So, What Has Changed?

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When Rishi Sunak stood to present his budget on March 3 there was a wide expectation that there would be dramatic changes announced, particularly to the capital tax regime. After his speech we knew that our fears had not materialised. The twin threats to the economy of Brexit and Covid had resulted in an absence of drama. Consequently this newsletter is not about higher rates of capital gains tax or changes to the inheritance tax reliefs. These may however be necessary topics of a future edition.

Instead we consider the announced super allowance for new plant and equipment, the opportunities of the Value Added Tax partial exemption rules and the importance of the correct trading structures for Inheritance Tax Reliefs. There is a warning about the uncertainty of unwritten agreements and consideration of changes to the subsidy regime. Finally, we look at sourcing finance amid rumours of declining enthusiasm towards agriculture from the clearing banks.

As ever, the future appears uncertain. We can but hope that the need for finance will be driven by the desire to cash in on the new Capital Allowance rules rather than resulting from the changes in governmental support to agriculture.

James Cater

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Succession Planning - Think Reliefs

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As the Spring Budget failed to produce any anticipated inheritance tax changes, are they likely to be contained in an Autumn Budget 2021 – if there is one?

Over the last 6 months discussions with our clients have been peppered with issues around business structure and succession. Massive change has been driven by Brexit and, with impending changes to subsidies, many of our clients have taken the opportunity to view their overall picture.

Inheritance Tax can be a crucial part of this landscape for future planning.

Where conditions apply, there should be a successful claim for Agricultural Property Relief (APR) on the farm and qualifying assets at either 100% or 50% but restricted to the agricultural value of each asset.

Taking into account the limitations to agricultural value, the focus then falls on any development or 'hope value' and to assets that do not qualify as agricultural property.

At this stage, consideration should be given to Business Property Relief (BPR) as it applies to the full value of an asset rather than being limited to agricultural value.

As with APR, conditions will need to be met, because the Relief applies to qualifying business assets which have been owned and used in a relevant business for the two years prior to a transfer, whether by death or gift.

Interaction of the reliefs can often be beneficial. For example:

Land under an Agricultural Holdings Act (AHA) tenancy which began prior to September 1995 will qualify for APR at a rate of only 50%, whereas land under tenancies starting after September 1, 1995, including all Farm Business Tenancies, will attract APR at a rate of 100%.

However, because of the tenancy there will be no relief under BPR, therefore any development or 'hope value' may become chargeable to IHT. In contrast, if the land was subject to a grazing licence or a contract or share farming agreement then there is a possibility BPR may come into play.

The business structure can also be crucial to eligibility for relief; a limited company occupying property owned by the shareholder will not attract BPR if the shareholder does not control the company.

A claim for BPR on shares in a company which qualifies as a trading company will cover the full value, representing the share of all assets held within the company. Similar rules apply where the business is operated through a trading partnership.

Be careful to consider the clauses that have been included within the partnership or shareholders agreements; if there are binding contracts in place which stipulate that shares or a partnership interest will be sold on death, then HM Revenue & Customs can and will deny relief. Cross-options avoid this.

The structure of a business and agreements as to the occupation of land are critical when undertaking succession planning and considering Inheritance Tax Reliefs. When you ask the question 'I should qualify, shouldn't I?' ensure the response is - yes!

130% Super Deduction

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The Spring budget included a new 130% Super deduction relief as part of the Capital Allowances legislation although this is open only to companies. It would seem therefore to be a sweetener in the wake of the announcement, also in the budget, that Corporation Tax is set to increase from 19% to 25% over the coming years. This, of course, will be governed by profit levels.

This means that where qualifying new plant and machinery are purchased for trading purposes between April 1, 2021 and March 31, 2023, the tax deduction is available on 130% of the costs. This is an additional 30% relief compared to the current rate available when claiming the Annual Investment Allowance (AIA), or an additional 112% where only writing down allowances are available.

Finally, the Budget also included the introduction of a 50% first year allowance for special rate assets. This is not quite as exciting as the Super deduction as in most cases, it will still be more beneficial to claim AIA for immediate 100% relief on these assets.

No doubt welcomed by the farming and wider associated communities, the Super deduction relief is actually quite complicated. If you need help, then our addresses and contact details are on Page 4.

Don't Agree to Disagree

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Life often moves faster than we record it. Agreements can be made without documentation. The payment of rent and occupation of land is indicative of a tenancy but there may not be a legal document to support this. Without one, any disagreement between landlord and tenant may only be resolved by applying the law, potentially leading to a court appearance.

Areas of disagreement may include security of tenure, rights to assign, tenant's improvements and rent review. For arrangements starting after Farm Business Tenancies were introduced in 1995 matters should be more straight-forward but there remain many situations which predate the FBT legislation.

As well as the scope for disagreement between landlord and tenant, tenancies have consequences for valuation and for Inheritance Tax (IHT) reliefs. Whilst ignorance may be bliss, ignorance of the legal position and its effect on available IHT reliefs may be expensive. An understanding of the terms of the relationship between landlord and tenant can be helpful for both parties.

Another area where written agreements are often missing is in relation to partnerships. If partners differ on the terms of a verbal agreement then their only recourse is to law.

The Partnership Act may provide a starting point but the involvement of solicitors and ultimately the courts can be hugely expensive. A common problem has been deciding what is or is not partnership property and who enjoys the profits arising on that property, whether these result from sale or from revaluation when a partner leaves the partnership.

It should be noted that a badly drafted agreement may not avoid problems. For sleepless nights google 'Ham v Ham'. You can then use the night time to read your partnership agreement – it must be a written agreement for you to have got this far – and to determine whether it provides what you had understood to be the terms of your partnership. If it does not you have opportunity to get it changed.

Remember, a partnership agreement is only really needed when partners do not agree, and by then it is too late to put one in place.

Subsidies Update

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From the beginning of April this year, the Basic Payment Scheme (BPS), surrendered to the new Environmental Land Management Scheme (ELMS).

The idea behind the change is to de-link the land from the payments and to provide claimants financial reward for a) being sustainable and b) making a positive environmental impact.

Reductions in BPS start this year running through to 2027. Whilst initial reductions are small at between 5% - 25%, with those receiving higher receipts being hit hardest in percentage terms, every BPS receipt will fall to at least half of its 2020 figure by 2024.

Money 'saved' from reductions in BPS will be re-directed into the new ELM scheme along with other temporary schemes designed to fill the funding gap. One example of this is the New Farming Investment Fund set up by DEFRA. Much like the new ELM scheme, this is designed to urge farmers towards more efficient and productive processes and equipment.

The new ELM scheme itself is split into three tiers:

- **Sustainable Farming Incentive (SFI)**
- **Local Nature Recovery**
- **Landscape Recovery**

They pretty much do what they say on the tin, or at least that's the idea. The SFI is aimed at single farm claims, the Local Nature Recovery will reward groups of farms working together on achieving local environmental benefits and the Landscape Recovery will reward groups for helping to achieve larger scale projects such as woodland planting and peatland restoration.

All three schemes are running pilots in 2021 and 2022, with SFI opening up to current BPS claimants in mid-2022, before expanding in 2024 to those not currently entitled to BPS, like smallholdings and pig/poultry farmers.

Whilst many will understandably be concerned about the BPS reduction, this fundamental change in environmental subsidies provides good opportunities for those who are willing, to secure a better and more sustainable future for our countryside.

Farm Borrowing Homework

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Farmers face difficult times. Farm subsidies are changing, Brexit is having an effect, add to those a generally changing and challenging environment, all of which raise the possibility of further borrowing requirements.

It may be necessary to increase borrowing or to re-finance current arrangements. If so, an approach may be for either current or new lenders.

Although there is often decent security available to pledge against borrowing, this is not on its own sufficient for the lenders, particularly with farming enterprise returns being scrutinised.

Gone are the days of the bank manager turning up and approving a loan or overdraft before getting his clean wellies dirty. It is not just the lender standing in front of you, it's the credit team back at head office that will often also need convincing.

There are several key areas on which lenders focus when considering a request.

Security - What security is on offer? In the farming sector this is less likely to be an issue as most farmers have valuable land or property to pledge against the borrowing. Lenders will carry out a 'Loans to Value' (LTV) calculation and lend up to the LTV against which they are prepared to lend. They vary on the LTV calculation which can differ anywhere between 50% to 75%.

Serviceability - Can you afford it? Lenders will consider if the new debt is affordable alongside any other lending including leases or HP agreements and any other existing borrowing that is not being repaid. Last accounts will be analysed and into the equation will be added drawings in the case of a sole trader or partnership, or dividends in the case of a company. The outcome will be what is known as a Debt Service Ratio (DSR). Most lenders require a DSR of around 1.5 times. If this falls short, any borrowing request is likely to fail.

The calculation of the DSR is based on historical accounts, although if you can demonstrate that any new borrowing for a project might improve this ratio, then it is worth doing.

Stress Test - What happens if interest rates go up? Unless you are looking at fixed rate borrowing then lenders may want to stress test the borrowings. The big question – can you afford to borrow if interest rates increase?

Succession - Who will take on the debt when you hand it over? A lot of farm borrowing is longer term, sometimes up to 30 years. Lenders like to see that succession has been considered. Depending on the age of the business owners, they may want to see if the next generations are already involved in the enterprise or if they are being prepared for succession. That way, the bank can see that the next generations who may be responsible for repaying the debt, are involved and are party to the borrowing or re-financing plans.

Projections and Forecasts - Finally, the numbers. Profit and cash flow projections may be required to support that you are going to be both profitable and generate enough cash to service the debt.

Our advice - before any lending request is made, do your homework and have the answers and information available to these five key areas.

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