CHARTERED ACCOUNTANTS, TAX CONSULTANTS & FINANCIAL PLANNERS

ALBERT GOODMAN

AG RURAL INTELLIGENCE SPRING 2019

Business and tax advice for farms, estates and equine businesses

INTRODUCTION

Welcome to our Spring 2019 agricultural newsletter. At the time of writing, there is no agreement with regard to our imminent departure from the EU. All business, including farming prefers certainty, and to understand what the future holds. To date we have not been dealt this hand by Parliament in their Brexit negotiations and voting. In fact the action of MPs has created greater uncertainty so far.

Fingers crossed that we know which direction Brexit will take (if any) soon. We can then help businesses make plans to deal with the likely changes.

In this newsletter we cover a wide range of subjects, from buying groups; how to enter hire purchase agreements onto your book keeping system; to partial exemption with regard to VAT. Hopefully there is something to interest everyone.

Also, I implore you to read Pat Tomlinson's upside down economics article. This examines how farmers make economic decisions, and helps to explain why normal economic behaviour is not always followed.

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Upside down economics when things get tough

Well-founded and proven economic theory is all well and good but in UK farming even the most basic theories do not always apply.

One of the most common rules is that as the income potential from an input rises or falls, then the cost of that input responds similarly. There are two very long term trends in UK farming – total income from farming (DEFRA's measure of UK farming profits) has fallen considerably in real terms since the early 1970s (it is now approximately half what it was in 1973); and the price of the main asset used for farming (land) has risen consistently over the same period. That is the wrong way around.

The reason for the land price being what it is, is far more complicated than that – it is driven primarily by a very advantageous tax regime in relation to land ownership and a great deal of emotion that together drive fundamental economic principles into the background. It could be argued that the froth on the top of the price does vary with farm incomes but no more than maybe the last £1,500/acre.

What may be more relevant to day to day decision making on farms is what the short term price for acquiring an asset is – in the case of land, what it can be rented for in the short run. Therein the next upside down economic theory – we continue to see that as grain prices fall then short term FBT rents rise, or prior to the abolition of milk quotas, as milk price fell then the demand for quota leasing increased, as did its price. In the case of milk, the greater output in this country then put further pressure on milk prices and made the situation worse.

This somewhat bizarre response is quite natural – most farmers' reaction to a fall in prices or profit is to do more farming; to expand output to try and spread some fixed costs over a larger size business. It is a laudable and very sound reaction in theory – but one that very rarely delivers the right result.

Economies of scale are a well versed and proven theory – as a farm expands it is able to share costs over greater output, obtain improved buying power and take advantage of larger and more efficient machines to drive the unit costs of production down. In my experience, economies of scale are far easier to calculate in theory to justify an expansion than they are to achieve in practice. What typically happens is that as the business expands, so do the fixed costs – often by stealth over a number of years. The end result is that the treadmill has simply been turned up; it goes faster but no further and as it goes faster there is an increasing danger that the "runner" will trip up and fall off – the "runner" being the farmer in this case is under increasing pressure and stress with it being more difficult to control the bigger business, especially as it fails to deliver the expected extra profit and soaks up more cash. It then takes a very courageous decision to decide that there may be merit and more profit in being a smaller farm.

We have been discussing the theoretical impact of the Agriculture Bill in our team. It is very easy to conclude that profits will come under pressure in some sectors as, at least, the level of subsidies reduces. It is then easy to conclude that rents will come down as a result (land prices may as well, but subject to the other drivers on price outlined above). However, it is just as likely that in the short term, rents will rise as farmers' first reaction to the falling profit is to expand output. The extra output from the expansion delivers more product to the market with two key consequences - prices fall and there is no apparent danger to supply and so consumers have no recognition that prices need to rise.

Individually and collectively, UK farmers' braver response would be to use the impending Agriculture Bill as a catalyst to review the whole business and decide whether that natural expansionist reaction really is the best plan for the family and the finances. If not, then we will probably continue with the perverse scenario that as profits fall, the cost of farming's main inputs will increase – which will mean an even bigger correction eventually as those well founded economic theories eventually and inevitably come home to roost.

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Protecting your financial security

Protecting your financial security – something many overlook, misunderstand or take the 'it will never happen to me' view.

Ask people about what insurance they have, they'll say their property, TV, sofa, etc and Landrover are all properly insured and they will have public and employer liability insurance. Ask them whether they've insured the financial security of their family, or their business – and a whole new mind set takes over.

'It's too expensive', 'they never pay out', 'I don't need it',' I don't understand it' are the typical off the shelf, 'done for you' objections that people roll off the cuff. Not wanting to confront the thoughts of your own mortality is wholly understandable, but the consequences of not having financial security for your family – when you die prematurely - can have very distressing consequences for your family. They're heartbroken, their lives devastated – the last thing they need is financial pressure.

So after you've insured your Landrover – which you'll do without a second's hesitation – partly because it's the law and partly because it's cultural, we value our cars, so we insure them against damage – insure yourself.

What to insure;

- Your life
- Your health
- Your income
- Your future prosperity
- Your business
- Your business's security

Yes, a lot to consider, help is available, pick up the phone and call us.

Since writing, we have had the Spring Statement, this outlined a call for evidence for potential simplification and improvement of the VAT partial exemption regime.

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Post Brexit business structures

With the future of farming and subsidies changing post Brexit we are likely to see an increase in the variety of business structures used to manage the farming business, particularly involving third parties.

Historically farming businesses have been run as partnerships and limited companies usually owned by family members. Where one generation wishes to retire with no successor and, usually for tax as well as sentimental reasons, wishes to retain ownership of the farm, it is often rented to a neighbour under a farm business tenancy. However, there are alternative arrangements that can be used and we expect to see more use of these post Brexit. These include:

Grass keep or Profit of pasturage

This involves an arrangement between the landowner and a third party where the landowner grows the grass and a third party brings livestock onto the land to graze or takes a cut of grass for hay or silage.

Contract farming

A contract farming arrangement is often used on arable land as well as dairy farms where the landowner wishes to remain farming but does not wish to carry out the day to day farm work. The landowner is responsible for the key decisions and the farm plan whilst the contractor will carry out the operations under the farm plan on behalf of the landowner.

Share farming

This is where two farmers agree to work together to share farm the land. They remain independent (they are not in partnership together) and often one farmer provides the land and buildings as well as fixed equipment whilst the other farmer provides the machinery and labour.

Arrangements such as these can provide many benefits including the pooling and bringing together of resources, experience and skills to provide economies of scale and a profitable business for both parties. They can also provide a great opportunity for new entrants to come into the sector.

In addition, managed well, there are many tax benefits for the landowner. Retaining farming status allows the landowner to deduct various expenses against the income, and to claim the VAT back. The farm will qualify for capital gains tax (CGT) rollover, holdover and entrepreneurs' relief, reducing the CGT payable on a later sale or gift. For inheritance tax purposes the landowner may still be in agricultural occupation of the farmhouse so agricultural property relief could be claimed on death and business property relief may also be available for any non-agricultural value, such as land with hope value or a rental property.

To ensure farming status is protected the landowner must be in occupation of the land and the occupation must be for the purposes of husbandry. In case law, the courts have been prepared to accept the landowner as the person with the primary use provided he conducts some activities on the land which are husbandry. For example, a grazing license should provide that the landowner is responsible for growing the crop of grass and the landowner should actively perform some activity on the land. This should include fertilising, seeding, and controlling weeds on the land. Mere acts of maintenance, such as hedge cutting, would not be treated as husbandry.

To be farming it is also important that there is always some business risk for the landowner. A guaranteed income every year would not give such risk. Often share farming and contract farming arrangements are set up with a guaranteed return for the landowner with all input costs and activities carried out by the share/contract farmer. In addition the crop is often sold to the share/contract farmer. Such arrangements are at risk of failing an enquiry with H M Revenue and Customs. Therefore, if farming status is required, to protect tax relief, advice should be sought.

Keeping evidence of the activities performed is vital. A diary should be kept recording meetings and conversations held with the third parties as well as meeting notes where the landowner has directed for certain activities to be carried out. Proper invoicing from the supplier of inputs is also crucial.

With the basic payment scheme being replaced by a new system for 'public goods' many farming businesses will need to adapt. The future receipt of direct payments may also be delinked so may no longer be contingent on continuing to farm or meeting cross compliance requirements. As a result there may be opportunities for some landowners to reassess their future. In some cases this may result in wholesale retirement. However, in the short term, more likely we will see a rise in the use of alternative farming arrangements and business structures. As always it is important to take professional advice early on.

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MAKING TAX DIGITAL
– the important bits

As the launch date for the first phase of Making Tax Digital (MTD) approaches we are being bombarded from all sides by information about what business owners need to do to become MTD compliant. But what does this actually mean in practical terms for our rural clients?

Who does MTD apply to?

The first phase of the MTD programme is directed at VAT registered businesses. In the agricultural sector, where sales are predominantly zero rated for VAT purposes, most farming businesses are VAT registered whether above the £85,000 VAT registration threshold or not. This means that some farming businesses are voluntarily registered for VAT with taxable turnover below £85,000 – this first phase of MTD does not require these voluntarily VAT registered businesses to comply with MTD, and the existing HMRC portal will continue to be available for these businesses to file their VAT returns online.

Voluntarily registered businesses can opt into MTD but will then stay within MTD until they notify HMRC that they wish to come out of the scheme.

What is the timeframe for MTD?

For the next VAT return period beginning on or after 1 April 2019 all compulsorily VAT registered businesses (with a few exceptions) will need to meet the new MTD requirements.

So, for businesses filing VAT returns monthly, the April 2019 VAT return will need to be filed under MTD. For quarterly filed returns the following timeframes apply:

March cycle – June 2019 return

April cycle – July 2019 return

May cycle – August 2019 return

Don't forget that the £85,000 VAT registration threshold must be reviewed on a rolling 12 month basis.

Do I have to do it?

Under the existing VAT regulations there is an exemption for the "digitally excluded". This covers those who do not use computers for religious reasons along with those who are unable to comply due to age, disability or location.

If you are not currently exempt from online VAT filing then it is extremely unlikely that HMRC would agree to the exemption applying under MTD.

In particular, location would cover you if you cannot obtain access to broadband because of where you are located. It would not apply to you if you have simply chosen not to sign up for broadband.

There is no specific age at which the exemption would apply; HMRC would take each case on its merits. It would probably be difficult to secure this exemption in a multi-generational farming business where, perhaps, the oldest generation has always maintained the records in a manual cashbook but there are one or more younger generations who would be capable of taking on this role using digital software. This can also provide a useful way to integrate younger generations into the administration of the business.

I currently keep my records on a spreadsheet. Can I carry on doing this?

Your existing spreadsheet on its own is not likely to enable you to comply with MTD. You will either need to start using a new spreadsheet which is Application Program Interface (API) enabled or upload information from your spreadsheet onto a piece of MTD enabled software. Either of these options would provide the link to the HMRC system that is required under MTD.

HMRC will operate a "soft landing" approach in the first year of MTD and will not enforce the requirement to have digital links between software in order to give more time for digital links to be built into existing software. But it is better to be compliant from day one.

I have never used accounting software, what should I expect and which software should I choose?

The gov.uk website publishes a list of MTD compliant software with over 200 software suppliers already compliant and a shorter list of software suppliers with products still under development. This list includes dedicated farming software as well as generic business accounting software.

Your accountant should be able to help you to make the right choice for your business and personal circumstances.

What do I need to do now?

HMRC have produced a useful Youtube video "How to sign up for Making Tax Digital". This can be accessed using the following link:

https://www.gov.uk/guidance/sign-up-for-making-tax-digital-for-vat

Otherwise, as always, we are happy to help if you have any queries.

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HOW MANY TRACTORS DOES IT TAKE TO RUN A DAIRY FARM?

One of the measures we at Albert Goodman use when looking at dairy farm efficiency is the cost of getting the milk out of the cows. We measure this as the labour plus power and machinery costs including contracting, divided by the number of litres produced on a farm. After feed costs, it is the largest cost on most dairy farms.

This cost varies between under 6 pence per litre (ppl) for the very best farms, up to more than 14 ppl for the least efficient, and averages about 11ppl.

I was looking at a set of farm accounts recently where the cost of getting milk out of the cows was high at 14ppl, with 4 ppl as labour and 10 ppl in power and machinery costs. It struck me that there was a lot of tractors and telehandlers for 500 cows as there was 14 of these machines.

This sparked my interest. After all does a dairy farm need one tractor per worker; or two tractors; or more? Is it more cost efficient leaving some tractors attached to specific machines, or is this an expensive luxury? Should dairy farmers use contractors or do the work themselves?

I carried out some research using the accounts of dairy farmers plus details of their milk production and tractor and telehandler ownership, and there were some interesting results.

From my sample of dairy farms it was striking that efficient farms had 55 cows for each tractor compared to the less efficient farms which only managed 30 cows for each tractor.

For a 220 cow dairy, the efficient milk producer would have four tractors, whereas a less efficient producer would have seven. This is a huge difference. I have not looked at whether the efficient farm uses more contractors, or why there is this difference, never the less it seems to me that this is significant.

Not only did the efficient farms have fewer tractors, but the tractors they had were smaller. The efficient farms had an average tractor size of 92 horse power, whereas the less efficient farms had tractors averaging 112 horse power. That is a big difference with the more efficient farms having tractors 20% smaller on average.

Another way of looking at this is the number of horse power per dairy cow. The most efficient farms had 1.7 horse power per cow and the least efficient 3.7 horse power, so going back to the 220 cow example, the most profitable farms would have 374 horse power in the holding, the least efficient 814 horse power.

So, what can we learn from this?

It seems to me that there is a direct relationship between the number of tractors on a farm and the efficiency with which they get milk out of cows. This is not really a big surprise, but the difference between the best and poorest is remarkable.

One farmer once told me, that they had milked 500 cows from Friday night until Monday morning without starting a tractor. OK, it was the summer, but his enthusiasm for cheap milk production was infectious. How many dairy farms can do this?

To survive and prosper dairying, farm businesses need to become more efficient, but how do you do this? A starting point would be to calculate how many tractors and telehandlers you have, and compare it to the above figures.

If you are not close to the best figures, then there is room to improve. Remember that doing the same thing again this year will give you the same result as last year, so some change will be needed if you want to improve.

Try selling a tractor and not replacing it, then use a contractor for the operations that you then cannot do yourself. There may be some inconvenience with having fewer tractors, however does the expense justify having the tractor? If it works once, could you sell another tractor without replacing it?

For successful businesses reducing machinery costs is an ongoing theme. Often it is not wholesale change that is needed, but incremental improvements over many years. Constant attention to costs and always focussing on how to reduce the number of operations and the amount of owned machinery is essential.

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Table of results

Efficient Dairy Farms		Less efficient dairy farms	
Cows per tractor	55	Cows per tractor	30
Average horse power per tractor	92	Average horse power per tractor	112
Horse power per cow	1.7	Horse power per cow	3.7

First published in Dairy Farmer

Good news for owners of vineyards and cider orchards

Last year CLA asked HMRC to provide certainty that vineyards would be accepted as agriculture for the purposes of claiming inheritance tax agricultural property relief. Early this year HMRC confirmed that their Inheritance Tax Manual had been updated. Their guidance now states that qualifying vineyards are to be accepted for the purposes of agriculture. Their previous version of the manual just referred to the "cultivation to produce food for human or animal consumption". This has been amended not only to include as an example the growing of grapes for wine but also apples grown to produce cider.

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ARLA CONFIRM PROFIT SHARE TO FARMERS!

Arla's board of directors have confirmed that all of its profit of £252m for the 2018 year will be paid to its 11,200 European farmer members.

This should equate to 2p/litre and will mean that a dairy farmer producing 1 million litres will receive an extra payment of £20,000.

While the payment will be very welcomed from a cashflow perspective, it is important to remember that it will increase the taxable profit for your business – discuss the implications with your accountant and amongst other things, make sure a full Farmers' Averaging relief assessment is completed to minimise any tax liabilities.

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VAT - PARTIAL EXEMPTION

More and more farming operations are experiencing the impact of partial exemption on their VAT accounting as they diversify away from farming activities and move into areas where they let cottages, land and buildings. Although in most cases these rentals will be VAT exempt i.e. no VAT is chargeable on the income received, the activities can lead to difficulties with recovering VAT on the associated costs.

The general premise here is that while the VAT incurred on costs directly associated with taxable business activities (i.e. the farm sales made at the zero rated, reduced rate or standard rate of VAT) can be claimed as input tax through the farm's VAT returns any VAT incurred on costs which are attributable to the exempt supplies (rent) can only be recovered where its value falls below certain limits. These are the partial exemption de minimis limits where in most cases the VAT on the costs associated with the exempt activities has to fall below both £625 per month on average and 50% of the total input tax claim for it to be recoverable from HMRC.

These provisions place an onus on the farm to correctly identify the VAT treatment of the sales it makes and then carry out an exercise under which the VAT incurred on the associated expenditure is attributed to the taxable and the exempt sales. This is the basis of a partial exemption calculation that needs to be carried out for each VAT accounting period and then again for each VAT year to calculate whether all of the VAT incurred can be claimed from HMRC. A VAT year will end at 31 March, 30 April or 31 May each year depending on the dates of the VAT returns and if any adjustment is required to the claims made on the previous returns it has to be taken into account, at the latest, by the submission of the first return for the next VAT year.

The provisions are not particularly straightforward and do carry an exposure to penalties and interest charges where the rules are incorrectly applied. However they also to provide an opportunity for some VAT planning through by considering the impact of VAT on a particular project. For example under the de minimis limits spending a VAT exclusive figure of £50,000 on the standard rated refurbishment of a cottage for residential letting in one VAT year would mean that the £625 limit above is exceeded with the effect that £10,000 in VAT incurred would be irrecoverable. In some cases it may be possible to spread the cost over two VAT years to take advantage of two years worth of de minimis limits. In other cases it may be possible to look at the liability of the building work – if the work qualified for the 5% reduced rate it could mean that the VAT involved falls within the de minimis limits anyway. In addition where you have commercial let property you can elect to opt to tax these which results in VAT being chargeable on the rent (which hopefully your VAT registered tenant can reclaim) but allows you to reclaim VAT on the associated costs. Advice should be taken before opting any property as there are long term implications of this.

The main point to note is that it is always better to consider the VAT recovery position at the outset of a project rather than having to make an adjustment to the VAT claimed later on.

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XERO TOP TIPS - PART EXCHANGE AND HIRE PURCHASE

A common question I get asked is how to enter an invoice including a part exchange and a balance financed on hire purchase.

In the example below:

- Cost of new tractor - £67,000 excluding VAT
- Proceeds from sale of old tractor - £33,250 excluding VAT
- Balance financed - £35,000
- Deposit paid - £5,500

Firstly, we need to enter the purchase price of the new tractor of £67,000 with a tax rate of 20% VAT on the expense.

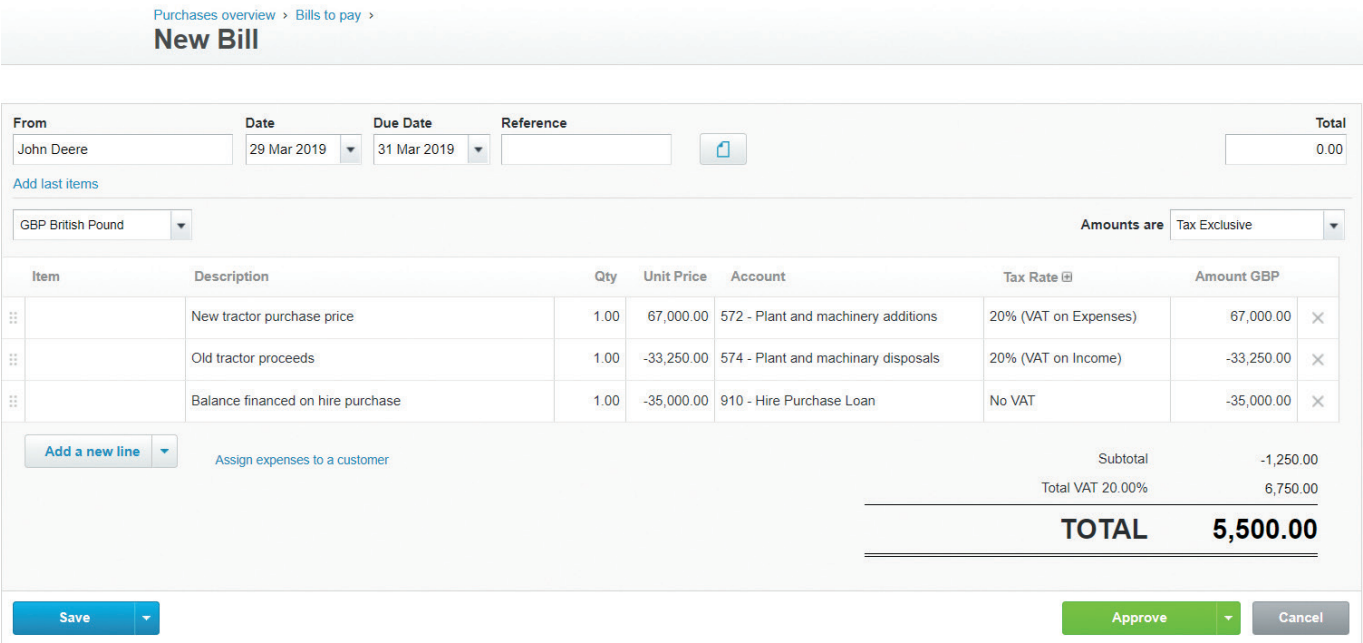
On a new line, we can then show the proceeds from the part exchanged tractor of £33,250 with a tax rate of 20% VAT.

On another separate line, we show the amount financed with a 'no VAT' tax rate.

At the bottom of the invoice, we are left with the total cash deposit physically paid for the tractor of £5,500. This amount can be bank reconciled.

The VAT total shown is the net VAT on the sale; however on the VAT return it is shown separately as £13,400 VAT on purchases and £6,650 VAT on sales.

See example below:



Purchases overview › Bills to pay ›

New Bill

From: John Deere | Date: 29 Mar 2019 | Due Date: 31 Mar 2019 | Reference: | Total: 0.00

Add last items

GBP British Pound | Amounts are: Tax Exclusive

Item	Description	Qty	Unit Price	Account	Tax Rate	Amount GBP
	New tractor purchase price	1.00	67,000.00	572 - Plant and machinery additions	20% (VAT on Expenses)	67,000.00
	Old tractor proceeds	1.00	-33,250.00	574 - Plant and machinary disposals	20% (VAT on Income)	-33,250.00
	Balance financed on hire purchase	1.00	-35,000.00	910 - Hire Purchase Loan	No VAT	-35,000.00

Add a new line | Assign expenses to a customer

Subtotal	-1,250.00
Total VAT 20.00%	6,750.00
TOTAL	**5,500.00**

Save | Approve | Cancel

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BUYING INTO CHANGE

It has been over 10 years since I discovered the joys of both Albert Goodman (my previous accountant seemed to be a fully paid up member of the HMRC tax collecting department), and being a member of a farm buying group.

The mixed arable/beef farm had expanded to over 1200 acres with one employee, although we were on top of the work, the process of getting quotes was always rushed. How many times did I lose a price written on the corner of a newspaper, or couldn't remember from the mass of numbers all over my diary which was the one I was supposed to ring back? The time consuming process of getting quotes for everything was going by the wayside for all but the larger capital items and other inputs were left to trusted trade partners including a full service agronomy and chemicals package.

The turning point came when I became aware of how much my local fuel supplier was charging and how many notes were being scribbled in the margin of my newspaper (was that a Sudoku solution or a phone number?), the most dramatic figure was how much agrochemicals were costing even after allowing for a separate charge for agronomy. It was time to change.

In one call I can now put in orders for seed, fertiliser, sprays, fuels and oils and all animal feeds livestock equipment and animal health. The order will be efficiently dealt with by friendly knowledgeable people, be the best price on the day and join over 300 other members to give that much more buying power. You can order by phone, email or text and receive one set of invoices per month by post or electronically. On top of this, where I have accounts at major agricultural stores like Mole Valley or Spaldings, or national retailers like Screwfix and Travis Perkins, I get an extra negotiated discount and all the billing goes through the group.

The time savings are difficult to quantify, but the peace of mind that you are buying at the best possible price and the simplicity of invoicing means I would never contemplate going back.

A couple of years ago I was asked to join the board, as this group is farmer run and we continue to strive to offer the best possible service, the price you pay is straight from the supplier, no add-ons and no levies with the group charging a fixed monthly fee to cover its running costs. When you add up the savings it is fantastic value whatever the farm size, and there's so much more space in the margins to work on the Sudoku!

So why not consider it, geographical location isn't important, local firms can still be used and we're only a phone call away.

We are The Orion Farm Group and always happy to discuss your requirements and benchmark your costs to see how you could save, do call us on 01865390011 email us on admin@ofg.org or look at the case studies on our website ofg.org.uk

by Tom Paton

AUNTY AGi

QUESTION:

I am a higher rate taxpayer and my spouse is not. We have recently married and I'm not sure if I want to give my spouse 100% of my let property, despite the tax savings?

ANSWER:

To achieve income tax savings you do not have to give your spouse 100% of your rental property. HMRC's default position for the taxation of rental income from husband and wife jointly owned property, where a Form 17 is not in place, is joint - taxed 50:50. Therefore you could give your spouse just a 1% beneficial interest in the property (keeping the remaining 99% yourself) but benefiting from the default 50:50 split of the profits for tax purposes. However, if you have lived in the property at any stage before marriage you should take advice to ensure main residence relief for capital gains tax purposes is protected.

This is also a useful reminder for those husbands and wives or civil partners with property owned jointly other than by way of 50:50. If you wish to have the rental income charged to tax in the actual ownership proportions this has to be done by election to HMRC.

This type of tax planning can also be helpful to protect:

- Receipt of child benefit
- Personal allowance
- Mortgage interest relief

Any questions? Send them to auntyagi@albertgoodman.co.uk

Keeping in touch

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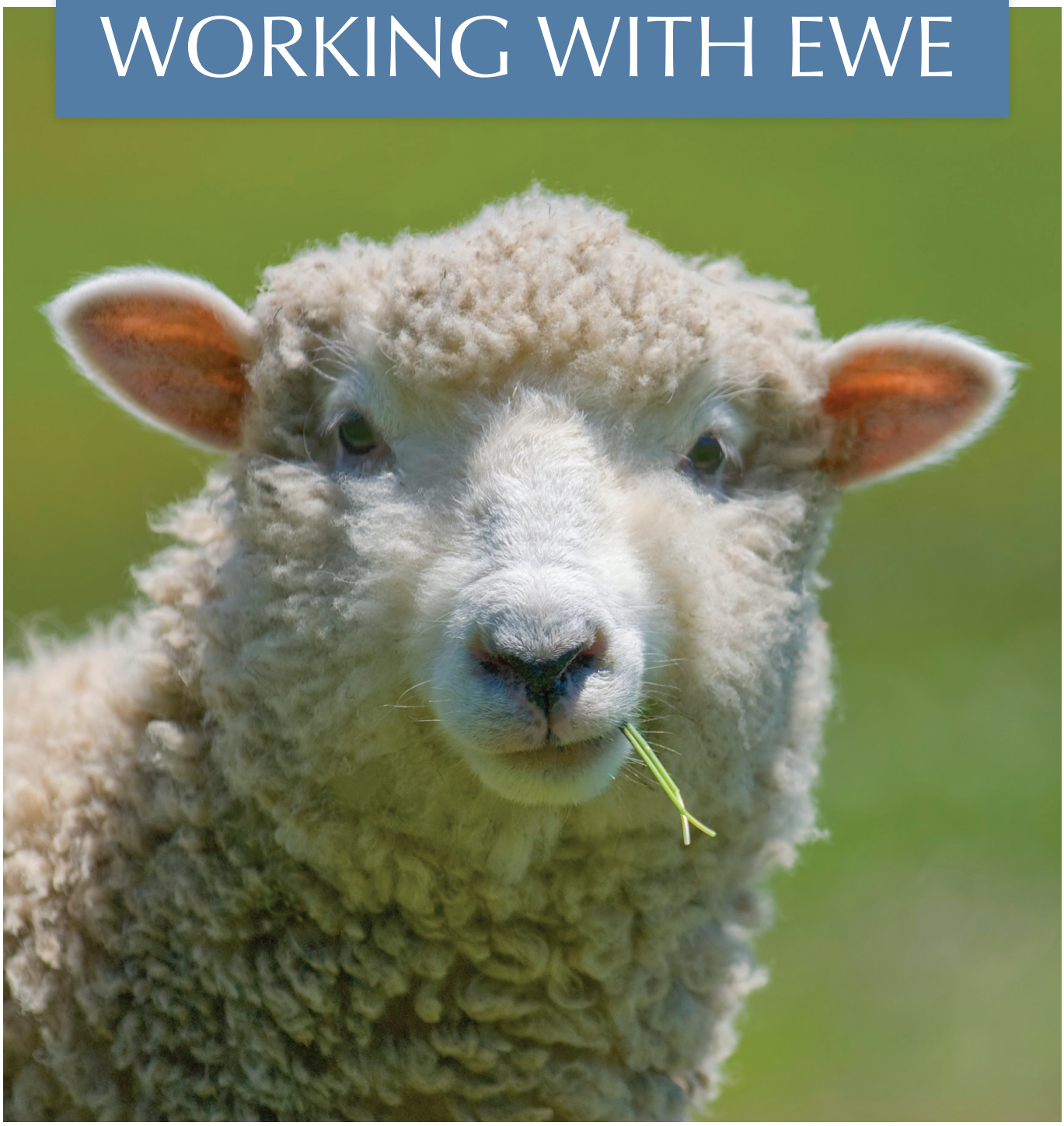

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