

Rural Business Services

update

The nature of farming: **The tax issues**



We are often asked "What is the most tax-efficient way of farming my land?" Normally this comes down to whether it is better to rent the land out under an FBT or enter into some other form of farming arrangement.

As with many tax questions the answer is "It depends!".

This is not to be evasive because there is no general rule of thumb, however, there are some guiding principles that can be followed.

Most tax benefits from owning land will be generated if the land is farmed by the landowner, rather than by a tenant under a farm business tenancy. The key ones being the potential for

• Inheritance tax

- agricultural property relief on the farmhouse
- business property relief where the value of land and buildings exceeds their agricultural value
- business property relief on let properties

• Capital gains tax

- rollover relief
- entrepreneurs' relief

There is more than one way in which the land can be farmed for the landowner to be seen as the farmer and these include genuine contract farming and share farming arrangements. Whilst these types of agreement are common, care must be exercised in their use because any hint of there being a guaranteed return to the landowner could lead to HM Revenue & Customs (HMRC) recategorising the income as a rental equivalent, resulting in the loss of valuable reliefs.

It is interesting to read what HMRC themselves have to say in their manuals.

In relation to contract farming, HMRC say that the landowner is 'likely' to be the occupier of the land and therefore farming, whilst with share farming the same manual refers to 'genuine' share farming agreements as ensuring that the landowner can still enjoy the inheritance tax and capital gains tax advantages of being treated as a farmer.

Whilst this sounds positive, the wording clearly indicates that HMRC may not automatically accept the landowner's farming status.

The importance of tax reliefs will vary from family to family, but what is common is the need to consider matters in the round and obtain specialist advice tailored to your particular circumstances. This way you can ensure that, wherever appropriate, the manner in which the land is farmed is on the right side of the 'tax line'. Failure to do so could result in an unexpected and significant tax bill.

Stephen Barratt on +44 (0)1635 35255 or sbarratt@jamescowper.co.uk



The VAT cost of barn conversions

You have a barn that you want to convert into a house. How much will it cost you in terms of VAT: what rates will apply and how much of it can you recover?

If you intend to live in the house and do the conversion yourself, then VAT can be recovered under the D-I-Y builders scheme with any bought in services being charged at the reduced or zero rate as described above.

Terry Dockley on +44 (0)1635 35255 or tdockley@jamescowper.co.uk

The answers turn on three main issues:

- 1 Whether there will be any planning restriction on the separate occupation or disposal of the house once the conversion is completed;**
- 2 How the house will be used;**
and
- 3 Whether the barn is listed.**

If there is a planning restriction in place, then all the conversion works will be standard-rated. There may be scope to recover all or part of the VAT incurred if the house is to be used for holiday lets by a VAT-registered person or for the purposes of a farming business by a sole trader or partner.

Otherwise, the VAT charged on the conversion will be at the reduced rate (currently 5%), provided the barn has not been used as a dwelling for at least ten years. If the barn is listed, then any alterations in the course of the conversion that require listed buildings consent will be at the zero rate. The standard rate will always apply to professional fees, unless the works are carried out on a design and build basis.



Inheritance Tax: Business Property Relief Update

I realise that some may think that this has been 'done to death' (no pun intended!) but it is worth recording that there has been a helpful case recently before the new First Tier Tribunal involving the estate of the Fourth Earl of Balfour deceased.

Whittingehame Estate, which extends to about 771.85 hectares (1907.25 acres), is an agricultural estate in East Lothian. Before Lord Balfour's death there were two in-hand farms (Whittingehame Mains Farm and Eastfield Farm), three let farms (on secure agricultural tenancies), some 26 let houses and cottages (mainly let on short assured tenancies), and two sets of business premises. The in-hand farms at Whittingehame Mains and Eastfield extend to about 269 hectares. The three let farms at Papple, Overfield and Luggate extend to about 371 hectares. There are also policy parks (let on a seasonal basis) and valuable sporting rights attached to the Estate.

What is noteworthy about this case is two-fold. The first is that the claim to relief was enhanced by the extent to which the various parts of the property and the activities carried on from them dovetailed and interlaced with one another, and the second is that the decision endorses the helpful approach adopted in the landmark 'Farmer' case.

It is understood that this decision is to be appealed, but whilst a successful appeal might limit the widened scope of relief in this instance, it is unlikely to undermine the result of the earlier Farmer case.

What the earlier Farmer case clarified was that properties used in a letting business (not normally attracting Inheritance Tax Business Property Relief - 'BPR') can qualify if that activity operates alongside a trading activity, so long as taking the two activities together one can conclude that the overall picture is one of a business activity. This assumes that the various parts of the property are in the

right ownership and that the land used for farming qualifies for BPR (see 'The nature of farming: The tax issues').

A number of factors were taken into consideration in arriving at the conclusion in that case and these provide a useful framework within which the potential for business property relief can be assessed.

Even if the necessary conditions are met, it is important to appreciate that, if not structured correctly, the relief may be at 50% only, as opposed to the optimum rate of 100%. Maximum relief normally requires the property to be shown on the balance sheet.

Given the extent to which many landowners have diversified their activities, it is essential that they review their property interests to ensure that the chances of relief are maximised and that this at the higher rate of 100%.

Stephen Barratt on +44 (0)1635 35255 or sbarratt@jamescowper.co.uk



Dairy Farmers of Britain: Tax Update

The recent events regarding the collapse of the co-operative have

left many concerns for its members over the tax position of any money lost.

For those producers who did not receive milk cheques for milk delivered, tax relief can be claimed as a bad debt and so these producers will receive income tax relief on this irrecoverable amount.

The position could be less favourable for members' loans and investment accounts. The members' loans and capital accounts are likely to be viewed as an investment by HMRC and are treated as loans to DFB. The tax relief on the write off of these loans, under the 'loans to traders' rules, will depend upon the type of trading entity incurring the loss.

For sole traders and partnerships these amounts are likely to be treated as a capital loss which cannot be used to reduce income, only against future capital gains. For companies, under the company tax rules, this loss will be allowable against income.

The position is more complex where the farmer holds shares or the loan has been converted into shares but some measure of capital loss relief (against capital gains) will still be available.

We are also aware that discussions are being held with HMRC, including the possibility of treating a member's loan to DFB as an integral part of the trading activity as a milk producer, providing an outlet for their milk and access to production and marketing of value-added dairy products. If successful, this could generate some level of income tax relief, but the outcome of these discussions is uncertain and is unlikely to be known for some time.

We are monitoring the progress of these and other discussions for our clients and will comment further once the position has been clarified.

Jane Goold on +44 (0) 1635 35255 or jgoold@jamescowper.co.uk



JAMES COWPER PRIVATE CLIENT

Whilst this is a specialist rural business publication, at James Cowper we recognise that any professional advice should be comprehensive and especially that all rural business advice should be delivered in the context of our clients' overall family and financial circumstances.

Within our practice we have expertise in all areas of private taxation and can provide



Ian Miles
Partner, Henley
imiles@jamescowper.co.uk



Mark Herson
Director, Oxford
mherson@jamescowper.co.uk



Stephen Barratt
Director, Newbury
sbarratt@jamescowper.co.uk



Louise Wickens
Senior Manager, Reading
lwickens@jamescowper.co.uk

advice and support in areas such as trust taxation and tax-efficient will and investment structuring, and we regularly work with legal and financial advisers in achieving the best result for our clients and their families.

If you would like to discuss any aspect of your personal taxation affairs, do not hesitate to call your normal contact or another member of the private client team, whose details are listed below:

MANY HAPPY RETURNS!

This year sees the centenary of the Newbury & District Agricultural Society, a landmark well worth celebrating in these times of urbanisation and disconnect between food producers and the consumer.

The first show was held at Enborne Gate Farm, Newbury, and from those modest beginnings the show has grown to be one of the country's leading agricultural shows. The significance of the show and its history are evident as one reads the archives and tracks the long historical association of many local farming families and businesses such as Dreweatt Neate with the show.

As rural business specialists, James Cowper are also proud to have been associated with and supported the show for so many years, and we look forward to continuing to be do so as the society embarks on its next hundred years.

Planning: Agricultural Occupancy Conditions

Stephen Rutledge, Partner Of Fisher German Looks At Agricultural Occupancy Conditions

The diversification of farm businesses and estates and the reduction of labour, has meant that more cottages and farm houses have become available to either let or sell away from the core property. However, many of the dwellings are subject to Agricultural Occupancy Conditions (AOC) limiting their occupancy to current or former agricultural workers. Typically, this limits the market and the appeal of the property and a discount on value of up to 40% is not uncommon, particularly in a weak market. Owners of property subject to such conditions should consider whether there is a possibility of removing or negating their effect.

As well as increasing value, the removal of an AOC gives greater flexibility in the occupancy, management and disposal of a property. An AOC can be removed in a number of ways. For example, a property can be marketed for sale, with the objective of demonstrating that there is no demand for such a property with an AOC. However, this can take a substantial period of time and incur marketing expenses.

An alternative route, depending on the circumstances, is to apply for a Certificate of Lawfulness, which confirms that the Council is effectively barred from enforcing the condition. The decision-making process in determining a Certificate of Lawfulness is quasi judicial in nature, meaning that the onus of proof is with the applicant and a decision is made based on fact – often this is a less 'political' process! Given that an exception to planning policy will have been made for the permission to have been granted in the first place, local

authorities can be reluctant to lift planning conditions, although they can be and have been removed where circumstances have significantly changed.

It is important that a thorough investigation is undertaken in order to put together the best case possible for the removal of an AOC. If the certificate is refused, the chances of success on appeal are generally low as an Inspector is more technically demanding when considering an appeal. In such a complex area of professional planning advice should be sought as early as possible.

Fisher German handle a wide range of planning matters – contact Stephen Rutledge 01295 226292 stephen.rutledge@fishergerman.co.uk



Arable farmers - potential one off tax saving



The tax cases of Mars and William Grant and Sons Distillers Ltd have given many arable farmers an opportunity to save considerable amounts of tax.

Closing stock and tillages include an element of depreciation and in a normal tax computation, this depreciation is added back to profits twice, once in closing stock and again when depreciation is added back in the tax computation, thereby increasing taxable trading profits.

An adjustment needs to be made to the depreciation element included in closing stock, so that it is only added back once in arriving at taxable profits. HMRC have stated that this adjustment is mandatory for

all businesses regardless of size. In the first year this adjustment is likely to generate a tax saving, as taxable profits will be lowered.

The reduction in taxable profits will depend on several factors, such as the accounting year end, the percentage of crops still in store, level of tillages, and the type and level of machinery used for arable operations. In subsequent years, especially where stock levels are consistent, the adjustment will be to both the opening and closing stock figures, so there may be no further significant tax savings, but this should not overshadow the potential benefit to be gained in year one.

Failure to submit your returns on this basis, could mean you missing out, as well as not complying with HMRC requirements.

Anne-Marie Cocker on +44 (0)1635 35255 or acocker@jamescowper.co.uk

Don't miss out on Tax Credits



Nine out of ten families in Britain are entitled to claim tax credits, and they don't need children to qualify! This is because of the existence of the Working Family Tax Credit, which can

include a childcare cost element, as well as the Child Tax Credit.

Government statistics put the average farm profits in 2007/8 at just under £40,000 but as we know profits vary considerably from year to year and this total farm profit is very often shared by more than one household. This means that many farming families are eligible to claim Tax Credits.

Key facts to remember include:

- Child Tax Credits can be claimed where family income is up to £58,170, though Working Family Tax Credit is phased out at a lower level.
- Entitlements depend on individual circumstances but for illustration purposes a husband and wife with three children might be entitled to the following awards at differing joint income levels:

- Profits of £30,000 to £50,000 - Tax Credits of £545
- Profits of £25,000 - Tax Credits of over £5,000
- Profits of £10,000 - Tax Credits of over £10,000
- Profits of £5,000 - Tax Credits of over £11,000
- Farm profits vary from year to year for many reasons but farm tax profits are likely to fluctuate even more in the future, following the introduction of 100% capital allowance for machinery purchases of up to £50,000. One off events such as the failure of DfOB could also have a significant impact on profits.
- HMRC ignores year on year profit increases of up to £25,000 when calculating the entitlements for the year which can be very beneficial when profits fluctuate from year to year.
- Tax Credits need to be physically claimed and are not part of the normal tax system.
- Renewals must be made by 31 July each year and there are strict reporting deadlines for changed circumstances.
- As Tax Credit claims can only be backdated by 3 months, farmers must act now to ensure that no more credits are lost than necessary. Protective claims can be made.

Sarah Pearce +44 (0) 118 955 1031 or spearce@jamescowper.co.uk

KEY CONTACTS IN RURAL BUSINESS SERVICES

Adrian Rann

Head of Rural Business Services and Bloodstock

01635 35255

arann@jamescowper.co.uk



Stephen Barratt

Tax Director

01635 35255

sbarratt@jamescowper.co.uk



Fiona Hawkins

Senior Manager

01635 35255

fhawkins@jamescowper.co.uk



Anne Marie Cocker

Manager

01635 35255

acocker@jamescowper.co.uk



Jane Goold

Tax Manager

01635 35255

jgoold@jamescowper.co.uk



Terry Dockley

VAT Director

01635 35255

tdockley@jamescowper.co.uk



James Cowper LLP offices:

North Lea House
66 Northfield End
Henley-on-Thames
Oxfordshire RG9 2BE

Phoenix House
Bartholomew Street
Newbury
Berkshire RG14 5QA

Willow Court
7 West Way
Botley
Oxford OX2 0JB

3 Wesley Gate
Queen's Road
Reading
Berkshire RG1 4AP

Tel: +44 (0)1491 572565
Fax: +44 (0)1491 411705

Tel: +44 (0)1635 35255
Fax: +44 (0)1635 40500

Tel: +44 (0)1865 200500
Fax: +44 (0)1865 200501

Tel: +44 (0)118 959 0261
Fax: +44 (0)118 939 3385

Business Assurance • Business Direction • Business Tax • Corporate Finance • Insolvency • Outsourcing • Private Client Tax

Registered to carry on audit work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales. The information in this newsletter must not be relied on as giving sufficient advice in any specific case.

 **jamescowper**

Accountants & Business Advisers

email: info@jamescowper.co.uk

www.jamescowper.co.uk