Adding Value, Pensions and ForEx rates

Welcome to our latest Whiting & Partners Farming Group newsletter.

'Adding value' is a phrase often used when looking at how businesses can prosper. In this issue we mull over how we enumerate value. Other topics include advice on pensions, auto enrolment and foreign currency transactions.

I'm confident that you will find something among the content that will stimulate the brain cells.

Enveloped Dwellings

Deep in the detail of Chancellor Osborne's 2014 budget were changes to the limits applicable to UK residential properties held by limited companies, partnerships with a corporate partner or collective investment vehicles where the annual tax on 'enveloped dwellings' applies.

Farmers could easily fall foul of these changes. We advise an early conversation with financial advisers particularly where a farmhouse, cottage or other dwelling is held by a limited company. Although there are exclusions, especially where the property is commercially let or for dwellings occupied by farmworkers, owners should review their positions as quickly as possible. Failure or delay could mean a tax bill of up to £7,000 per year as well as an unexpected Capital Gains Tax charge when the property is sold.

Initially the tax applied to properties worth in excess of £2m. From April 2015 the limit drops to £1m and in April 2016 to £500k.

In addition to the annual charge and the CGT payable on a sale, a 15% Stamp Duty Land Tax Charge will apply on the purchase of a property caught up in the changes.

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WHITING & PARTNERS
Chartered Accountants & Business Advisers

Accounting for your Success

Borrowing may be easy but be careful

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There has rarely been an easier time for farmers to borrow with interest rates low and banks eager to do business. The agricultural sector continues to be courted by specialist agricultural bank managers. The High Street's big four still lead but agriculture is attracting some of the alternative providers of business finance.

Santander, historically a building society, is increasingly active in this marketplace. Clydesdale is reassessing its position and the Co-Op Bank is attracting the wrong headlines.

Other sources of finance open to the farmer include the Agricultural Mortgage Corporation (AMC). This is part of Lloyds but is happy to do business with customers of any bank. AgriBank, is a new bank, which has connections with Eastern Counties Finance.

Farming's track record with the banks is enviable. There have been few instances of bankruptcies or liquidations where losses have been suffered. No doubt it is this record which encourages the banks to look towards the industry when they are under pressure to lend to businesses.

Farmers are not entirely immune from the normal routine for securing agreed proposals. They must demonstrate both affordability and adequate security and their bank manager must be able to convince his credit team. The singular nature of the industry has encouraged the banking sector to create specialist agricultural banking positions and very few of you will find yourselves dealing with an individual who does not claim dedicated agricultural expertise. Inevitably personalities play a part and many difficulties experienced tend to arise through clashes in personal chemistry.

The European Investment Bank and the Government's Funding for Business programme's discounting of interest rates have also eased access to funds available to agriculture. Even without these incentives, very competitive margins can be negotiated with adequate security. The required loan to security ratio for AMC tends to be up to 60%. Higher ratios may be negotiated elsewhere. Despite the tighter lending multiple borrowers often favour AMC because of their 'lend-and-leave' policy. Once a loan is made they tend to not revisit if land values drop.

Although it is an easier time for a farmer to borrow the shrewd businessmen among you will remember that rates can rise and that land values, after a period of sustained growth, can fall.

Propositions should be carefully assessed!

Auto Enrolment Staging

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We are nearly half-way through one of the biggest changes in workplace pension provision in this country's history. Every employer must now help their employees to save for their retirement. Through 'Automatic Enrolment', AE, legislation all employers must introduce a workplace pension scheme to meet strict rules and standards.

Launched in October 2012, the scheme requires employers to 'automatically enrol' all eligible employees in suitable and compliant workplace pension schemes to enhance their overall retirement income and reduce reliance on state benefits.

Employers are faced with several challenges. Those with a pension scheme in place will have to thoroughly audit their arrangements to ensure that AE rules are met. For those without a current pension scheme, it may be easier to ensure any new plan is compliant.

The introduction of AE has been rolled out to the largest employers and those employing 50 - 250 workers are approaching their 'staging date'– the point at which everything needs to be in place, ready to receive the relevant employees.

Ultimately, the roll-out will capture all employers, dependent upon employee numbers, by 2018.

So you should, if you have not already done so, establish the specific date affecting your business and build in time to prepare – ideally 9-12 months before staging.

AE is not just about pensions. Compliance with your obligations entails a continual assessment of your workforce. In itself, this creates considerable challenges for agriculture sector employers who may have weekly payrolls with variable pay, a high turnover of workers perhaps on seasonal contracts as well as a significant number of foreign workers.

Computer software known as 'middleware' has a number of features beneficial for both employer and employee. The most critical of these is access to information ensuring that the employer can demonstrate compliance, at any given time, with the obligations laid down by the Pensions Regulator.

Our proposition provides a full end-to-end service, from initial advice to implementation & maintenance, which will fully integrate with our in-house payroll bureau or work with your current arrangements.

Accounting for Divorce!

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Marriage breakdown and divorce are more commonly linked to solicitors than accountants but all too often, they impact significantly on businesses where husband-and-wife have started with comparatively little and subsequently accumulated lots.

Seemingly, the courts' starting point for division on divorce appears to be an equal splitting of assets. This is an uncomfortable reality for anyone to face, let alone a farmer who has invested almost everything into operational land.

As an accountant some of the pain and acrimony arising on clients' divorce is experienced at a distance. Often the obvious conflict of interest requires the accountant's involvement to be factual rather than subjective. On occasions, from this neutral position, the use of professionals fighting on behalf of each of a divorcing couple whilst seen as a 'necessary step' can actually be detrimental to the financial interests of both parties, if taken to extremes.

In farming cases where assets have been inherited from previous generations rather than earned by a divorcing 'recently married' couple settlements can be reached which recognise this and are significantly less favourable to one party than the other. Where there is extreme wealth a settlement may be by reference to the needs of one party and again be far less than one half of the combined wealth. But in many cases any divergence from an equal split is relatively small.

Perhaps the most favourable settlements, from a business perspective, come about where children are actively involved in the farm and both spouses wish to see the next generation succeed to a healthy farming business. A shared objective like this can reduce the levels of both financial and emotional conflict.

If a realistic settlement can be negotiated then both costs and unpleasantness can be limited. Where unrealistic expectations are fostered the expense of the full legal process can be truly frightening.

Experiences like this make the concept of pre-nuptial agreements attractive. Those marrying may find the idea both offensive and out-of-step, parents perhaps more aware of the risks, may favour a 'pre-nup'. This may be quite reasonable when assets likely to be divided on a subsequent divorce are acknowledged to have been gained through parental toil.

Perhaps, if a happy marriage really cannot be sustained, an unhappy divorce should be avoided.

Valuing Shares – Art not Science

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There will be numerous occasions when it is necessary to value shares in a farming company. The drivers are varied - tax implications of a proposed transfer of shares, the death of a shareholder requiring a valuation for probate purposes or the valuation of assets around a marriage breakdown.

Farming companies possess specific characteristics taking them outside the 'norm' in valuing other trading companies. Typically a farming company will have a strong asset base in terms of freehold and leasehold land values against low earnings in comparison to those asset values. The usual approach to value trading companies may be to capitalise earnings on a price/earnings basis but this often fails to give a sensible result for a farming company.

An 'assets based' approach is more relevant and represents the starting point laid down by HM Revenue & Customs.

Up-to-date property valuations will be required. These include freehold land and buildings and the company's interest in any tenancies, particularly those held under the 1986 Agricultural Holdings Act. Other assets like Single Farm Payment entitlements must be included. Probate requires consistency with the valuation of land held personally by the shareholder and the availability of Agricultural and Business Property reliefs.

Other assets will normally be valued by reference to the latest available accounts.

Potential corporation tax liability arising if the company's property was sold at current value must be considered as well as the company's Memorandum and Articles together with any Shareholders' Agreement to consider any impact upon the share value.

If a holding of less than 100% is being valued, it will be necessary to discount the full asset value of the company to take account of the specific size of the holding and any rights attached.

Finally, It is important to realise that any valuation of private company shares is something of an art not a science. Often there will be no right or wrong answer but a specialist share valuation expert will approach the exercise in a way that is reasonable, defensible and will stand up to scrutiny if challenged by the taxman.

Stock Valuation

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As accountants and business advisers we have been hit by the biggest change to UK accounting standards in a generation.

Financial Reporting Standard 102 (FRS 102), means that all existing UK accounting standards are thrown out with the bathwater this year. It applies to all types of entity, not just companies.

For the first time in the history of UK accounting standards there is embodied within FRS 102 a section devoted specifically to agriculture. This simply underlines the importance of agriculture to the UK economy.

Historically stock has always been valued at cost or sales value, if this is lower than cost. From January 1, 2015, you will be able to choose between either continuing to use the cost model or to employ a fair value model, effectively 'market price'. The implication of using fair value is that usually stock value will be raised and consequently any business profits will also increase.

The main advantage to using this model will be to strengthen the business balance sheet and improve your chances of bank lending and ratings with the credit agencies.

There is a downside - an increase in tax liabilities and the likely volatility of those tax liabilities. HMRC will be releasing additional FRS102 guidance in the course of this year.

What a difference a day makes...

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The difference between a €100,000 Single farm Payment, translated at the best and worst exchanges rates on the September 30 since 2005, is precisely £23,160! If we assume an average wheat price of £150/t, that equates to some 150 tonnes of wheat.

How many of you would like to find six extra loads of wheat at the back of your sheds? I suspect many more than those actually acting to protect the value of their SFP through any form of 'hedging'.

Hedging should not be seen as an activity practised only by city traders. It's a mechanism we can all adopt to try to ensure that income derived from our SFP is managed so we have some certainty on the amount we shall receive but also to hopefully, maximise the return.

In my experience not many of our farming clients take any positive action but rely on the rate determined on the September 30 to dictate their income. It is however, markedly different that the same individuals do not commit to sell an entire crop on a specified day for a price unknown at the time they enter into the contract.

What we are really addressing is risk management. Farmers sell their crops in the hope of maximising the average price that they receive. Some may also enter into contracts to secure their price even before the crop is sown. The same risk management can apply to SFP's and in fact any other income derived in a foreign currency. The aim is to select a future rate that one feels is fair, and then to fix it. This gives certainty to the amount that will be received in the future.

These types of arrangements can be put in place through your normal agricultural bank manager but there are also specialist finance providers who can assemble them for you.

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The information in this newsletter is supplied as guidance only, always seek professional advice.

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