing my editor's page it occurs to me that I always start them with a similar theme, the weather! It would be impossible not to mention the awful summer weather we have had across our region this year, which has made it extremely difficult or impossible to harvest crops and forage for the winter. This will undoubtedly have a knock on financial cost to farming businesses which can be seen already by the record high straw prices.

I think brave unusual decisions may need to be taken and for some it may be better financially to sell some stock than buy the feed or bedding to keep them.

The other hot potato which I always seem to write about is 'Brexit'. Another six months have passed and we know little more about what the trade situation and support system will look like after Brexit. This makes planning extremely difficult.

There are many articles in the press but the lack of a decent trade deal in my opinion will have a huge impact on UK Agriculture especially the livestock sector and could change the industry for good. As ever, there will be some opportunities for those that are willing or able to take them.

Our advice currently is to try and make your farming business as robust as possible before 2020 then if the divorce from Europe puts pressure on farm incomes at least you can batten down the hatches.

We therefore have an article which explains why having a good understanding of cashflow and the working capital requirement of your business is so important. We also take a brief look at how countries outside the EU support their agricultural industries.

Another topic that keeps cropping up on these pages is Making Tax Digital. This is another area which potentially results in huge changes to the way farming businesses interact with HMRC. Fortunately the government appears to have listened to lobbying from the accountancy profession, NFU, CLA and others, and the changes originally due to be introduced in 2018 have been put back. At present there is a proposal to change the way VAT returns are filed with HMRC from 2019 that we are looking at in detail.

Still on the subject of VAT, we have an article which looks at some of the common problem areas which can result in farming businesses either having to pay VAT on part of their income, or not be able to recover VAT on expenses. Another area where we see confusion arising is whether Inheritance Tax Relief is due where a business has diversified. We comment on a tax tribunal case concerning holiday cottages.

Staying with tax tribunals, our Agricultural Tax Director, Keith Johnston, comments on two recent cases involving tax credit claims where HMRC's approach was criticised by the judge, and another decision which may be

useful when looking at Capital Gains Tax on selling land.

On a much more positive note, it is great to see and meet so many young people who are keen to drive agriculture forward. I am chairman of the Northern Farming Conference and some of the inspirational younger generations I have met through that are brilliant.

As always I welcome feedback on this newsletter, and hope that the weather is much improved when we are writing the next edition.



*Andrew Robinson*

Andrew Robinson  
Head of Agriculture

## Global Farm Support Schemes

We know for certain that farm subsidies in the future will be totally different to what we have now, but we have little or no idea as to precisely what the new system will look like. In this article we take a brief look at the type and amount of support given around the world. The statistics quoted in this article are from the OECD. EU support levels have declined steadily over the last 30 years – from approximately 40% of total farm receipts in the mid 1980's to about 20% now – which interestingly is only slightly higher than the OECD average.

### New Zealand



It is well known that there have been no direct payments or market support since 1984. This means commodity prices are aligned with world prices and support equates to less than 1% of farm receipts. However, New Zealand does restrict imports of certain agricultural products on health or biosecurity grounds which does provide some indirect market price support. Other indirect support is given in terms of promoting animal welfare, animal disease control, and funding of agri-innovation.

### Brazil



As with New Zealand, there are no direct payments to farmers but there are several forms of support, which equate to 2.6% of farm receipts. These include:

- Regionally set minimum guaranteed prices
- Reduced rate bank loans to enable farmers to keep produce off the market until prices improve
- Subsidised crop insurance against natural disasters or production losses

### Switzerland



Swiss farmers are protected by a system of import tariffs and quotas covering a range of products, which results in support payments accounting for almost 60% of farm revenues. There are a range of different schemes, from dairy farmers who are paid to produce milk from cows fed with hay rather than silage, which is then used to produce artisan cheese, to area payments for various crops.

### Norway



Norway provides much higher support levels than the EU – over 60% of total farm incomes. There are many similarities to CAP, and includes both area payments and headage payments. Payments differ according to farm size and region. Market price support – in the form of target prices – is negotiated annually between the government and farmers' organisations. Import tariffs, of up to 400% at certain times of year, mean that commodity prices are on average 80% higher than world prices.

### Australia



Support for Australian farmers amounts to only 1.3% of total income. However, the government provides funding for rural research and development corporations which assist rural innovation and agricultural productivity growth. Some direct support is given – particularly to farmers affected by drought – in the form of insurance against drought, income support payments, and subsidised loans.

### United States



The 2014 Farm Act abolished direct payments to US farmers. This has reduced farm support by more than half, but it is still almost 10% of farm income. Support now takes the form of crop insurance with payments received by farmers when market prices are low. There is also an "Agricultural Risk Coverage" programme which pays out when farm incomes fall below a benchmark figure.

## Making Tax Digital

The Department of Work and Pensions (DWP) is continuing to introduce Universal Credit across more areas of the country. As reported in previous issues of Agri Matters, this process has not gone smoothly and there is still uncertainty over when the process will be complete and in particular when self employed claimants will be transferred from Tax Credits to Universal Credit.

- In 2015 it was reported that over 4.5 million people were claiming tax credits.
- In summer 2017 the DWP stated that just over 0.5 million people are now claiming Universal Credit.
- Only certain people are eligible to claim Universal Credit at present. For example, the self employed and company directors are excluded and can continue to claim Tax Credits.
- The transfer of existing Tax Credit claimants onto Universal Credit has been delayed, and is not due to start until July 2019.
- March 2022 is the current target date to have all tax credit claimants transferred onto Universal Credit. It is likely that self employed tax credit claimants will be among the last to be transferred over.

In our spring 2016 newsletter we reported on an increased number of tax credit enquiries being received from HMRC querying if businesses were being carried out "on a commercial basis with a view to the realisation of profits". Most, if not all, farming businesses should be able to provide sufficient evidence to meet this test and tax credit claims can continue.

Additionally there have been two recent tribunal cases – see Keith's briefing page for more details – where HMRC have stopped tax credit because they did not think sufficient evidence had been provided. In both cases the tribunal judge was scathing of HMRC's interpretation of the legislation and reinstated the claims.

## Scottish Limited Partnerships – new reporting requirement

The introduction of new legislation in June 2017 entitled "Registers of people with significant control" imposes a new annual reporting requirement on a number of Scottish farming partnerships.

These apply only to Scottish Limited Partnerships (SLP), largely formed before 2003 for tenancy purposes. An SLP comprises general partners (usually the tenant and family members) and a limited partner (the landlord or a company controlled by the landlord).

An SLP is a separate legal entity under Scots law and should have been registered at Companies House when it was first created. Until now there has been no requirement to file any other documents at Companies House apart from when there is a partnership change.

An SLP needs to firstly check that they are registered at Companies House – this should have been done by 7th August 2017 – and secondly from 2018 need to file an annual confirmation statement. The details to be filed are as at the anniversary of the formation of the partnership, and have to be filed within 14 days. For example a partnership registered on 21st March 2001 has to file a statement by 3rd April 2018 based on the partners at 20th March 2018.

## Trading and Property Allowances – a new tax relief

These are two new £1,000 tax allowances which were introduced from 6th April 2017. A taxpayer who qualifies for both allowances can therefore have £2,000 of income tax free, so a basic rate taxpayer can save up to £400 per year. The key points are as follows:

- They are separate reliefs – one for trading income and one for property income – and have to be calculated separately.
- The £1,000 limits refer to turnover not profit.
- All sources of trading income and property income are aggregated for the purpose of calculating the relief.
- If the source of income is more than £1,000, the taxpayer has a choice of either not claiming the exemption or paying tax on the gross income less £1,000.

### Examples

- 1) Alan is a sole trader farmer receives £800 of wayleave payment from a utility company. He has no other rental income and the whole £800 is now tax-free.
- 2) Bob is a sole trader farmer whose only rental is £1,500 from renting out a building. He incurs £500 of expenses insuring and repairing the building. He has a choice of paying tax under the normal rules - £1,000 of net income – or deducting £1,000 from the income and paying tax on £500. Thus Bob saves tax on £500 of income.
- 3) Colin is a sole trader farmer who is also a part-time magician who earns £1,500 from children's parties. Colin is worse off if he claims under the scheme as he cannot claim any of his farming expenses against tax.
- 4) Derek farms in partnership with his son Dean. Derek receives £1,000 from a neighbour for building a stone wall. This income does not have to be aggregated with the partnership income and the £1,000 is tax-free.

## Higher tax bills on dividends

The following changes were introduced from 6th April 2016 and the first tax bills calculated using the new rules are due for payment on 31st January 2018:

- The 10% tax credit on dividends was abolished.
- A £5,000 tax free dividend allowance was introduced.
- Dividends above £5,000 are taxed at 7.5% (basic rate taxpayers), 32.5% (higher rate) and 38.1% (additional rate)

For a taxpayer who pays the maximum dividend to utilise their basic rate tax band, there is an additional tax liability of up to £2,025. The tax free dividend allowance will reduce from £5,000 to £2,000 from April 2018. This will further increase tax payable by a basic rate taxpayer by up to £225.

## Environmental Stewardship Schemes and VAT reclaims

We have had recent enquiries from a number of clients who have joined Environmental Stewardship Schemes, and who have had a VAT inspection challenging the recovery of VAT on related expenses. HMRC have been challenging input tax recovery on these schemes on the basis that there is no link to a taxable supply. The issue here is that the receipt of environmental subsidy is classed as outside the scope of VAT.

Where the scheme pays for fencing or walling of land grazed by livestock, there should not be a problem. However, where the scheme takes land out of agricultural production and grazing is prohibited, the position is less clear cut.

If a VAT inspection takes place it is likely that these schemes will be a major focus of the enquiry. We can assist with dealing these enquiries and if you have signed up for our Tax Compliance Service, then any time we spend on this on your behalf is covered.



## Cash is King

There is a saying in business – “turnover is for vanity, profit is for sanity, and cash is reality”. In this article we will look at various issues surrounding farm finances, and we will see that the key consideration is always about understanding cashflow.

### How can my accounts show an increased profit when my overdraft has gone up?

Financial accounts are prepared using the accruals concept. This means that part of the profit made can consist of increased stock or money owed to the business, and not cash in the bank. A typical example would be if your business has got 100 extra sheep at the end of the year than at the beginning. These are included in closing stock, which increases the profit figure. The additional animals will have impacted on cashflow - they will either have been purchased or have been lambs retained that otherwise could have been sold.

Not all expenditure is included in the profit and loss account. New machinery or building improvements are shown on the balance sheet and only part of the cost goes to the profit and loss account via the depreciation charge.

Most farming businesses are run as partnerships and any drawings taken out of the business to cover living costs are not shown in the profit and loss account. Thus a business needs to generate sufficient cash to cover those drawings. Any business where drawings regularly exceed profit will find that cashflow is under pressure.

### Is expansion always the right answer?

Let's go back to the example of the livestock farmer keeping an extra 100 sheep, which are to be kept

on an extra 50 acres of rented land across the road from the main farm. The extra sheep can be managed without any extra labour, buildings or machinery, and the margin generated from selling say 180 additional lambs each year should improve the profit of the business.

However, what if the extra land is 20 miles away and keeping the extra sheep will require the construction of a new lambing shed, the purchase of an extra quad bike, and another part-time member of staff? Careful thought needs to be given as to whether the additional margin generated is sufficient to cover the extra overheads.

### How should expansion be financed?

In our simple example, we will have to pay the rent on the new land up front and purchase 100 ewes - a total cost of say £20,000. It might be tempting to finance this on overdraft, but this could put your cashflow under pressure as it will be several years before the extra sheep generate £20,000 of profit.

It is more complicated if expansion requires additional machinery or buildings. It is generally unwise to use short-term finance to purchase assets which have a long-term payback period. For major expenditure on buildings, a loan period of at least ten years is usual, whereas finance on machinery should match the useful life of the equipment.

It can be tempting to repay loans on purchasing land or putting up buildings as quickly as possible. This can create cashflow problems in years to come if profits fall or you wish to expand your business further.

## Our Agricultural Tax Director casts an eye over some recent tax cases.

In an ideal world we would have tax legislation that was easy to understand and there would be no disagreement between taxpayers and HMRC on what certain phrases meant and how they should be interpreted. In this article I will illustrate how the tax tribunal system can be used when the taxpayer and HMRC cannot agree.

### Two recent tax credit cases

I have to concede that most tax tribunal decisions are less than riveting reading. However there are exceptions and when in the opening paragraphs of a recent decision the tribunal judge stated his “sense of frustration bordering on despair” and went on to describe “a sorry tale of HMRC institutional incompetence and inefficiency”; I was compelled to read on!

On 15th May 2013 HMRC wrote to a taxpayer who was claiming tax credits and asked for certain information about the number of hours worked and childcare expenditure. This information was provided 2 weeks later but HMRC apparently lost it and later wrote terminating the tax credit award for not supplying the requested information.

The taxpayer naturally appealed the decision and said she couldn't provide the information because HMRC had already received it! The first tier tribunal found in favour of HMRC and most taxpayers would have

concluded that the world was against them and given up. However, this tax credit claimant was made of sterner stuff and appealed to the upper tier tribunal where the judge looked at the case in detail and HMRC admitted that there was a note on their computer that information had been received from the taxpayer. The judge ordered HMRC to reinstate the tax credit award.

Note however that this sorry tale commenced in May 2013 and was not concluded until August 2017!

The second tax credits case was heard by the same tribunal judge, and concerned an individual who had set up in business as a painter and decorator having been unemployed for some time. HMRC denied his tax credit claim on the basis that they were not convinced that his business was being carried out “on a commercial basis with a view to the realisation of profits”. One of the factors that HMRC considered relevant was his inability to produce a written business plan.

The judge gave this short shrift and told HMRC to “get real” saying that tax credit claimants are not preparing business plans “to pass muster on an MBA course or withstand scrutiny in an episode of Dragons Den”. Again the appeal was allowed and the tax credits claim reinstated.

### Capital Gains Tax – part of a business?

The final case illustrates how a tribunal decision can change our understanding of how a piece of legislation is interpreted. Mr Gilbert was not a farmer but his case is relevant for whether Entrepreneurs' Relief (ER) is due when part of a farm is sold. To qualify for ER it is necessary to show that a distinct part of a business has been sold, rather than just assets used in a business.

Prior to the Gilbert case, HMRC would look at the seller's business and say that ER was not due if all that had happened was that it was farming less land. The judge in the Gilbert case said the correct approach was to look at the purchaser's position. If the assets acquired were capable of being used to run a separate business, then ER was due.



Keith Johnston

# Furnished Holiday Lettings - Is It A Business?

Ask the owner of a holiday cottage whether they were running a business or holding an investment, the answer will come back – “of course it is a business”. Recently, HMRC have denied Inheritance Tax (IHT) relief on holiday cottages. What actions can cottage owners take to improve their IHT position?

Property rental has always been treated as an investment activity for tax purposes whereas the operator of a hotel or guest house is clearly running a trading business. A furnished holiday letting (FHL) business lies somewhere between these two extremes. There are different types of FHL businesses, some offering a range of additional services, whilst others leave their guests to their own devices.

In 1984, legislation was introduced treating holiday letting as a business for income tax and capital gains tax purposes, but no mention was made of IHT. However, for many years HMRC routinely allowed 100% Business Property Relief (BPR) on holiday cottages. They have recently changed their interpretation, arguing the business is wholly or mainly one of holding investments. We have now had three tax tribunal cases on this and unfortunately HMRC has won all of them.

## The Ross Case

Mrs Ross acquired a holiday business in Cornwall known as Green Door Cottages Partnership which consisted of eight cottages. There was an agreement with the adjacent hotel whereby cottage guests received their cottage keys from hotel reception and could purchase meals at the hotel at a discounted price.

The judge made several comments which make it unlikely that any holiday cottage will qualify in the future:

- That the level and standard of services was irrelevant as what the guests really wanted was “access to a property to call their own in a beautiful part of Cornwall.”
- That a holiday cottage should generally be treated as an investment activity and that additional services were unlikely to be material.

## IHT Planning Points

1) Give away the property – if done more than 7 years before death, no IHT will be payable.

This can usually be done without paying CGT. This can have an adverse CGT position if the property is sold in the future though.

2) Restructure the business – a farming business can qualify for 100% BPR on all its assets, including those used for investment purposes, provided it can be shown that the overall business is predominantly of a trading nature. The VAT position needs to be considered – see below – as an improved IHT effect may come at the cost of having to pay VAT over on the income.

## A brief mention of other taxes:

Income tax - FHL income is treated as earned income, subject to meeting several occupancy conditions. It is however still entered on the property pages of the Tax return. A FHL loss can only be offset against future profits from holiday letting.

Capital Gains Tax – FHL properties can qualify for several CGT reliefs – Rollover Relief on sale and purchase of other business assets, Entrepreneurs’ relief on sale, and Holdover Relief on a gift.

VAT – FHL income is standard rated – see VAT article on next page for more details.



# VAT – not as simple as you think!

For most farmers VAT is one tax that seems straight forward - VAT is not charged on much, if any, of their income and all VAT on expenses is reclaimed. However in this article we will see that this is not always the case!

## VAT basics

There are three possible types of sales or supplies in a farming business:

- Standard rated – for example wool sales, contracting work done, sale of machinery, sale of sheep dogs – where 20% VAT has to be charged and paid over.
- Zero rated – for example sales of cattle, sheep, milk – where no VAT is charged.
- Exempt – for example rent of residential property and most land – where no VAT is charged.

The distinction between zero rated and exempt supplies is in whether VAT on related expenses can be claimed. For VAT on an expense to be reclaimed there must be a “direct and immediate link” to either standard rated or zero rated sales.

## Grassletting income

There is a subtle distinction between the rent of a field (generally exempt from VAT) and the provision of grazing rights

(zero rated) for VAT purposes.

The difference here is whether the owner of the field is entitled to reclaim VAT on related expenses. For grassletting to be zero rated the owner of the land must be involved in the husbandry of the land, which means being responsible for applying fertiliser, controlling weeds, etc.

## Sale of non-food crops

The sale of crops for consumption by humans or animals is zero rated, while crops for non-food use are standard rated. This is simple enough in most cases, but what is the position where a product has more than one use? HMRC guidance is that it depends on how the item is “held out for sale”. This leads to the position where feed straw is zero rated whereas bedding straw is standard rated. Where a farmer agrees to supply crops for an AD plant, he knows they are being used for non-food purposes, and is therefore standard rated.

## Cattle keep

Where a farmer has an empty shed and takes in other farmers’ cattle for the winter, is this income exempt from VAT as rent, or do the services provided turn it into a standard rated supply? In most

cases the owner of the building will be feeding, watering, mucking out, etc and HMRC will argue that the whole invoice should have 20% VAT added. As both parties to the transaction are almost certain to be VAT registered this should not create a problem. Furthermore, because the owner of the building is making taxable supplies from the building, there can be no restriction on reclaiming VAT on related costs.

## B&B’s / Holiday Letting

This income is standard rated and VAT will need to be paid to HMRC if it is part of a VAT registered business. Holiday cottages are always standard rated for VAT, and again it is how the accommodation is advertised or held out for sale.

The amount of VAT on related expenses is usually limited, which can put the business at a commercial disadvantage if competitors are not charging VAT. 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.



## Making Tax Digital - *where are we now?*

In the last edition of Agri Matters we advised that following intense lobbying from the accountancy profession and other industry bodies, that the start date for Making Tax Digital (MTD) had been delayed. We also said that the unexpected General Election had delayed the introduction of the legislation.

We have now had the Finance Bill with details of how HMRC intend to implement MTD and encouragingly it seems that the Government has taken heed of the concerns and delayed the start date for most businesses even further. However, changes to the way VAT returns are to be submitted are now on the horizon:

### From April 2018

There will be voluntary pilot schemes:

- VAT registered businesses can report quarterly data to HMRC using MTD compatible software and will have to maintain digital records to provide an audit trail to support the figures filed.
- Other businesses and individuals, eg businesses with turnover under the VAT threshold or property landlords, can submit tax return information on a quarterly basis.

### From April 2019

VAT registered businesses will be required to submit VAT information using MTD compatible software. We are still awaiting guidance from HMRC as to what precisely they mean by digital records, and in particular whether spreadsheets are an acceptable way to keep records.

The first VAT quarter starting on or after 1st April 2019 is the first return that needs submitting under the new system. As most VAT registered businesses already submit quarterly VAT returns online,

this should not be a major change, but software upgrades may be needed. The deadline for filing the MTD for VAT submission remains five weeks after the end of the VAT quarter.

Businesses who are voluntarily VAT registered, eg those with turnover under the VAT threshold (currently £85,000), will not be required to make MTD reports.

### From April 2020

This is the earliest date that all taxpayers will be required to submit regular information to HMRC for income tax purposes. For most businesses this will mean quarterly submissions, but more frequent returns can be made, eg where monthly VAT returns are prepared. HMRC has committed not to do this until it is satisfied that the software and systems can be shown to work.

### What about companies?

VAT registered companies are included in the changes described above and will need to submit returns using MTD compatible software. We are awaiting an HMRC consultation document as to how MTD will be implemented for Corporation Tax purposes. It is safe to say that this will not be until April 2020 at the earliest.

### The end of Tax returns?

All the information submitted via HMRC will appear on an individual's Personal Tax Account, together with PAYE and other data already collected by HMRC. Once other miscellaneous information has been entered, a person's tax liability for the year can be calculated without the need to submit a tax return. This is a "work in progress" and HMRC has not set a timetable for the phasing out of tax returns.

## Growing Agricultural Team in Dumfries

We are delighted to announce the addition to our Dumfries team of Nick Heaney. Nick has joined the office from Haines Watts in Edinburgh, where he looked after clients from a variety of industry sectors. Nick will be working alongside Douglas Russell and Douglas Murray, overseeing the provision of the wide-ranging services and advice offered by the Dumfries office to the Agricultural and Rural business sector.

Nick will be predominantly responsible for looking after the office's current agricultural clients' affairs and also to increase the office's offerings to both existing and new clients.

Having bought a smallholding in North Cumbria, Nick

is keen to integrate back into the rural community of Cumbria and the South West of Scotland and is looking forward to applying his no-nonsense, plain speaking approach to his advice, to current and prospective clients.

A keen horseman, who show-jumped before turning to accountancy, Nick has lived in the countryside for most of his life. As a result he shows a true understanding of issues faced by rural businesses and communities.



## SUMMER SHOWS

We've had a fantastic time at our summer agricultural shows this year. Here is a recap.



# Serving farmers across the country for 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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