



Spot the Difference



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What makes agricultural accountants different? We would argue industry knowledge not just the straw stuck in our hair. That is not to say that one of us could plough a straight furrow or grow the biggest sugar beet but rather that we understand the farm business environment and have a grasp of the more specialised areas which impinge on business decisions or affect the tax position of our clients.

An area unique to agriculture and of huge significance in a tax context is tenancy legislation. Another commercial opportunity that can be significant for farmers is contract farming. This has implications for Single Farm Payments. VAT legislation has quirks of particular significance to agriculture.

These subjects all crop up, no pun intended, in the following pages. There is also the more general issue of business structure that is addressed from the specific viewpoint of a farming business. I hope that you find something thought provoking and will be pleased to hear from anyone who is interested in a more detailed discussion of any of the topics covered.

Polytunnels: Machinery or Buildings?

The tax treatment of expenditure on polytunnels can be contentious. As a yardstick HMRC will not accept a claim for plant and machinery allowances if the tunnels are unlikely to be moved, for example where they shelter raspberries or strawberries grown in a raised bed. Conversely, despite their lengthy growing period, if these crops are grown in the ground, so rotation of the growing area and relocation of the tunnels will be required, a claim should be accepted.

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**WHITING
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Breaking Up is Hard



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Business succession is a common objective for farmers but it's not always straight-forward. Circumstances can sometimes create pressures to split a farming business.

Whether a split is amicable or driven by dispute a formal partnership agreement can be of great benefit. This will have been drawn up long before partners decide to continue in the business or leave, so such documents tend to provide a degree of protection for all.

Seeking guidance at this stage is imperative. By definition a partnership's advisers will have a conflict of interest which should be declared. If they are trusted by both sides they can facilitate negotiations. Knowledge of the background to the business and the individuals can enable constructive ideas to be put forward to facilitate the best balanced outcome for everyone. Alternatively in some situations a fresh pair of eyes can help. In either event, the tax consequences, particularly for capital taxes, must be factored into the equation.

It is easy to overlook taxation and it can be a costly oversight. Potential Inheritance Tax Relief or Entrepreneurs Relief for Capital Gains Tax can be lost, sometimes in ways that are not obvious. For instance, the availability of Business Property relief or Agricultural Property relief is not assessed by HMRC until a potentially exempt transfer becomes chargeable, usually on a death within seven years of a gift. There are conditions which must be met both at the time of the gift and at the date of death for the reliefs to apply. Changes

on a partnership break-up in the interim period can impact on these.

Limited companies operating as quasi-partnerships face similar hurdles. A balanced shareholders agreement can avoid these issues and protect minority shareholders.

Not all is negative. Businesses evolve and a partnership split can allow one or more parts to forge ahead. A split can give the opportunity for personal goals to be met. Often in hindsight they are recognised as the catalyst for future success.



Family Farming Ltd



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Conventional tax planning for businesses generating more than modest profits is to incorporate. The principle advantage comes from lower Corporation Tax rates against the top Income Tax rate of 45% plus NIC's.

For a farming business it's not that straightforward and the possible impact on potential Inheritance Tax (IHT) and Capital Gains Tax (CGT) liabilities must be studied to ensure that any additional exposure to

Capital Taxes will not outweigh the income tax/NIC saving.

There are a number of positives:

- Potential reduction in annual tax/NIC liability.
- Possible introduction of family members as shareholders.
- Goodwill of all or part of the trade can be transferred to the Company enabling the value to be drawn as tax free loan account repayments in the future.
- Employer Company Pension contributions are often more tax efficient than personal contributions.
- Limited liability to protect against risky activities.

Where there are positives there are negatives:

- Potential double taxation of Capital Assets transferred into Company.
- Inability to obtain sideways loss relief against other income in a loss making year.

- Onerous income tax charges on benefits in kind for houses.
- Income tax charges on overdrawn directors' accounts.
- Potentially less attractive IHT reliefs on assets held outside the Company.

Potential reduction in annual income tax/ NIC liabilities should not drive a decision to incorporate an agricultural business.

There may be a half-way house with the incorporation of a separately identifiable part of the business taking advantage of lower corporate tax rates but keeping the main farming trade and property outside the company to protect existing Capital Tax reliefs.

Incorporation, in the context of agricultural businesses, as an automatic tax saving tool, is too simplistic. It's vital that the overall position is considered in detail because the mechanics of reversing a decision to incorporate, taken in haste, are complex and costly.

Contract Farming



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Landowners have a variety of options for the use of their land. Among them farming 'in hand' and 'letting' under an FBT arrangement are both well recognised and understood. In the middle ground sits 'contract farming' and it is one of those expressions in today's farming vocabulary that everyone understands but is subject to interpretation.

Take landowners who are fully engaged in the management of the business, making decisions, possibly with the involvement of the contractor, yet leaving the contractor responsible for the actual farm operations. Without doubt they are operating a business, benefiting from profits and risking losses. An arrangement like this will benefit from the continued tax advantages afforded to farming enterprises.

In comparison there are contract farming arrangements where the management and all activity on farm is performed by the contractor. The landowners receive payment for their 'dues', or as we have seen referred to in clients' records, their 'rent'. The contractor may raise an account showing crop proceeds, inputs supplied and charges which 'net off' to the agreed amount.

The latter example may sound somehow inferior but this is not necessarily the case

and may simply be what both parties desire. However, such a plain arrangement may jeopardise the advantages offered by the tax system.

HMRC manuals recommend that their Inspectors review any documentation relating to contract farming arrangements and actual practices. In recent years the courts have restricted the circumstances in which agricultural property relief can be claimed in respect of a farmhouse by measuring the activities of the farmer. It is not inconceivable that there will be further tightening of the rules.

In our experience there are only two factors that need to be in place when setting up a contract farming arrangement. Firstly - both parties should appreciate the arrangements and be happy with them. Secondly - the tax position should be understood. Consequences there may be but there should be no surprises.

Tread the VAT Maze



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One of the advantages of being a farmer is that you don't have to worry about VAT – except, of course, that is far too simplistic a rule to apply in practice. There is no VAT chargeable on the sale of produce for human consumption or of certain animals and animal feed if the animal in question produces food that is normally used for human consumption. However, VAT is in fact chargeable albeit at zero per cent. That zero rating is enormously important because without it, if food was exempt from VAT, the ability to reclaim VAT on purchases would be severely curtailed.

There are of course many potential income sources that require the farmer to charge VAT including revenue from contract work, contract farming charges and sales of machinery. Currently the maize being grown for fuelling AD plants will be zero rated if suitable for human consumption but if varieties are introduced which are not fit then it will be standard rated. Curiously the rental from a building used by a tenant to store produce that he owns is now standard rated as a result of HMRC's determination to impose tax on the provision of self-storage facilities. Rent for commercial premises, including bare land, may be standard rated for VAT if an option to tax has been made.

The main source of exempt income farmers encounter relates to the letting of residential property. The distinction between exempt income and zero-rated income is significant when considering reclaiming VAT on expenses.

There are rules around reclaiming input VAT relating to exempt activities. These apply for each VAT quarter but are then reviewed on an annual basis. When considering a major outlay on 'let' residential properties, timing is critical.

VAT registration covers all activities by the registered individual, partnership or company. If a farmer trades as a sole proprietor but he and his wife jointly own and let residential property then the VAT registration will not extend over the letting and recovering relevant 'input VAT' is not permitted. Conversely, if the farm is a partnership between husband and wife and there are other sources of income receivable jointly by husband and wife, perhaps from a diversified business, then the registration will cover all income.

As the rate of VAT is so high great care needs to be given to the structuring of new ventures. The pros and cons of registration should be considered and the business structured appropriately before launching into a fresh activity.

Because VAT is usually recoverable by farmers it's easy to forget that it can represent a sixth of income or an extra 20% on expenditure. Once zero rating of income ceases to apply getting VAT planning right can be crucial to the viability of new activities.

FBT versus AHA



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Farm Business Tenancies came into existence in 1995 and Agricultural Holdings Act tenancies disappeared. Except of course they didn't. Existing agreements endured and, in some circumstances, new AHA tenancies can arise even now. Tenancy legislation has a significant influence on farming, both for commercial reasons and because aspects have been incorporated into tax legislation.

Inheritance Tax rules state that subject to qualifying conditions 100% agricultural property relief applies to land let on tenancies starting after September 30, 1995. In many cases only 50% relief will apply where tenancies started before that date. Owners of tenanted land attracting this lower level of relief, or at least the beneficiaries of their wills, would prefer the higher rate of relief.

Tenancy legislation allows tenancies to be surrendered and re-granted either by contract or by 'deemed surrender and re-grant'. However, tax law suggests that in reducing the landlord's tax threat a Capital Gains Tax liability will be created for the tenant. In addition, the tenant may lose the protection of his AHA tenancy. This can be avoided by ensuring that any new tenancy is created through 'deemed surrender and re-grant'. Following this route, we have convinced the District Valuer that the tenant is not disposing any material value so lifting the threat of CGT.

The succession rights inherent with AHA tenancies can also result in the landlord benefitting from the higher rate of relief. Providing succession is obtained via application to the Agricultural Land Tribunal HMRC accepts that the succession tenancy is a new tenancy. Alternatively, succession can be agreed with the

landlord without also making application to the Tribunal. In this event the old tenancy will have been assigned and so there will not be a new tenancy and relief for Inheritance Tax will remain at 50%.

From an aging tenant's perspective an unopposed succession is likely to be an attractive option. Where the next generation hopes to continue the farming business, failure to secure a succession tenancy can lead to a reduced acreage and for that reason it may be advisable to pre-empt the situation rather than wait until the tenant's demise.

If a succession tenancy cannot be negotiated and is unlikely to result from an application to the Tribunal, it may be worth considering an offer to buy the land subject to the tenancy. Even if a significant discount cannot be obtained to reflect the tenancy's existence, a privately negotiated purchase tends to be far less stressful than an auction or sale on the open market.

There are commercial options for the tenant who has no successor including the timing of packing up and surrendering the tenancy. Many landlords can be persuaded to pay in order to obtain vacant possession because they expect to re-let on a FBT at a higher rent than under an AHA tenancy or to sell with vacant possession at a much higher price than could be achievable if the land was tenanted. If the landlord will not negotiate for surrender of the tenancy it may be possible for the tenant to enter into a contract farming arrangement, which will provide an income in excess of the rent payable.

Where a tenancy is surrendered there may be a base cost for Capital Gains Tax purposes by reference to the value of the tenancy in 1982 or when acquired, if later. This can easily be overlooked resulting in the overpayment of capital gains tax or the failure to establish CGT losses for future relief.

AHA tenancies, whether we love them or loathe them, the agricultural accountant must understand them!

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