Agriculture newsletter

Summer 2017

pem.

Welcome

Welcome to the summer edition of PEM's Agricultural Newsletter. Over the last year we have seen a huge amount of change, it is now just over a year since the BREXIT vote and I am not sure we are any clearer on what BREXIT will mean for the UK economy even though Article 50 has now been triggered. We have also gone through a period of political change with David Cameron stepping down, Theresa May being voted in and then a snap general election.

One area of certainty is that we will all need to continue to pay tax although with continuous changes to the tax system the actual amount of tax is not always clear!

In this Newsletter we have focused on some of the changes that have, or are about to take place in the world of tax. These include the new farmers five year averaging claims which can help farmers to reduce their overall tax liabilities. We have also highlighted the ATED changes with the new revaluation date of 1 April 2017. With the ATED threshold having fallen to £500,000 we expect to see more clients caught by these rules from 2018/19.

With farming profits having suffered a downturn we have highlighted the more aggressive approach HMRC have been taking where losses have arisen over a number of years.

We increasingly hear about the need for further housing and we have commented on some of the tax issues the larger scale developments can give rise to when developers look to a number of landowners to provide the land for the development.

Finally we have included some details on the proposals for Making Tax Digital which will affect all of our farming clients. These are currently just proposals but we expect to see legislation passed in the near future.

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 or Daren Peacock.

Contents

Development land collaborations - update	3
Hobby farming anyone?	4-5
Making Tax digital (MTD)	5
ATED - 1 April 2017 revaluation	6
Farmers' five year averaging claims	7

Nicola Anderson - Partner, Private Clients

Development land collaborations – update

In our Autumn 2016 edition, we outlined how multiple land owners can join together with a view to securing planning permission on a larger site thereby making it an attractive proposition for developers.

Land joint ventures can take various forms depending on the commercial and tax drivers, but this often results in quite complex setups, particularly if certain land owners are seeking entrepreneurs' or rollover relief to alleviate their capital gains tax (CGT) bills. Additionally, the agreement needs to be carefully structured to avoid land proceeds being taxed twice.

One possible solution to the potential double CGT charge is a land pooling arrangement where all landowners own a share of the development land committed to the "pot".

The idea behind land pooling is to promote sustainable development by equalising values through a pooling process in recognition that all the land is integral to the development whether used for high value prime residential, for community infrastructure or parkland. It helps to promote a 'patient capital' approach rather than the need to maximise short term returns. However, this sort of arrangement can lead to a loss of valuable tax reliefs such as entrepreneurs' relief.

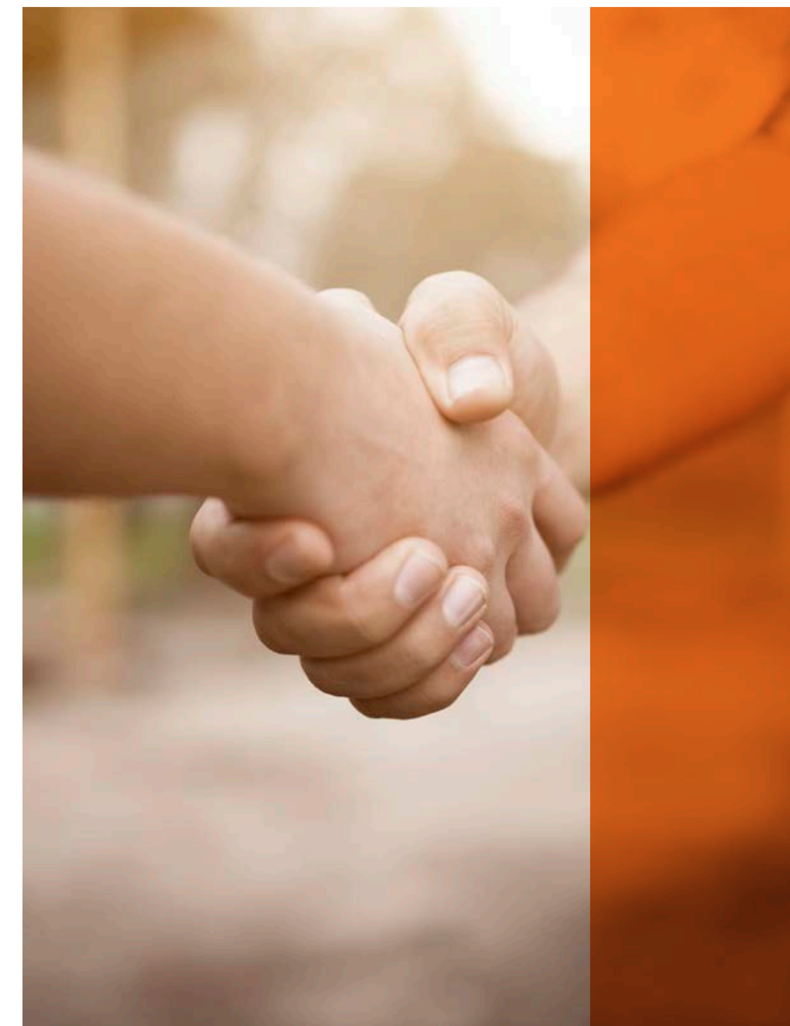
By contrast, the traditional development model involves the landowner granting an option to the developer to buy the land once planning permission has been obtained. The option is exercised and the land is then sold. Release of the land to the developer is deferred which, in turn, leads to a condensed construction phase to maximise short term returns. Landowners also have an incentive to be the last to sign-up to a development because they can gain extra (ransom) value by being the final piece that unlocks the site.

Both land pooling and the traditional option route have their own tax issues which we hope the government are now looking to address.

In February 2017 the Department for Communities and Local Government published *'Fixing our broken housing market'* setting out the government's proposals to boost housing supply and create a more efficient housing market. The White Paper includes a consultation on specific planning proposals including how land pooling can make an effective contribution to assembling land for sustainable development.

The Chartered Institute of Taxation have made a submission that tax cannot be sensibly excluded from wider consultations such as this one, in view of the potential tax barriers of pooling. The submission considers briefly a land pooling vehicle that effectively freezes the tax status of the land at the point of entry into the pooling vehicle, preserving the status of the land pre-pooling. An alternative route might be a wider permissive statutory power to grant particular tax breaks to landowners participating in a development that satisfies the defined requirements of a sustainable development with the costs of exercising the power met, at least in part, out of the development.

It is hoped that the submission may lead to further discussion to develop potential solutions but in the meantime specialist advice should be sought on the structuring options if the optimal balance between the commercial and tax drivers is to be found.



Hobby farming anyone?

HMRC have launched a number of attacks on farmers in recent years in relation to claims made by individuals to offset farm losses against other income and capital gains.

The so called "sideways" loss relief claims include profits made from diversified non-farming activities that exploit other uses of farm assets. This is of particular concern where the other income is subsidising the farming activities.

Since 6 April 2013, the ability for individuals to offset farm losses against other income has been subject to a cap of £50,000 or 25% of income, whichever is greater. Other restrictions apply in particular circumstances. Generally speaking, sideways loss relief is not available at all unless the trading activities are carried on commercially with a view to making a profit (all farming in the UK is treated as a trade). It is possible that the business has been blown off course due to unexpected circumstances and evidence of such problems can help the argument for sideways loss relief with HMRC.

However, commercial farmers and market gardeners can still be denied such claims under the "hobby farming" rules if they have made losses in the previous 5 years. Exceptionally, sideways loss claims can be made regardless of how many years the farm has been making losses in a genuine cases where a farmer has engaged in specialised activities, or perhaps where there has been a change from livestock to arable farming with a profit only being possible after working on the land over an extended period of time.

A common reason for HMRC's recent success in denying these loss claims is the lack of profitability cannot be attributed to external factors such as grain prices, disease, theft, higher borrowing costs, currency exchange volatility and other unforeseen events that could not be contemplated when the chain of loss making periods began.

Crucially, the onus is on the taxpayer to demonstrate that a competent farmer:

- Would have reasonably expected more than 5 years' worth of consecutive losses (taking into account all foreseen circumstances), and
- Has a reasonable expectation that the farm will make profits after the year of the sideways loss claim.

The first test looks back in time to the start of the chain of losses. Were extended losses expected on the assumption all would go according to plan? HMRC expects to see hard evidence in the form of contemporaneous business plans, profit forecasts and industry specific statistical information.

It is not possible to blame unexpected future events for the lack profitability in the long term. For example, it is no use justifying further sideways loss claims on grounds of grain price volatility as it is equally possible that the price could have gone up resulting in a profit.

How could a chain of extended losses have been expected from "day 1" with any reasonable certainty? As regards the second test, evidence should be kept to show why profits have not been achieved and the timescale in which profits will be achieved. Good evidence includes the type of information which would satisfy a bank manager.

The "hobby farming" rules were announced by James Callaghan in his 1967 Budget speech when he said: *"I shall propose that, except in special circumstances, gentlemen known as "hobby farmers" may no longer set off their losses against other income for more than five years running."*

It was perceived at the time that genuine farmers would not make losses except in exceptional circumstances. How times have changed! It would seem that it is time for the rules to be revised to reverse the harsh effects, particularly for the diversified farmer.

Making Tax digital (MTD)

The biggest shake-up of the tax system for 20 years in underway as online personal tax accounts are set to replace the annual tax return.

The government announced the plan in March 2015, which will bring together all of the taxpayer's details in one place and allow you to update and review your tax affairs in real time. All individuals are able to access their own personal tax account already, although limited information is currently shown in the account.

Taxpayers will be able to let their agents manage their personal tax account on their behalf in due course.

What do we know so far?

HMRC have announced some details of how the new digital system will look. The changes are wide ranging with the potential to cause headaches for self-employed individuals including farmers and landlords. The plans for MTD have not yet been legislated and could therefore change. The current intention is that:

- From April 2018 HMRC will require the self-employed and landlords with receipts over the VAT threshold (currently £85,000 per year) to update their personal tax account with details of their income and expenses on a quarterly basis.
- From April 2019 all self-employed and landlords with receipts in excess of £10,000 will need to report their income and expenses on a quarterly basis.

Businesses will be required to maintain their records digitally, using either software or aps to keep details of receipts and expenses.

HMRC automatically update your account with details of income it already holds. Employment and pension income is uploaded to the account already and details of interest paid by banks and building societies will be uploaded from early 2018.

By 2020 the transition to digital taxation is scheduled to be complete, and the personal tax account will provide a single place for taxpayers to manage all their tax liabilities (income tax, national insurance and VAT).

PEM will update you as and when further details are announced as currently the information available is limited. We are considering holding some seminars on making tax digital, when the details are available, to discuss how this will affect you. If you are interested in attending these seminars please register your interest at **mtd@pem.co.uk**.

Get digital ready

In anticipation of the transition to digital PEM is pleased to offer a secure online portal, enabling you to send and receive information directly to your PEM contact. For example, you can use the portal to upload the information for your tax return, and once your tax return has been prepared you will be able to electronically approve the document ready to submit to HMRC.

The portal offers many advantages over email and we would like to encourage as many clients as possible to use the system.

Further details can be found at **www.pem.co.uk/services/portal**.

If you are interested in using the portal please ask your usual PEM contact to set up a portal account for you.

ATED – 1 April 2017 revaluation

The Annual Tax on Enveloped Dwellings (ATED) applies to companies (and partnerships with corporate members) which own residential property in the UK that is valued at £500,000 or more. Currently, a property's value for ATED purposes is taken to be its market value at the later of either 1 April 2012 or the date it was acquired by the company.

Many farming companies will hold properties whose value has only exceeded £500,000 since the valuation date and which are therefore outside the current scope of ATED.

However, these dwellings will come into charge from 1 April 2018 when the ATED values are updated to reflect market values as at 1 April 2017. This revaluation may also result in properties moving into the next tax band thereby incurring higher tax charges.

Companies holding residential properties with values that are close to a band threshold may wish to consider obtaining valuations as at 1 April 2017 before the 2018/19 ATED filing date of 30 April 2018. The bands are set out below.

A number of reliefs exist which mean that a company may not have to pay the tax. Many farming companies are able to make use of the farmhouse relief, the letting relief and/or the employees' relief.

However, each relief is dependent upon meeting certain stringent conditions so those companies that are new to ATED or whose circumstances have changed should take appropriate advice in order to ensure that they are eligible.

It is worth noting that ATED returns must be submitted, even if a company is claiming full or partial relief. HMRC is routinely imposing late filing penalties for returns that miss the 30 April deadline regardless of whether any tax is due. It is therefore important that companies with high value dwellings take advice if they are unclear regarding their ATED obligations.

Property Value	Annual charge for 2017/18
More than £500k but not more than £1m	£3,500
More than £1m but not more than £2m	£7,050
More than £2m but not more than £5m	£23,550
More than £5m but not more than £10m	£54,950
More than £10m but not more than £20m	£110,100
More than £20m	£220,350

Farmers' five year averaging claims

Recent years have been challenging for farmers' profitability. The fall in the commodity prices for 2015 harvest followed by the corresponding increase in prices for 2016 harvest together with the ever changing level of input costs have caused peaks and troughs in profits and tax payable.

On 5 April 2016, the new five year averaging rules came into play. This is an extension of the two year averaging rules which have been in existence for many years whereby farmers also have the option to make a claim over a five year period.

At the time of introducing these rules former Chancellor of the Exchequer, George Osborne said:

"Today's reforms will provide farmers with additional security to plan and invest for the future, allowing them to spread profits over a longer period of time. Over 29,000 farmers can benefit from the changes, saving an average of £950 a year."

Providing profits fluctuate sufficiently, an averaging claim allows farmers to spread taxable farming income over a two or five year period potentially generating a tax saving for farmers who pay tax at higher rates in one year, followed by basic rate or no tax in other years.

Below we have considered the total tax and National Insurance due for a farmer over a five year period under the three options available; no averaging claim, two year averaging claims and a five year averaging claim. The result show there is a total tax and National insurance saving under a five year claim of £7,369 with a drop in the effective rate of tax from 26.4% to 22.7%.

Each case will be different and it is important to consider tax planning before the end of each tax and accounting year. Planning will determine whether to accelerate or slow down purchases of plant and machinery, carry out extensive repair work or make pension contributions in order to generate the most tax efficient outcome.

Calculations can prove complicated particularly when other sources of income, capital gains and allowances are involved. It is therefore important to keep good records and maintain regular contact with your advisors in order to take full advantage of the new rules, particularly with regards to the pre yearend tax planning.

	2012/13	2013/14	2014/15	2015/16	2016/17	Total
Position with no averaging claim						
Farming income	60,000	60,000	60,000	10,000	10,000	200,000
Tax and National Insurance	17,511	17,366	17,185	320	320	52,702
Effective rate of tax						26.4%
Position under two year rules						
Farming income	60,000	60,000	60,000	10,000	10,000	200,000
Averaging adjustment	-	-	(25,000)	12,500	12,500	-
Average income	60,000	60,000	35,000	22,500	22,500	200,000
Tax and National Insurance due	17,511	17,366	7,577	3,825	3,745	50,024
Effective rate of tax						25.0%
Position under five year rules						
Farming income	60,000	60,000	60,000	10,000	10,000	200,000
Averaging adjustment	(20,000)	(20,000)	(20,000)	30,000	30,000	-
Average income	40,000	40,000	40,000	40,000	40,000	200,000
Tax and National Insurance due	9,432	9,154	9,027	8,900	8,820	45,333
Effective rate of tax						22.7%

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

Nicola Anderson
Partner, Private Clients
01223 728261
nanderson@pem.co.uk

Daren Peacock
Director, Private Clients
01223 728220
dpeacock@pem.co.uk

Sarah Davis
Assistant Director, VAT
01223 728300
sdavis@pem.co.uk

Fleur Edwards
Assistant Director, Business Tax
01223 728256
fedwards@pem.co.uk

Stephen Peak
Partner, Audit
01223 728244
speak@pem.co.uk

Gordon Plumb
Head of Agriculture
01223 728266
gplumb@pem.co.uk

Graham Newman
Senior Manager
01223 728243
gnewman@pem.co.uk

Evie Olley
Manager
01223 728321
eolley@pem.co.uk

Douglas Myers
ACA Trainee
01223 728265
dmyers@pem.co.uk

PEM
Salisbury House
Station Road
Cambridge CB1 2LA

t. 01223 728222
e. pem@pem.co.uk

pem.co.uk

A member of Kreston International | A global network of independent accounting firms

For General Information Purposes only
Please note that this brochure is not intended to give specific technical advice and it should not be construed as doing so. It is designed merely to alert clients to some issues. It is not intended to give exhaustive coverage of the topics. Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.