Agriculture newsletter

Summer 2016

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Welcome

Welcome to the summer edition of PEM's Agriculture Newsletter. In this edition we have looked at some recent tax changes, revisited some points that we believe are key to our farming clients and commented on what life might look like for farming businesses should we vote to leave the EU.

The changes to Stamp Duty Land Tax (SDLT) on commercial property may save money for some who are looking to buy commercial property but for those spending more than £1.05m this will increase their costs. There may be scope to plan if you are purchasing both residential and commercial property together.

Most farms will have at least some employees and we have summarised some of the changes taking place where benefits are provided to those employees.

The whole landscape of subsidies and trade outside of the UK could change dramatically should we vote to leave the EU. There are no certainties and our article provides some thoughts on what the position might be.

Capital tax reliefs for farming clients remain very generous. These reliefs are being scrutinised and in many cases challenged by HMRC. Our articles on Agricultural Property Relief, Business Property Relief and capital gains tax provide you with a useful update.

There has been some recent clarification from HMRC on the VAT position where permitted developments are carried out and our article explains the correct treatment.

Finally we take a brief look at the new lifetime ISA, this is a useful vehicle for saving funds to purchase your first property or as a long term savings vehicle.

We hope you will find the newsletter of use to you; if you would like to discuss any of the articles in further detail, please contact Nicola Anderson.

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Nicola Anderson - Partner, Private Clients

Stamp Duty Land Tax – Commercial Property

The 2016 Budget brought further changes to Stamp Duty Land Tax (SDLT), this time in relation to commercial property. In December 2014 the residential regime changed from a cliff edge system to a slice arrangement. From 1 April 2016 similar treatment applies to commercial property. The new rates are:

Property lease premium or transfer value	SDLT rate
Up to £150,000	Zero
The next £100,000 (the portion from £150,001 to £250,000)	2%
The remaining amount (the portion above £250,000)	5%

This change will benefit those who buy properties for less than £1,050,000, giving a lower SDLT liability. However, those making purchases for higher values will be subject to a higher charge.

Residential or commercial?

Deciding whether a property is commercial or residential is not always straightforward, indeed HMRC's Stamp Taxes are reviewing the definition of "residential property" for SDLT purposes as there is often a lack of clarity. Currently there are varying definitions across the different taxes, with a range of terminology; given the significant difference in the rates of SDLT for residential and non-residential it is vital that buyers can obtain certainty on their position. In particular it can be difficult to clarify what forms part of the garden or grounds of a residential property. This is clearly defined for capital gains tax purposes but not for SDLT. This may be of particular importance where a farmhouse is being purchased with substantial surrounding land. If part of the purchase can be deemed to be non-residential then the whole transaction will fall into the commercial rates (subject to the 15% SDLT charge for certain higher value properties being purchased by companies). It is well worth investigating whether your purchase could benefit from this treatment. An example below shows how significant savings can be:

Farm being purchased for £2m	SDLT payable
Residential rates*	£213,750
Mixed use rates	£89,500

It is also worth noting that if you are purchasing 6 or more dwellings in one transaction then this can be treated as non-residential and the more beneficial SDLT rates apply, the top rate for non-residential being 5% contrasting with up to 15% for residential.

Job-related accommodation – a major change ahead?

The Government has recently ended a consultation which sought evidence on the provision of accommodation to employees; we are currently awaiting their analysis of the feedback.

The Office for Tax Simplification (OTS) suggested this review even though it had been unable to find figures for the amount of tax-exempt living accommodation provided by employers. The OTS have spoken to representative bodies and used some initial HMRC estimations which indicate that the number of individuals that are potentially affected could be significant.

The current HMRC list of classes of employee who are provided with exempt living accommodation under the "necessary test" includes many agricultural workers who live on farms or agricultural estates.

There is no doubt that the rules regarding tax exempt accommodation are ripe for review and there are inconsistencies in the approaches taken by HMRC. Distinctions in the operation of "customary" accommodation have developed which appear totally arbitrary. For example, all agricultural workers can be provided with exempt accommodation but nurserymen cannot. For example, it seems unfair that lettuce growers using intensive greenhouse production do not qualify for tax exempt accommodation despite the fact that they need to be constantly on hand to tend to humidity and temperature levels.

The outcome of the consultation process should produce more fairness between individuals carrying out comparable roles but it is likely that fewer rather than more agricultural workers will benefit from tax exempt accommodation.

Some good and bad news for the provision of benefits to employees

The current tax year has seen a fundamental overhaul in the taxation of expenses and benefits which affects all UK employers.

Some good news

The P11D dispensation regime ended on 5 April 2016 and any dispensations agreed with HMRC will have no effect from 6 April 2016 onwards. Instead, employers need to apply the new exemption for qualifying paid and reimbursed expenses. This means that employers do not need to report an expense to HMRC if the employee would not be taxed on the sum received because it would meet the ‘wholly, exclusively and necessarily’ rule.

For 2016/17 there should also be a new statutory exemption for trivial benefits which allows employers to ignore most benefits costing £50 or less (except those provided via salary sacrifice), provided as a reward or consisting of vouchers or cash. This should cover items such as Christmas turkeys. Directors of agricultural companies wishing to join in this generosity offered by HMRC should note that there is an annual cap of £300 which applies to tax-free trivial benefits provided to the directors and their families.

The demise of the form P11D?

From 6 April 2016, employers can choose to collect the income tax and National Insurance Contributions (NICs) on most benefits-in-kind via the payroll rather than reporting details to HMRC after the year-end on the form P11D. Payrolling benefits is available for all benefits with the exception of vouchers, credit tokens, interest-free or low-interest loans and employer provided living accommodation. In our experience, most employer-provided agricultural living accommodation will currently be tax exempt job-related accommodation.

This change has been introduced in the form of a voluntary soft launch whereby employers needed to have registered to payroll benefits before 6 April 2016 as HMRC are not yet able process changes in-year. Employers who have missed the boat this year will need to register before 6 April 2017 to start payrolling benefits from 2017–18. If voluntary payrolling takes off P11Ds could become a thing of the past for many employers and employees.

Once an employer has registered to payroll a benefit, the cash equivalent of that benefit is treated as extra pay for the year. The cash equivalent is divided by the pay frequency (typically monthly) to calculate the amount of extra pay that needs to be “added” at each pay day to collect the tax on the benefit. The PAYE income tax due on the benefit is then deducted from the cash element of the employee’s pay. Adjustments are required to payrolled amounts during the tax year to reflect any changes so that the full taxable benefit for the year is processed through the payroll during the tax year. Because benefits are liable to Class 1A NICs rather than Class 1 NICs, the cash value of the benefit does not need to be included in gross pay for Class 1 NIC purposes. Where a benefit has been payrolled, the employer does not need to include it on the P11D. However, if other non-payrolled benefits have been provided to the employee, the employer will still need to report details of these to HMRC and the employee on form P11D. Even where employers do not need to submit any P11Ds, the Class 1A NIC return form P11D(b) will still need to be submitted to HMRC and Class 1A NICs paid separately in the same way as previously.

Some bad news for lower paid employees and their employers

Prior to 2016/17 tax year it was necessary for employers to establish whether their employees were lower paid (up to £8,500) as there was a different regime and a different form P9D that needed to be completed. Some agricultural employees who worked on a seasonal basis could be treated as lower paid employees. This artificial distinction based upon the individual’s level of pay has been effectively removed and taxable benefits will be calculated the same way for almost all employees.

From 6 April 2016 onwards all benefits are taxed on an employee in the same way regardless of how much the employee earns. Consequently, benefits provided to employees earning at a rate of less than £8,500 must now be taken into account in determining their taxable income. If the employee’s total income remains below the level of their personal allowance, (currently £11,000 for the 2016–17 tax year), this will be irrelevant as the employee should not be liable to pay income tax. However, if the employee has other income, works seasonally or has more than one job, they may now have to pay tax on a benefit that was previously tax-free.

What will life be like for farming businesses outside of the EU?

This article considers how UK farmers may be effected should we vote to leave the European Union on 23 June 2016.

Income and support

One of the main concerns for farmers over Brexit is the uncertainty surrounding support payments. The UK currently pays £6 billion to the Common Agricultural Policy yet UK farmers only receive £3 billion in subsidies. There is clearly scope for the UK Government to continue to pay farmers subsidies but it is likely the decision will be influenced by politics. Farmers' reliance on subsidies largely stems from the supermarkets' price wars putting pressure on the cost of food. Whether this continues depends on consumer choice and the state of the economy, both of which will no doubt change on exiting the EU.

Trade

With over 72% of UK food and non alcoholic drinks exported to the EU, it is by far our biggest customer. It is essential that UK farmers have access to EU markets free of tariffs and, considering the value of goods the UK imports from the EU, it seems likely that a trade deal would be agreed. Being outside the EU will allow the government to set up trade agreements with other countries with much less interference than is possible within Europe.

Labour

Assuming the UK does not retain freedom of movement of labour with Europe, farming salaries are likely to increase. Although this is beneficial for farm workers, the economy and unemployment levels, there will be an added cost to farming businesses who may also struggle to recruit staff. If the UK were to join the European Economic Area or the European Free Trade Association there will be little difference to the current situation as these come in hand with freedom of movement.

Regulation

One would hope that, on Brexit, the UK will take the opportunity to reduce any unnecessary regulation which is particularly rife in the farming sector. This should help increase efficiency by driving down costs enabling farmers to increase competitiveness in the international markets.

Interest rates

The uncertainty over the UK economy on Brexit will undoubtedly discourage banks from increasing interest rates in the foreseeable future. Although this is bad news for savers, this will keep the cost of finance low allowing farmers the opportunity to grow their businesses.

Foreign exchange rates

Sterling has declined since the announcement of the referendum and may continue to do so whether or not we are in the EU. Although this increases the cost of imports, UK goods and services are becoming increasingly more competitive in international markets. The devaluation will also help attract new tourists to the UK providing further opportunities for farms to diversify.

Land values

The questions over farming income will deter some from buying more land however it is likely we will see those smaller farmers sell to larger, more commercial farms who can become more competitive through economies of scale. The low interest rates may attract investor purchasers to the market although this will depend on the profitability of each farm. Overseas investors may look to invest whilst sterling is low although the uncertainty surrounding the economy will undoubtedly discourage some.

A farmer’s life is full of uncertainties over tax...

Agriculture wasn’t specifically mentioned in the March 2016 Budget but, under the radar, it would appear that more Inheritance Tax (IHT) Reliefs (Agricultural Property Relief and Business Property Relief) claimed by Executors of a deceased farmer are being scrutinised and claims for Capital Gains Tax (CGT) Entrepreneurs’ Relief on land disposals are being challenged by HMRC.

Agricultural Property Relief (APR)

Agricultural Relief was introduced in 1894 to stop farms from being broken up and sold to settle what was then known as Estate Duty (now IHT) on the death of a farmer. Nowadays, the next generation are able to sell their inheritance without realising large tax bills – but is this against the spirit of APR? APR may be removed at some point in the future but for now it is key to maximise your chance of a successful APR claim by ensuring:

1. Your farmhouse contains an office
2. The farm must be able to financially support the running of the farmhouse
3. All farm cottages must be occupied by farm workers who have employment contracts
4. Farm building and woodlands must be ancillary to the farming activity carried out
5. All farm buildings must be in constant agricultural use
6. Keep the older generation involved in the management of the farm – charge them with record keeping and ensure they attend all management meetings; their knowledge and expertise is invaluable
7. Contract and share farming agreements should record what is expected of the landowner – keep meeting notes and photographic evidence to demonstrate your active involvement in the farm.

Business Property Relief (BPR)

Farm incomes are volatile. Many farmers look to secure steadier sources of income by diversifying their activities – for example renewable energy such as solar and wind power, the introduction of farm shops and cookery schools and the conversion of old barns into holiday cottages. With the uncertainty over APR and increasing land prices (especially where development opportunities exist), farmers should look more towards BPR as their IHT shelter.

Debts are normally deductible for IHT purposes although there were major changes introduced with effect from April 2013 which have reduced some of the tax planning opportunities that were previously available. Where you have debt arrangements in place at April 2013 it is important not to disturb these so that you can maximise the APR and BPR claims available.

A final word of caution?

The outcome of the EU referendum may result in higher taxes in the future - George Osbourne has already demonstrated that he is good at springing surprises! And as Benjamin Franklin wrote back in 1789 “In this world nothing can be said to be certain except death and taxes”, this still holds true today. Our best advice is to have foresight and plan ahead.

Capital gains tax update

Reduction in headline rate

George Osborne's announcement of the reduction in the headline rates of CGT from 6 April 2016 came as a major surprise. The rates for individuals are now 10% and 20%, although gains on residential property are still taxed at the old rates of 18% and 28%.

The thinking behind this is that the reductions will kick-start a strong enterprise and investment culture.

The tax cuts should be welcomed by those farmers not qualifying for Entrepreneurs' relief.

Entrepreneurs' relief developments

Entrepreneurs' relief (ER) is of particular importance to farmers, especially if the sale of land for development is being contemplated where capital gains can be taxed at just 10%. The rules for the relief are complex, especially in relation to 'associated disposals', where the land being farmed by a partnership is not a partnership asset, but is instead owned by one or more of the partners.

From 18 March 2015 rules were introduced that made it difficult, if not impossible, to claim ER on an associated disposal where an appropriately worded partnership agreement has been put in place as part of a sensible family succession plan.

We are pleased to report that this anomaly is being addressed in the current 2016 Finance Bill, which is proposing to rectify the position retrospectively. However, the Government would also like to backdate some additional requirements which could lead to a loss of ER in some circumstances e.g. where the land sold has been owned for less than 3 years.

A further u-turn has been announced that will allow farmers to enjoy ER where they have entered into commercial joint venture arrangements with developers.

Please remember that professional advice should always be obtained in advance of any land sale as the availability of ER is not automatic. It is sometimes possible to restructure the farmer's affairs in order to qualify for ER but this cannot be put in place after the event.

Investors' relief

This new relief has been billed as an extension to ER where gains on the disposal of shareholdings in certain private trading companies are eligible for the 10% CGT rate, provided that they have been owned for at least 3 years. A person's qualifying gains for investors' relief will be subject to a lifetime cap of £10 million (in addition to the £10 million lifetime allowance for ER).

Whilst investment in farming and property development companies is permitted, relief is not available if the investor (or anyone connected with him) is an officer or employee of the company. Although working farmers would not qualify for relief, outside investors could be attracted to help fund particular projects thus providing a valuable source of funding.

The New Lifetime ISA

George Osborne was widely expected to make significant changes to tax relief given on pensions in the March Budget, but in fact thought better of it. Perhaps bigger fish to fry given the Brexit vote in June... However, and possibly an interesting indicator for the future, he introduced a new savings vehicle – the Lifetime ISA. The target market for this ISA is young people between the ages of 18-40. They could be saving up to buy their first home, or looking for an alternative long term retirement vehicle or a combination of the two. Perhaps this is the first shot at revolutionising the way we all save money in the future.

These days, many parents are helping their youngsters to get onto the housing ladder, and for some this is a very useful way of gifting money to children and reducing their potential inheritance tax liability. The new Lifetime ISA offers an opportunity for regular saving for both parents and their children alike.

The maximum investment each year into these ISAs will be £4000 until you reach the age of 50, and then active saving must cease. The government will top up the money saved each year with a bonus equivalent to 25% of the ISA holder's contributions. If the individual invests £4000, they will receive a bonus of £1,000. Lo and behold, the Government bonus is effectively an overall 20% tax benefit, similar to that given at basic rate on pensions....

The Lifetime ISA will be introduced in April 2017. The basic rules are that the money can be accessed to use as a deposit on a first house purchase with a purchase price capped at £450,000. Alternatively the money can be released as a tax free lump sum from the age of 60. However, beware, there are stiff penalties if the money is released for any other purpose under the age of 60. These penalties include the loss of the Government contribution together with any interest it has achieved, and an overall 5% penalty thereafter.

Lifetime ISA is ideal for those young people who are good at saving, or who have parents who help them to save, and gives them the goal of achieving their first house deposit. However, thereafter, the savings will make a welcome tax free addition to other pension savings at retirement. Certainly this is a healthy development and a good encouragement to save. For those people who have already opened a Save to Buy ISA, they will be able to transfer these across to a Lifetime ISA next April. If a couple are saving towards a house, they can each open a Lifetime ISA.

A Lifetime ISA can be set up as a cash or stocks and shares account; please note that the value of investments can do down as well as up and so you could get back less than you invested. The £4000 limit on contributions will form part of the individual's overall ISA allowance which will be £20,000 in 2016/17. If you would like to take advice on this or any other savings issue, please contact one of our advisers at PEM Carrwood.

VAT and conversions under permitted development rights

HMRC has recently clarified its policy on the VAT treatment of conversions carried out under permitted development rights (PDR).

PDRs are a national grant of planning permission for particular types of development. They are intended to streamline the planning process by removing the need for full planning permission. Of particular relevance to farmers is the PDR allowing the conversion of certain agricultural buildings into dwellings.

What are the VAT implications of PDRs?

The VAT legislation is fairly generous where the creation of new dwellings is concerned. Building services will qualify for VAT relief, either at the zero rate for new construction or at the reduced rate of 5% for conversion works. In addition, any VAT incurred on the creation of a new dwelling will be recoverable if the dwelling is to be sold (zero rated) and a claim may be made under the DIY House Builder Scheme if the dwelling is to be retained for private use.

However, it is a requirement of the VAT relief that certain conditions are fulfilled. One of these is that planning permission must have been granted in respect of the dwelling and the construction must have been carried out in accordance with that permission. If this condition is not met, the standard VAT rate of 20% will apply to all construction work and VAT recovery is unlikely to be possible.

This has led to concerns that PDRs, in an attempt to make minor building works easier, have actually increased the costs of such projects by preventing the VAT relief that is dependant upon the grant of full planning consent. HMRC had previously suggested to the NFU that it would not take this point. However, the position remained confused with developers and landowners unsure about where they stood.

Policy clarification

HMRC has now issued Revenue & Customs Brief 9/16 providing this long sought-after certainty. It has said that it will continue to require evidence that work is lawful in order for VAT reliefs to apply or for a claim to be eligible under the DIY House Builder Scheme. Where a conversion is covered by a PDR rather than a specific planning consent, this must be evidenced by at least one of the following:

- Written notification from the LPA advising of the grant of prior approval, or
- Written notification from the LPA advising that prior approval is not required, or
- Evidence of deemed consent and evidence that the development is a permitted development.

A last thought

It is worth noting the often overlooked point that VAT relief is also dependant upon there being no restriction on the separate use or disposal of the new dwelling. If the planning consent requires a building to be occupied by the employee of a particular business, for example, VAT relief will not be available.

About us

Our experienced Agriculture team offers expert advice and support for all areas of accountancy and taxation to suit your specific needs. Please meet the Agriculture team who will be happy to talk to you about any issues you may have.

For further advice, information or to feed back please do not hesitate to contact Nicola Anderson on 01223 728261 or email nanderson@pem.co.uk

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