



Agricultural Spotlight

This Agricultural Spotlight aims to enhance awareness of current issues and potential tax planning opportunities for all those involved within the agricultural sector.

September 2011

Welcome to the second issue of our Agricultural newsletter which is designed to enhance the awareness of recent developments and tax planning opportunities for all those involved within the agricultural sector.

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HAVE YOU CONSIDERED YOUR BUSINESS STRUCTURE?

When did you last consider the business structure that you operate under? It may have been set up by previous generations and the farming activities may have changed significantly since then.

The improvement in farm profitability over recent years has meant that businesses have looked increasingly hard at the tax liabilities that result from these increased profits and the ways in which these tax liabilities can be minimised.

In last quarter's article we looked at the forthcoming reduction in Annual Investment Allowances, and the significant impact that this would have on farming investment. It was recommended that capital forecasting for expenditure up to March 2012 should be urgently addressed.

Given the current favourable cereal prices and comparable yields from this year's harvest it is now becoming ever more important that your choice of business structure is the correct one.

The business structure will have a major impact on the amount of tax you pay. This business structure may have developed over the generations, with family members having different ideas on how best to utilise the farms assets. What may have operated well

for a number of years may now need to be reviewed to ensure it is still appropriate. For example have any inheritance tax allowances been compromised with a change of farming activities or from the change in use of farm buildings?

It is useful in any planning exercise to complete a farm usage and property usage audit. This sets out the activities that are undertaken on the farm and the uses that each property is put to. This can then be easily updated when changes take place.

This is a useful exercise to provide information upon which to give consideration to the business structure.



The decision to restructure should not be made without a full planning exercise being undertaken and should be centred on the overall long and short term objectives of the family. It is often difficult to get the whole family together to make these decisions, but talking now will reduce possible disputes later.

Where there are different businesses within the current business structure it may well be worth considering separating these activities. For example, a company could be set up to offer the farming business contracting services. This would ensure that profits would be taxed at lower rates.

In order to provide more flexibility, the contracting company could become a partner in the farming enterprise.

There are other significant considerations which need to be taken into account and these include VAT, Inheritance Tax and Stamp Duty Land Tax.

DO YOUR BUSINESS RECORDS MEET THE NEW H.M. REVENUE AND CUSTOMS CRITERIA?

Businesses are required to keep records which allow them to prepare accurate business accounts and tax returns.

However H.M. Revenue and Customs (HMRC) believes that many small and medium sized businesses are either not currently meeting this obligation, or could make improvements to their business record-keeping.

HMRC has therefore announced that they will be carrying out checks for small and medium businesses with the aim of improving standards.

Having held a consultation, HMRC has now commenced initial business records checks in eight locations. During this initial phase, HMRC has said it will not be charging penalties for record-keeping failures.

However, further checks have been running from July 2011 onwards and penalties will be levied where it is found that a business has failed to keep adequate records.

There is no insistence on a specified format, but HMRC will be looking to see records of all business income and outgoings recorded appropriately for the size and nature of the trade.

We await to see the actual impact of how these checks will operate in practice and the stance that HMRC will take on enquiry.

We are in a good position to discuss our clients' business record keeping requirements. Whitley Stimpson, as a firm, is proactive in suggesting improvements, if required and the implementation of these improvements to their record keeping may assist in avoiding potential penalties.



ARE YOU PAYING YOUR PAYE LATE ?

PAYE late payment penalties have been with us for a year now, but we have not seen their impact yet because of the way they are calculated.

Penalties for late paid PAYE and related liabilities commenced in April 2010, but due to the way that penalties are calculated none will have been levied until now. Even then, it is not clear how the penalty regime will be applied in the period until Real Time Information is implemented.

The new penalties for late payment of payroll taxes are determined by the number of defaults (i.e. late payments) in a tax year. The first default does not attract a penalty if it is the only late payment in the year. However if there are further defaults, the penalty is as follows:

- ▶ When there are 2, 3 or 4 defaults in a tax year the penalty is 1% of the total of the defaults (including the first)
- ▶ When there are 5, 6 or 7 defaults the penalty is 2% of the total of the defaults,
- ▶ When there are 8, 9 or 10 defaults the penalty is 3% of the total amount of the defaults, and
- ▶ For 11 or more defaults the penalty is 4% of the total defaults.

Any amounts that are unpaid more than six months after the penalty date are liable to 5%, and a further penalty of 5% applies after 12 months. Higher penalties are due when the amounts relate to periods of six months or more.

Some businesses will clearly be due to pay a penalty for late payments in the 2010/11 tax year, but it is not until after the last payment was due (19th or 22nd April) that it is possible to determine the number of defaults in a year and therefore the rate of penalty.

We are concerned that these penalties could come out of the woodwork some years down the road. For example if a business has a compliance check and it is found that late payments have been made, there is the possibility a compliance officer could track back through each year identifying the amounts on which penalties are due and collecting a huge penalty in one go.



CONTRACT FARMING AGREEMENTS

Now may well be a good time to revisit those Contract Farming agreements (CFAs). Many landowners may consider that their CFAs are watertight when that will not actually be the case in the eyes of HMRC.

The penalties that HMRC can impose on informal or poorly structured CFAs far outweigh the costs of setting up such agreements properly in the first place or carrying out a regular review of these agreements.

The acid test as to whether these agreements pass HMRC review is that the landowner carries the ultimate risk. The landowner must be actively involved and this may include at least quarterly meetings with records kept, forward planning and budgets, and a direct say in how the farming operation is managed.

Potential taxation risks to the landowner may include loss of IHT reliefs, including agricultural property and business property reliefs, and re-coding and backdating of unpaid income tax plus interest that, depending on the length that an informal CFA has been running, could amount to a substantial sum. In addition, under a revised CAP, it is increasingly likely that only active farmers will qualify for subsidies, with that definition applying across the board.

HMRC are becoming aggressive in attacking these favourable tax reliefs and everything possible must be done to protect these.



EASEMENT ESTABLISHED BY USE LIMITED TO ACTUAL USE

When land is used over a long period of time by persons other than the owner of the land, they may acquire an easement (a legal right to use the land). Easements can also be acquired by express agreement, in which case the rights of use over the land will depend on the agreement.

In cases where an easement comes into existence as a result of use, the rights of use are less clear. However, in a recent case, a dispute arose over the right of way over a private road which had been used by a farmer for more than 20 years. The County Court held that the use was effectively unlimited as far as his agricultural purposes were concerned. Since this included driving stock along the road, the owners of adjacent properties opposed it and appealed the decision.

The critical point was that although the use of the road by the farmer for pedestrian and vehicular access had been shown to have been permitted for more than 20 years – thus establishing the general right of easement – the use for driving stock had not. Since this was more burdensome on the owners of the adjacent properties than pedestrian or vehicular access, the High Court ruled that the right of easement did not include the right to drive stock along the road.

Allowing other people free use of your land for a long period can mean that you lose the right to prevent such use. If you have concerns about others using your land, you should take legal advice to take the appropriate steps.

INHERITANCE TAX - AGRICULTURAL PROPERTY

An important case was recently put before the First-tier Tax Tribunal. The case of *Golding –v- HMRC* regarded an appeal against the determination that the *Golding* residence was not Agricultural Property within the context of the Inheritance Tax Act.

Mr *Golding* had for more than 65 years farmed a smallholding of just over 16 acres near Lichfield, in the earlier years intensively, but latterly at a much lower level of activity, a lot of the produce being for his own consumption, though he had continued to make modest profits each year.

On his death Agricultural Property Relief (APR) was claimed on the farm to reduce the liability to Inheritance Tax on his estate. HMRC, whilst accepting the claim in respect of the land and buildings, denied it in respect of the farmhouse, which was a small 3 bedroom house in a poor state of repair. HMRC argued that the farmhouse was not

character appropriate for APR purposes and issued a Notice of Determination that it did not qualify as agricultural property for the purposes of APR.

There was a preliminary issue at the Tribunal Hearing since, whilst HMRC had in open correspondence agreed that the only basis for their refusal of their relief was that the farmhouse was not character appropriate, on the eve of the Hearing they sought to argue a second ground, namely that the house itself did not qualify as a farmhouse for APR in any event. The Tribunal did not allow HMRC to take this point so the case proceeded on the character appropriate point only.

The Tribunal found in favour of the executors and made it clear that they would have won on the farmhouse point too had that been considered.

Had HMRC Revenue been successful, it would have had a major impact in narrowing the definition of character appropriate, since the thrust of their argument was that there was in essence a single objective test based upon the financial viability of the farming operation to sustain the house, one factor in which was their assertion that APR would only be available if the house would continue after death to be a working farmhouse.

The important issues arising from the case are:

1. The assertion that the Antrobus principles for establishing character appropriateness still hold good and that the test is one of fact and degree taking into account a number of different physical and other factors, and is not based simply on financial viability.

2. The acknowledgement that as farmers grow older and their work rate drops, reduced business turnover and profitability do not of themselves mean that the farmhouse will cease to qualify for APR.

3. The recognition that the lifestyle aspirations and expectations of the working farmer are very different from others and that the character appropriate test needs to be viewed through the eyes, and with an appreciation of, the working farmer's approach to life.

A victory for HMRC would have meant that the character appropriate test would have been subjected to the vagaries of farming profitability and would probably have meant that few farmhouses in the country would qualify for APR in bad years. The case is very important in confirming that Antrobus is still very much alive.

The Revenue have until mid-July to lodge an appeal if they wish to challenge the decision.

RENEWABLE PROJECTS - WATCH THE VAT

Renewable projects are currently in the headlines and clearly these can benefit the sustainability of the environment.

Whilst there can be good immediate opportunities to reduce farmers' income tax bills, there may be issues with regards to VAT.

If an individual owner undertakes a renewable project on his own private house, the feed-in-tariff (FIT) income should be tax free as long as the system intends that the amount of electricity produced will not significantly exceed the amount of electricity consumed on the premises. However the individual owner is not able to register for VAT and make a VAT reclaim on the initial purchase of the asset.



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Where renewable projects are wholly business (income is taxable in full) then VAT is recoverable and payable as normal. Generation tariff income is outside the scope of VAT, whilst the feed in tariffs are charged at 5%.

Farmhouses will be treated differently and may well be a mixed business and private use. The farmhouse will be treated as a dwelling (although partly used in the farming business) and VAT initially charged at 5% on the assets acquired for the renewable project. However the VAT reclaim may be restricted and it may only be possible to claim a portion of the input VAT and disclaim a proportion in accordance with the NFU agreement or specific written agreements with HMRC.

It is likely that the income will be taxable in full on such Enterprises. However this will depend on the circumstances of the business enterprise.

This new source of income may also affect any partial exemption calculations that operate on the farming enterprise and care needs to be taken as the VAT treatment does not always follow the tax treatment.

FURTHER INFORMATION

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