Hagar 'loves to pay taxes'

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Mention of tax in recent weeks and conversation has turned to exotic locations – including the Isle of Man - and the goings-on of the great and the good with tales of tax avoidance, hints of tax evasion and references to 'schemes'. Surely 'The Paradise Papers' are destined for the best-seller lists.

I'm reminded of a cartoon of Hagar the Horrible standing before the Tax Collector with his accountant who was professing that Hagar 'loves to pay taxes'.

Our half-yearly offering hopefully will not attract Panorama but may provide some points of interest both about tax – the ATED rules, Mineral royalties and stock valuation for tax purposes. Other topics include – Contract Farming Agreements and Balance Sheet errors.

As ever, I hope you find something of interest, and may I take this opportunity to wish you a Happy Christmas and Prosperous New Year.

James Cater

Annual Farming Seminar 2018

Whiting & Partners' Annual Farming Seminar will be held at The Maltings, Ely, on Wednesday, April 18, 2018 from 10am-2pm. Once again The Andersons Centre specialists will review the UK Farming Industry with less than a year to go before the Brexit deadline.

To book your place please contact Victoria Scott on 01284 752313 or email at victoriascott@whitingandpartners.co.uk

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Farming Stock Valuation

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For many arable farmers, the value of their year-end stock will be a very significant item in the Balance Sheet. This will include harvested crops from the previous harvest, growing crops in the ground as well as chemicals and other items in store. For tax purposes the value of stock included in the Balance Sheet will be included in taxable profits – so there is every incentive to ensure that this value is correct, not only to comply with Inland Revenue requirements but also to avoid overstating profits and consequently tax liabilities.

The normal accounting treatment for most farmers is 'lower of cost and net realisable value'. So, unless the cost of stock is likely to exceed selling price most farms will include stock at cost. Although this sounds simple, the question of how cost is determined can be tricky. If the farmer has detailed records of inputs, machinery and other direct costs, HM Revenue & Customs will require that actual costs based on expenditure incurred will be the correct approach. In many cases however the required level of detail will not be available and in such cases the taxman will accept a 'deemed cost' basis assuming this is adopted consistently from year to year. This is a simplistic approach whereby, for harvested crops, 75% of the market value of the crop at the Balance Sheet date is assumed to equate to actual cost.

Whatever basis is adopted, stock value for tax purposes should exclude any element of machinery depreciation. This treatment is compulsory and will often mean that an adjustment is required to reduce taxable profits. Known as the 'Mars adjustment' it followed a House of Lords decision in two 2007 tax cases - William Grant & Sons v CIR and Small v Mars UK Ltd.

FBT or CFA

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Prior to the introduction of Farm Business Tenancies in 1995 allowing another person to occupy your land placed you at risk of being unable to readily recover vacant possession. FBTs have circumvented that problem and facilitated the procedures around land occupancy changing.

Although FBTs have many advantages, Contract Farming Agreements - CFAs - have also increased in popularity and can be measured against the Business Tenancies.

CFAs can allow continued but reduced involvement in the farm business; they can enable a tenant under the Agricultural Holdings Act legislation to continue benefiting from a secure tenancy beyond the date when his tractor driving days have expired.

From a tax perspective, they can preserve the right to Entrepreneurs' Relief and may retain some Agricultural Property Relief for Inheritance Tax in respect of the farmhouse. They can also allow the farmer to bank more than a rent yield when profits are high although the downside of this is the possible risk from low profits or losses being suffered.

The latter can be particularly contentious and it is recommended that careful thought is applied to the clauses in a CFA relating to losses. These agreements are contracts for services and so Stamp Duty Land Tax is not an issue. Problems around securing entitlements to state subsidy for future occupants of the land rather than being retained by a former tenant are avoided because it is the farmer rather than the contractor in a contract farming arrangement who claims the subsidy. This could be particularly relevant over the period of Brexit.

Great ingenuity can be applied to the drafting of legal agreements. The substance of some CFAs may approach that of an FBT but these are different beasts and care should be taken. The reason for the selection of a Contract Farming Agreement as opposed to an FBT should be borne in mind and the terms of the agreement assessed in that light. Likewise, the additional risk inherent in a CFA should also be carefully considered.

Annual Tax on Enveloped Dwellings

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For companies which have an interest in a dwelling that is valued at more than £500,000, the directors should consider whether Annual Tax on Enveloped Dwellings, ATED, is payable. Since the tax was introduced in 2012 the valuation date for the taxable value of a dwelling used since the tax was introduced has been April 1, 2012. The valuation date has now been reset to April 1, 2017 for the chargeable period starting on April 1, 2018 and the following four years.

Using that 2017 revaluation date, we could find that properties which had been valued at below £500,000 now fall into the chargeable rate or find that some properties, valued near the upper limit of one band, moving into a higher tax band. Revaluation will fix the property in a particular band for the following five years.

It is possible to for directors to self-assess the value of a dwelling at April 1, 2012, but a professional valuation is more likely to be accepted by HM Revenue & Customs.

A Pre-Return Banding Check will be provided by HMRC where the value of the dwelling falls within 10% of a banding limit and certification is required.

Where an April 2017 valuation is likely to exceed £500,000, directors should consider their options before tax becomes chargeable as it may be expensive to take the property out of ATED once it is caught. These options may include disposing of the property before April 1, 2018 and perhaps taking further steps to qualify for an ATED relief.

A sensible move would be for directors to review the company's dwellings and plan the preparation of a professional valuation as this will form the basis of the tax payable for the next five years.

Mineral Royalties

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Since April 2013 mineral royalties have been taxed as income, subject to a deduction for any management expenses incurred. Prior to this half the income was treated as a capital gain which generally resulted in a lower overall tax rate.

With a top marginal rate of tax for individuals of 45%, it may be worth planning in advance of the receipt of the royalties to reduce the rate of tax due.

If the intention is to enable various family members to benefit from the income, then the use of a trust may be beneficial. Alternatively, it may be possible to 'gift' a share of the land to family members outright.

If the intention is to use the income to buy more farming land or build up the infrastructure on the farm, incorporation of the farming business may reduce the tax rate on the income as the Corporate Tax rate is due to fall to 17% from April 2020.

Before completing this tax planning, it is essential to consider Capital Gains Tax, Inheritance Tax and Stamp Duty Land Tax to ensure that the gift or incorporation can be completed without any of these tax charges arising, so negating the benefit of the planning process.

It is always worth considering tax planning measures as soon as you aware that you may be in receipt of mineral royalties in the future. There is a variety of tax planning alternatives worth consideration and they really all need professional guidance to ensure that you maximise your income from the royalties.

An Eye for Detail

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We have recently obtained a steady flow of new farming clients. Good news for us and recognition of our reputation as farming specialists who understand the sector and its nuances. BUT…. yes, you knew there was going to be a BUT.

Our new clients are very welcome but they have brought with them an unexpected number of issues which are worth highlighting. In many cases these are minor and of a more embarrassing nature rather than financially costly. Some, on the other hand, are quite significant.

The less significant instances tend to relate to amounts left in fixed assets when in fact the asset has been sold. How, you might ask, does this arise when we accountants have all the information and paperwork? Generally, it occurs where an asset is sold but where other additions to it are not identified at the time of the disposal. Examples could include guidance systems acquired subsequent to the purchase of a tractor but sold with it; additions to drills and other machinery. In one instance, we found that land drainage had been listed when in fact the field in which it was located had been sold in previous years!

Investments are another area of minor confusion. We sometime see them sitting on the balance sheet where the farming group or cooperative has long since ceased to exist. Again, not a major fundamental issue but an embarrassing faux pas.

We have identified some instances of 'closing valuations' being incorrectly calculated. By their nature these errors reverse in the following year, so it's not a long-term problem unless they are taxed at different rates for fluctuating profits. As with Mars adjustments, it will be desirable to save tax at the earliest opportunity.

Failure to obtain tax relief has been seen where expenditure on new projects has been carried forward but ultimately the project has been aborted. We have discovered that these costs have been carried forward over multiple years when, had they been written off, tax relief would have been secured.

None of these is insurmountable and is relatively easily to rectify.

A more significant error relates to the position of land in partnerships. Does it belong to the partnership? Is it included in the accounts? Do separate classes of capital exist, or should they? These are all important questions that need careful consideration as these ultimately do not reverse the following year and getting things wrong can be costly!

HMRC has failed to remove individual farmers from the VAT flat rate scheme for farmers.

The EU Court of Justice case, Shields & Sons Partnership v the Commissioners for HM Revenue & Customs, revolved around the authority of HMRC to remove the Partnership from the scheme after seven years in which it had benefited by nearly £375k.

In most situations, the VAT flat rate scheme offers little or no advantage as the 4% of turnover which farmers receive from using the scheme seldom equates to the amount of input VAT which they are barred from recovering.

In the Shields & Sons Partnership case the Court heard that the appellant reared cattle purchased from an associated company before selling them to a processor and presumably little input VAT was incurred.

The Court ruled that HMRC had no general discretion to remove individual farmers from the scheme.

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