Farming Update

issue 24 • spring/summer 19

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VAT RECOVERY

ON FARM BUILDINGS, FARMHOUSES AND COTTAGES

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INCOME TAX RELIEF FOR FARM TRADING LOSSES

Farming is an unpredictable business and a year's hard work does not always produce a profit. While losses are always disappointing, there may be some consolation if tax relief can be secured.

The principal reliefs are to offset the farm trade losses against:

- Other income (and thereafter capital gains) of the current tax year.
- Other income (and thereafter capital gains) of the previous tax year.
- Future trading profits of the same business.

Relief is usually claimed against other income (where it exists!) to secure immediate tax relief. Relief claimed against future profits will only ever achieve tax relief if and when the farm becomes profitable.

Some other tax measures can help utilise losses more efficiently:

- Around the commencement or cessation of a trade, a taxpayer can set losses against up to 3 previous years' income.
- A farm averaging claim can affect loss reliefs (even though losses are excluded in calculating the averaging adjustment).
- A tax loss can be reduced by claiming reduced capital allowances. This can sometimes change wasted loss into future tax relief.

Restrictions
Loss relief claims are subject to detailed rules and restrictions, including:

a) Relief against other income is only available where the trade is undertaken in pursuit of profit.

b) There is no relief for a farming loss against other income if tax losses (before capital allowances) have also been incurred for the 5 preceding tax years. (The 5 year limit may sometimes be extended to up to 11 years for a stud farm.)

c) For a sole trader or a partner who works for less than 10 hours a week in the farm business, loss relief against other income is restricted to £25,000.

d) Income tax reliefs are capped at the higher of £50,000 or 25% of total income.

Capital gains tax losses
An individual's capital losses are automatically set against capital gains in the same tax year (including gains that would otherwise be covered by the annual exemption). Any excess capital losses are carried forward for relief against future years' capital gains. Some dairy farmers currently have carried forward capital losses from purchased milk quota, which was abolished on 31 March 2015.

STRUCTURES AND BUILDINGS ALLOWANCE

The 2018 Budget introduced a new Structures and Buildings Allowance (SBA) for capital expenditure from 29 October 2018 on commercial buildings and structures. There must have been no contract before that date for any of the work and no preparatory work must have started. Excluded from relief are dwellings and planning and land costs.

The SBA will enable farmers to claim modest income tax relief on new livestock or arable buildings and extensions for the first time in many years.

The rate of SBA relief is low – just a 2% straight-line deduction against farm profits over 50 years, starting when the building or structure comes into qualifying use. This is less favourable than the old Agricultural Buildings Allowance but is still welcome.

The detailed legislation has still to be released but Government have indicated that:

- Relief may be suspended if a building falls into disuse.
- On disposal, the eligible base cost for capital gains tax will be reduced by the amount claimed for SBA. There will be no clawback of SBA.
- A future purchaser will be able to claim SBA on the original cost only, providing the purchaser has obtained evidence that the asset originally qualified and of its original cost.
- Unlike capital allowances for equipment, unclaimed SBAs cannot be carried forward for later tax relief.

We would be happy to discuss your potential SBA claims and the impact on your tax position.

VAT RECOVERY ON FARM BUILDINGS, FARMHOUSE AND COTTAGES

Some farmers dealing with their own VAT affairs may be losing out on input VAT claims.

Farm cottages
Where farm workers occupy farm cottages completely free of rent, because they are working wholly for the business, then the business can reclaim all input VAT on expenses it incurs for the farm worker's cottage.

If a small rent is charged to the farm worker (perhaps for legal reasons), HMRC will consider the expenses partly attributable to the exempt letting activity. Then the input VAT should be included in the partial exemption calculation as residual input tax.

If a farm cottage is to be let out at a commercial rent, future expenses will be wholly attributable to the exempt letting. Care is needed in the timing of major expenditure and any change in usage intention, so that VAT recovery (and potentially also income tax deduction) is not sacrificed. This might involve undertaking some works before the change in use. Alternatively, dividing expenditure across a VAT year end might increase the scope to reclaim input VAT on property letting expenses under the de minimus rules.

Farmhouse
HMRC generally allow 70% of input VAT to be reclaimed when structural repairs are undertaken to a typical farmhouse which is the centre of operations on a full time working farm. Where the works are of an improvement nature, then HMRC will only allow 40% of the input VAT to be reclaimed.

Less VAT is reclaimable for houses which are not full time traditional, working farmhouses.

Consideration must also be given to the nature and use of the works. VAT cannot be reclaimed on works relating to areas which are wholly private (e.g. bedrooms and bathrooms).

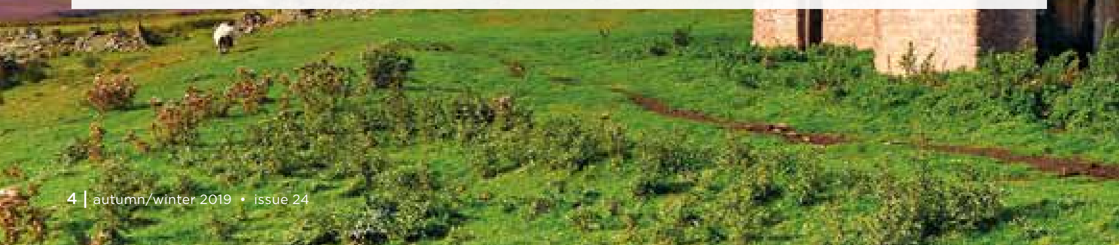
Buildings
Many farmers are converting redundant farm buildings to dwellings. Many of these works are eligible for the 5% 'reduced' rate of VAT (and some new build projects may even qualify for zero rating).

The 5% rate applies for a conversion to residential use, or alterations which change the number of dwellings, or renovating/altering dwellings that have been empty for more than 2 years.

Only 'construction services' (i.e. a contractor's work on the building) qualify for the 5% rate. Professional fees, as well as materials bought on their own, are always chargeable at 20%.

By default, many builders will charge 20% VAT if not instructed otherwise. It is important to ask the builder to charge 5% (where eligible) because of the cash flow benefit and because HMRC could disallow your reclaim if you have paid 20% VAT when you should only have paid 5%.

If you are considering a residential building project, please ask us for early VAT advice.



LIFETIME GIVING – A FOLLOW UP

Grandchildren's Trust
We now consider the trust IHT implications for the Grandchildren's Trust set up in the 'Lifetime Giving' case study in our Spring/ Summer 2018 edition. Mr and Mrs White gifted a let residential property, worth £250,000, into a newly created trust for the benefit of their 5 and 8-year-old grandchildren.

Decennial charge
Most lifetime trusts are subject to an inheritance tax charge every 10 years ('decennial anniversary') based on the value of the trust fund at that point. The maximum rate of tax on each 10 year anniversary is 6%. The actual effective rate is usually less than 6% because it is calculated after deducting the trust's nil rate band.

The Grandchildren's Trust was settled by both Mr and Mrs White jointly and is therefore treated as two separate trusts for inheritance tax; each with its own nil rate band. Neither Mr nor Mrs White had previously made any gifts into trusts, so each of their trusts has a full nil rate band, currently £325,000. No IHT will be payable on a decennial anniversary unless the value of the Grandchildren's Trust exceeds £650,000.

Exit charge
On the distribution of capital to beneficiaries from a trust, there is an 'exit charge'. This is effectively a part of a decennial charge calculated according to the number of complete calendars from the last 10 year charge (or, if before the first decennial charge, from commencement of the trust).

The value of Mr and Mrs White's gift of a residential property to the Grandchildren's Trust was £250,000 (i.e. well within the available nil rate bands) and neither Agricultural Property Relief and Business Property Relief applied. Therefore, the effective inheritance tax rate on any exit charge before the first 10 year anniversary would be 0%.

18 to 25 trusts
There are different rules for some trusts known as '18 to 25 trusts'. The Grandchildren's Trust cannot qualify because these can only apply for new trusts where the trust is established on death for an orphaned child.

Tax planning is essential to ensure you are mitigating your exposure to inheritance tax liabilities and preserving your wealth for your family, therefore please contact us for advice.

PRENUPTIAL AGREEMENTS

A prenuptial agreement is a written agreement, made before a marriage, as to how assets should be divided in the event of relationship breakdown.

The rise in property values has made prenuptial agreements relevant for sons and daughters in farming families. Coupled with that, matrimonial courts have shown much greater willingness over the last decade to enforce a prenuptial agreement providing it is judged reasonable. To be deemed as such it must be proven that the agreement was entered into willingly by both spouses, in the light of full information on the other's financial circumstances and independent legal advice.

A prenuptial agreement will not eliminate the cost of a divorce, but in some cases, may reduce the exposure from 'half the farm' to perhaps 'a house'.

Because of the importance to the financial security of a family farm, a modern partnership agreement will sometimes include a clause requiring a partner to enter into a prenuptial agreement in advance of any future marriage. If the partnership agreement contains such a clause before a son or daughter meet their future spouse, this will also provide a tactful way to raise the subject when marriage is contemplated!

PRIMARY FACTORS OF UNIVERSAL CREDIT

Key points of the new systems are as follows:

- Universal Credit is means tested and anyone with more than £16,000 savings is excluded.
- Self-employed claimants with fluctuating incomes are disadvantaged. This will include many farmers whose income is concentrated over a short period with livestock sales and subsidy receipts.
- Universal Credit is based on 'actual receipts' minus 'permitted expenses'. This is different from taxable profit.
- For a farm partnership member, the relevant amount of receipts and payments is the 'amount attributable to their share in the partnership'. This may be problematic where profit allocations are agreed in arrears.

TAKING MORE ADVANTAGE FROM PENSIONS

‘Pension Freedom Day’ (6 April 2015) was a watershed in making pensions more relevant to farmers. It is no longer compulsory to use a pension fund to purchase an annuity by age 75. Instead, from age 55, you can draw down any amount (or leave it invested for your future or your heirs).

The following example illustrates the flexibility:

Example

A 57-year-old farmer has £200,000 in a pension fund but needs £50,000 to pay for a new building.

One option is to draw down the 25% tax-free lump sum, taking £50,000 from his pension with no tax. The remaining £150,000 can be left in the pension to provide future income.

An alternative option is to sell say £50,000 of land to the pension fund to release personal cash. There might be a capital gains tax liability – or there might not! The business will in future have to pay rent to the pension fund for the land – but the rent payments will qualify for tax relief and increase the value of the pension. What’s more, the opportunity to take a future tax-free lump sum remains intact.

Always remember

- Make sure you have sufficient provision to live off in your later years.
- Don’t forget the State Pension – make sure you have got sufficient ‘qualifying years’ to receive a full state pension. Class 2 National Insurance Contributions (around £3.00 per week) may be the most profitable investment you ever make.
- Find out how much tax-free lump sum you can draw down from your pension pot. Other drawdowns and income are taxable.
- Check if your pension fund can be left Inheritance Tax free to your family.
- Keep a record of historic and current pension providers.
- Check what would happen to your pension plans on death – some older policies may pay out as cash while newer policies probably provide wider options. But some older policies have attractive guaranteed annuity rates.
- Seek independent financial advice.

We can put you in touch with one of our in-house Independent Financial Advisers if you would like to explore your options in more detail.

- No account is taken of stock. Income will be high in months when livestock is sold and low in months when livestock is purchased.
- Expenditure on plant and machinery can be deducted.
- Interest on business loans can be deducted, but only up to £41 per month.
- Car running expenses must be calculated on a mileage basis. This will require maintenance of a business mileage log.
- Information must be submitted to HMRC monthly.
- Bar the first year of claim, all claimants will be deemed to have received income equal to the national minimum wage each month – called the ‘Minimum Income Floor’

Because of the complexity, some current tax credit claimants may be deterred from claiming Universal Credit.

Rotherham Office:
The Old Grammar School
13 Moorgate Road, Rotherham, S60 2EN
Tel: 01709 828400, Fax: 01709 829807, Email: info@allotts.co.uk

Doncaster Office:
Sidings Court, Lakeside, Doncaster, DN4 5NU
Tel: 01302 349218, Fax: 01302 321739, Email: donc@allotts.co.uk

Website:
www.allotts.co.uk

Directors:
Steven Pepper FCA
Neil Highfield FCA
Steven Watson BA ACA CTA
Mark Garrison BCom FCA DChA

Associate:
Lisa Empson BSc(Hons) FCA

Consultants:
Jackie Saunders BA FCA DChA
Tony Grice BA FCA Cert PFS

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