CHARTERED ACCOUNTANTS, TAX CONSULTANTS & FINANCIAL PLANNERS

ALBERT GOODMAN

AG RURAL INTELLIGENCE WINTER 2017

INTRODUCTION

I know one thing, and that is I like my eggs soft boiled not hard. I am not sure how I like my Brexit, however it seems to me to be too early to even talk about the impact on agriculture. Having said that, the weaker pound combined with reduced production is helping many farmers benefit from rising prices at present. Long may this continue.

This morning I heard that it is Blue Monday, which is supposed to be the most depressing day of the year. So, maybe this is the day to consider business risk?

Farmers are always taking business risks, whether it is buying stock, planting seeds in the hope they will grow, buying land, or many other actions. Some business risks can be managed, others cannot.

Most farming businesses have historically operated using partnerships or as sole trade businesses. This is simple, but there is unlimited liability. On this depressing Monday, I contemplate that there is greater risk of things going wrong in farming today. There is greater price volatility, globally moving diseases, and the prospect of greater swings in weather patterns. Combined with larger farming businesses the risks are now greater. This could be the year to protect your assets using a limited company.

We at Albert Goodman enjoy helping farming businesses, so please enjoy our newsletter and, as always, get in touch with one of us if you have comments, or would like some expert help.

Iain McVicar
Agricultural team
iain.mcvicar@albertgoodman.co.uk

WHAT'S AT THE END OF THE MILK PRICE TUNNEL?

At last there seems to be a little light at the end of the tunnel for dairy farmers – but be careful because it might just be the bank manager coming the other way with a torch!

The majority of dairy farmers have needed extra support from their bank to survive the last 12 months and with the odd notable exception and occasionally with more difficulty than might have been expected, the banks have been very supportive and should be recognised and applauded for such.

However, both borrower and lender will have learnt some important lessons during the process that will help the relationship when the next downturn in milk prices occurs.

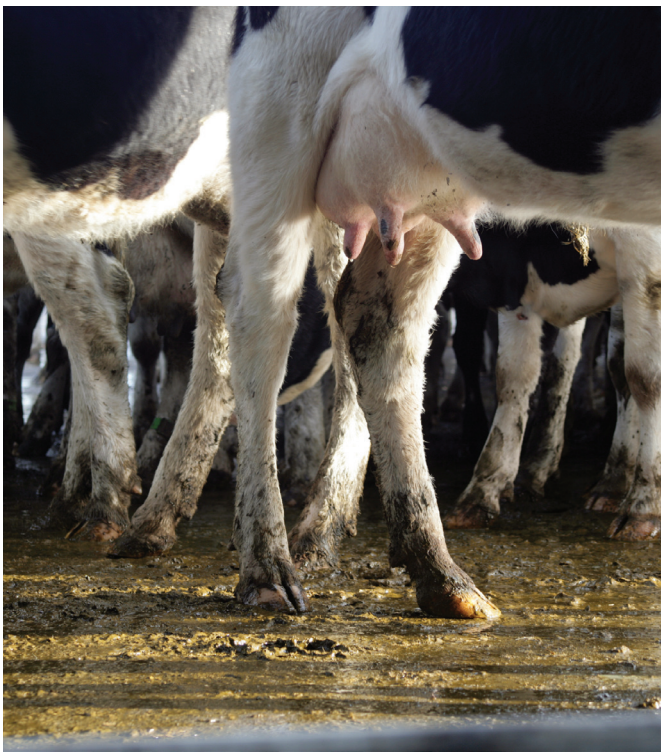
For the borrowers it was a case of needing the cash to carry on farming as the monthly milk cheque was not enough to pay the bills and for the banks it was a case of trying to support those farmers that they thought had a long term future in milk production. I am sure there were some situations where the banks and borrowers disagreed about whether or not the farm had a long term future – and I am also sure that the banks were supportive of some where they thought that the best way existing borrowing would be paid back was to keep the farm going long enough for it to come out of the downturn before "asking for" the money back.

Now that the concept of milk price volatility is firmly (and bitterly) entrenched with no part of the supply chain apparently that enthusiastic to do anything about it in the future, some very clear business lessons have come sharply into focus:

1. Whatever the milk price, it is the producer with the lowest unit costs of production that is the best off.
2. In times of poor milk price, more cash will be needed and so borrowing facilities will need to increase, and critically...
3. In times of better milk prices there will be a cash surplus and that is when the extra borrowing taken on in the downturn must be repaid to make sure the business is able to access extra support again from its bank.

It is that last point that worries me most – at what rate and when will the banks want the extra money back? Not only are they obviously entitled to it, but both borrower and bank will be better placed for the next downturn to be able to ask for and provide (respectively) the extra support that will inevitably be needed. If the extra borrowing from the downturn is not repaid, it is likely that the bank will not have the flexibility to support (on the basis that if they do they will simply be entering every downturn with more borrowing in place which is clearly unsustainable).

So the critical questions of the bank over the next year are by how much and by when does it want the borrowing repaid? Ideally this is a question that the borrower will have the answer to before the bank has a chance to reply – it is in the farmer's interest to know the answer rather than pretend or assume it doesn't matter. It can very easily be worked out once unit costs of production are known.



I have no doubt that the mainstream banks all want to support dairy farmers in the long term but that cannot be interpreted as universal support in principle for the next downturn. This is not about being unnecessarily pessimistic, it is about making sure the better price years are used prudently to make sure that the lower price years can be coped with.

So while pleased that our dairy farming clients are at last seeing some relief from the awful last 12 months, it is a word of caution to recognise that the bank manager is going to be asking some important questions about the future of the business, its borrowing needs across the whole milk price cycle and what level of debt needs to be repaid before the business runs out of cash again. Hopefully both parties will then be much better placed when the relationship is properly tested again.

Pat Tomlinson
Agricultural team
pat.tomlinson@albertgoodman.co.uk

ARE YOU REALLY FARMING?

This is a very important question for those who 'farm' their land through grazing or cropping licenses, contract or share farming arrangements. HM Revenue and Customs are often raising this question – whether you are farming or not can have significant tax consequences.

The case of John Carlisle Allen v HMRC [2016] TC05100, referred to in our summer 2016 newsletter, was such a case where this question was asked. The case concerned a landowner in Northern Ireland who was letting land under a conacre arrangement (similar to a grazing license). The dispute concerned capital gains tax (CGT) and essentially whether the landowner was selling an investment asset or a business asset. In the latter case relief from CGT would apply.

Securing landowner 'farming' status gives several tax advantages. These include the treatment of the income as earned income, allowing the landowner to deduct various expenses against the income, and to claim the VAT back. The farm will qualify for CGT rollover, holdover and entrepreneurs' relief, and for inheritance tax purposes the owner may still be in agricultural occupation of the farmhouse. In addition, business property relief will also be available for any non-agricultural value.

To qualify as a farmer attention needs to be paid to the legal agreement and the activities the landowner performs. To be farming the landowner must be in occupation of the land and the occupation must be for the purposes of husbandry. The approach by the courts is to determine the primary use of the land and then to ascertain the identity of the person who had that use. In case law, the courts have been prepared to accept the landowner as the person with the primary use provided he conducts some activities 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 would include fertilising, seeding, and controlling weeds on the land. Mere acts of maintenance, such as hedge cutting, would not be treated as husbandry.

It is also important that there is always some business risk for the landowner. A guaranteed income every year would not give such risk.

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.

In essence, if you wish to protect your farming status, and you are relying on such arrangements, you should take advice now. The agreements and the relationship between the landowner and third party should be reviewed.

Sam Kirkham
Agricultural team
sam.kirkham@albertgoodman.co.uk

AUTO ENROLMENT – KEY POINTS TO NOTE

- Auto-enrolment was introduced decades ago by nations such as Denmark, Switzerland and Holland – the UK is 35, even 40 years behind.
- It is a legal requirement – there are significant fines for those who don't comply.
- It applies to all employers – from one employee upwards.
- Employers are given a staging date – the date by which the pension must be ready to start. It is possible to postpone the staging date (max 3 months).
- All employees must receive a letter from their employer about the new pension arrangement.
- Employees aged between 22 and state retirement age, earning £10,000 per year or more must be automatically enrolled.
- Employees outside the age range or with earnings below £10,000 are not automatically enrolled, but must be offered the opportunity of joining the pension scheme.
- Contributions to the pension are made monthly, with both employer and employee starting contributions at a minimum 1% of annual salary.
- In future contributions will increase - up to 4% for the employer and 5% for the employee.
- There is an opt-out option for employees – but the employer cannot be involved with this.
- Employers have certain duties – regular reporting, record keeping and the on-going monitoring and maintenance of the pension scheme.
- A range of pension providers and solutions are available – for which research is essential.
- Professional help tailored to employers' needs is readily available from Albert Goodman.

Andrew Hooper
Workplace Pensions
andrew.hooper@albertgoodman.co.uk

DIVIDENDS – WIN OR LOSE?

The new system for taxing dividends has been with us for nearly a year. With the tax year end approaching it is important your tax position is reviewed and your business makes maximum use of the new dividend allowance.

- All UK taxpayers have a £5K dividend tax allowance – no tax is due on the first £5K of dividend income.
- The balance over £5K will be taxed as the top slice of your income, at 7.5% within the basic rate band; 32.5% within the higher rate band; and 38.1% within the additional rate band.
- The 10% notional credit ceased to apply from 6 April 2016.

Example 1: Non-dividend income of £6.5K and dividends of £12K

The non-dividend income and £4.5K of dividends fall within the personal allowance so are below the threshold for tax. The next £5K of dividends is tax-free too - they fall within the dividend allowance. Tax of £187 (7.5%) is due on the balance of dividends. (Under the pre-April 2016 rules no tax was due)

Example 2: Non-dividend income of £18K and dividends of £22K

The first £5K of dividend income is covered by the dividend allowance and is tax-free. Tax of £1,275 (7.5%) is due on the remaining £17K. (Under the pre-April 2016 rules no tax was due on this dividend income).

Example 3: Non-dividend income of £40K and dividends of £9K

The first £5K of dividend income is covered by the allowance. Tax of £1.3K (32.5%) is due on the balance of the dividend income. (Under the pre-April 2016 rules tax of £900 would have been due on this dividend income).

In summary, those who receive dividends of up to £5K a year will be better off. However, higher tax liabilities are likely for those with significant dividend income - particularly investors and those running their business through companies.

It is important that farming businesses run through limited companies make maximum use of the £5K allowance. Consider putting shares into the names of spouses, parents and children where appropriate. It is important this is reviewed before the end of the tax year.

Andrew Withers
Agricultural team
andrew.withers@albertgoodman.co.uk

TRUSTS - WHY USE THEM?

Trusts are commonly perceived as being both complex and only for the very wealthy. However, the reality is that trusts are available and accessible to many and should probably be considered by all families!

The main benefits that trusts can achieve are:

- To ensure assets move through and between generations of a family, protecting against claims by third parties (on marriage break-ups or financial difficulties), taxes or unexpected changes in circumstances;
- To help protect against assets being unnecessarily taken to pay for care fees;
- To pay assets out sooner on a death, without having to go through a lengthy probate process;
- For efficient gifting of funds from grandparents or parents to help future generation's school or university fees, or to support a property purchase.
- As part of an inheritance tax planning exercise either to minimise capital gains tax on a gift of assets or (and sometimes in addition to) where the parent or grandparent does not wish to relinquish control immediately or continued protection against the unexpected or unknown (divorce or who will actually take over the farm) is required.
- To keep life assurance benefits from being taxed in the deceased's estate if the life cover pays out, likewise with pension assets.
- To provide flexibility in a will. This is particularly helpful where it is not yet known who should inherit the farm.

Trusts are of use in most family and business situations. However they are particularly useful for farms and estates where assets need to be retained and protected for future generations to run the business. Trusts often form part of any planning for succession of a business, inheritance tax, will and capital gains tax planning.

Sam Kirkham
Agricultural team
sam.kirkham@albertgoodman.co.uk

BUDGETING AND IMPORTANCE OF CASH FLOW MANAGEMENT

Cash flow will be key for most businesses to survive over the next 12 - 24 months. With good planning, there are a few decisions you could be making now, to help alleviate future cash flow pressures.

Accurate budgets and financial projections will be a good starting point to get a detailed picture of where you expect your business to be in the next 12 – 24 months. To be able to critically review this will be crucial to ensure that future commitments or essential spending can be met, such as:

- Will you be in a position of taking advantage of better terms on seeds, fertilisers and sprays and other input costs?
- Will you have sufficient means to meet capital expenditure plans?
- Will existing and future borrowing obligations be met?
- Will you miss opportunities by not having the available residual cash?
- Living requirements and life style.

Asking such questions may reveal a shortfall and indeed, in some cases, an early discussion with your bank manager may be required. However, there are a number of other questions that you should ask before approaching your bank.

The timing of crop sales will be crucial as will price fluctuations over the coming year. Futures prices do show an upturn but, much will depend on global demand, the weather and international tensions, including any impact from Brexit. Decisions regarding possible forward selling and pooling will become increasingly relevant. Discussions on the level of risk you are prepared to accept is also central to the final decision.

Decisions regarding discretionary spending such as repair projects, capital investment plans, new projects and restructuring should be assessed closely with reference to cash flow or availability of additional finance. In most cases businesses would have taken advantage of the high levels of annual investment allowance available and be heavily geared up with machinery to see them through these tougher periods with little need for further investment.

On the upside there is likely to be lower levels of tax to pay and with GBP weakening against the Euro following Brexit, it will help to increase the value of your Basic Payment Scheme income.

On the face of it, 2016 and 2017 may be difficult, but early discussions with your accountants, possibly in conjunction with your bank, may make the next 24 months a little easier all round.

James Bryant
Agricultural team
james.bryant@albertgoodman.co.uk

VAT AND PARTIAL EXEMPTION

Many farmers will look at ways of diversifying their activities to generate additional turnover but very often overlook the implications on their VAT accounting. This is especially true where there is a move away from the traditional taxable but zero rated activities such as crop, livestock and milk into activities which centre on property letting.

Generally the letting of property is exempt for the purposes of VAT and although this will mean that no VAT has to be accounted for on the income received, it will also mean that that the VAT incurred on the associated costs is not automatically recoverable through the farm's VAT returns.

In a situation where VAT exempt property letting is the only activity with the effect that there is no taxable turnover, there is no prospect of a VAT registration and no entitlement to the recovery of VAT on the associated costs. However where there is a mix of taxable and exempt activities partial exemption will be a feature and the farmer will need to carry out partial exemption calculations to determine his VAT recovery position.

These calculations will identify the amounts of VAT incurred on the associated expenditure and establish how much relates to each side of the business, i.e. to the taxable farming and exempt property letting. There are limits to take into account in that if the VAT calculated to relate to the exempt activities is less than both £625 a month on average and less than 50% total input tax it can still be claimed but calculations still need to be put in place to work this out.

Although there are some simplifications available the calculations will generally have to be made each VAT accounting period and an annual adjustment carried out at the end of the VAT 'year' – unless an alternative is agreed with HM Revenue and Customs this will be 31 March, 30 April or 31 May according to the dates of the VAT return periods, for those on monthly returns the VAT year ends at 31 March each year.

In some cases steps can be taken to reduce the impact of partial exemption – for example for non-residential lettings an option to tax can be taken so that the rental income received becomes liable to VAT at the standard rate rather than VAT exempt . As a result the activity is taxable for VAT purposes removing the problem of any irrecoverable input tax or indeed the need to carry out calculations to prove the position. Residential letting can only be VAT exempt and there is no chance of converting this into a taxable activity for VAT purposes.

This is a complex area of VAT and this brief note only really touches on the principles involved. If this is area where you require any advice or assistance please let us know.

Andy Branson
Agricultural team
andy.branson@albertgoodman.co.uk

PAYING YOUR CHILDREN

It is common practice on farms for the business owner's children to work within the business from a relatively young age. In this article I do not propose to look at the legislative quagmire surrounding employing children, but would like to focus on the financial consequences of the employment.

Every child has a tax free personal allowance totalling £11K, which is the amount that they can earn before paying income tax. There is a slightly lower limit before National Insurance (NI) is due, which totals just over £8K per year.

Where a child is aged 16 or over they will have a NI number, and so any pay will need to go through the farm business payroll. For children younger than 16, their pay does not need to go through payroll unless their total income is over their personal allowance.

There was a legal case from 1981 called "Dollar v Lyon (HM Inspector of Taxes)", where the Judge stated, that for the payment of wages to children to be tax deductible expenses, then the payments need to be wholly and exclusively for the benefit of the taxpayers' trade. Also, the payments should not be seen to be pocket money in return for work.

For the pay to be a tax deductible expense in the business it should reflect the type of work that the children are undertaking and be justifiable.

The child's age and the type of work undertaken make a difference. In practice it is unlikely that a child under the age of 13 would contribute that much to the farming business, so paying children under this age, and expecting the cost to be tax deductible may be unwise.

Also, the wages do actually need to be paid to the child, so setting up a payroll amount, but never paying the child is not the same as paying the children.

It is best if a record of the number of working hours can be kept, and this used to calculate the amount payable to the child on a weekly or monthly basis, on the same basis as you would for any other employees.

Ultimately, there is often a tax benefit from having properly paid children. The farming parents, if they are basic rate tax payers, will probably be paying 29% tax (20% income tax plus 9% NI). Therefore if a child receives pay totalling £5K in a year, then the parents pay £1,450 less in tax themselves. This helps to make the additional administrative costs worthwhile.

Iain McVicar
Agricultural team
iain.mcvicar@albertgoodman.co.uk

FRS 102 FOR FARMERS – NOT JUST ACCOUNTANTS TECHNICAL JARGON BUT IMPACTING YOUR ACCOUNTS

One of the most substantial changes to accounting standards in a generation is now in force with the introduction of the key new standards FRS 102, FRS 102.1A for small entities and FRS 105 for micro entities.

Whilst this might sound like technical jargon that you will just leave to your accountant, it is important you are aware this will have an impact on the way your accounts are prepared, what they look like and potentially the amount of tax you will pay.

FRS 102 became mandatory for medium-sized companies with effect from 1 January 2015 and for small companies and LLPs in the form of FRS 102.1A with effect from 1 January 2016. This now represents UK Generally Accepted Accounting Principles (UK GAAP) and, as such, will apply to all businesses including, to some extent, those that are not incorporated.

Some of the changes from adopting FRS 102 will have significant impact and may affect many aspects of agricultural accounts which are not mentioned below. However, the key changes for agricultural accounts are in the areas of stock, income recognition of grants and financial instruments.

Stock

”Stock” in farming terms means livestock or crops grown for sale. Under FRS 102, there is a choice between carrying stock at either “fair value” or “historic cost”.

Under FRS 102 the definition of cost is similar to that under the current standards and therefore it is unlikely that any changes will be required.

However, the area which is most likely to cause concern is where production livestock is held on the “herd basis”. In the past there has been little consistency in the way that an elected herd was disclosed on the balance sheet or valued, however many include the herd within fixed assets using the tax value.

Under the new rules herd animals are “biological assets” and must be included within stock at depreciated cost or fair value but not at the tax value of the herd. This change is likely to lead to transitional adjustments in your accounts in order to change the presentation and the amount in the prior year to make it consistent with FRS 102.

Recognition of grants

Almost all farming businesses will be in receipt of Basic Payment Scheme (BPS) and essentially the main issue here is one of when the grant income should be recognised. Under FRS102, government grants cannot be recognised until there is reasonable assurance that the farmer will comply with the conditions for the grant and that the grant will be received. Depending on your year

end this has an implication on the way that BPS income is recognised in your the accounts.

Specifically, the greening conditions cannot be met until 31 December at least and therefore farms will be unable to recognise the income until after this date, despite the occupation date and submissions being triggered in May. For those businesses with a year end between May and December this means that BPS income cannot be recognised until much later than under the old rules. Potentially this will cause BPS income to skip a financial year and will impact your profit, although potentially it may also defer tax bills.

Financial Instruments

This captures arrangements to sell crops or livestock under forward contracts. Such contracts will need to be carried at fair value, as will loans containing caps or collars or swaps. This may require a specialist valuation.

FRS 105 for micro entities

Businesses which qualify as micro entities can chose to adopt FRS 105 rather than FRS 102. This will remove some but not all of the changes outlined above, one of the main points being that FRS 105 does not allow the use of fair value. To qualify as a micro entity a business must meet two of three criteria, being, turnover of not more than £632,000, total assets of not more than £316,000 and not more than 10 employees.

Sophie Parkhouse
Technical Manager
sophie.parkhouse@albertgoodman.co.uk

AUNTY AGi

A new spot in our newsletter - please email auntyagi@albertgoodman.co.uk if you have a query you would like answered by Aunty AGi.

Our first query asks – Do I have to pay my January tax bill?

Income tax and capital gains tax liabilities for the 2015/16 tax year were due for payment by 31 January 2017. In addition the first payment on account towards the 2016/17 tax year was due at the same date. The payment on account is calculated as half the liability for 2015/16. The second payment is due by 31 July 2017.

Where tax is paid late interest is charged at 3%. In addition penalties will be charged as follows:
30 days late - 5% of tax overdue
6 months - further 5% of tax overdue
12 months - further 5% of tax overdue

Agree time to pay with HMRC

If you are not able to pay your tax in time you should contact HM Revenue and Customs as soon as possible. You may be able to agree with them either:

- more time to pay, or
- to pay your bill in instalments by direct debit

Interest will still be due. However, you may avoid penalties by contacting HMRC as soon as possible.

Reduce payments on account

Where you expect income to reduce in 2016/17 you should also review your payments on account to see if they can be reduced. A claim can be made to reduce your payments on account now so that your 31 January 2017 and 31 July 2017 liabilities are reduced.

Review loss and averaging claims

Where you expect a loss in your accounts in the tax year to 5 April 2017 the tax position should be reviewed as soon as possible with a view to carrying back losses and making averaging claims. These claims can reduce your 2015/16 tax liability and payments due in January and July 2017.

DATES FOR THE DIARY

Farmer's Question Time – The Winds of Change at White House Farm
Thursday 16 March 2017 – Taunton Racecourse

The Budget 2017
8th March- Somerset County Cricket Club

Farming – A Family Business – Joint seminar with Stags and Porter Dodson

Tuesday 28 February 2017 – The Beambridge Hotel, Wellington

Wednesday 1 March 2017 – Red Lion, Beaminster

Tuesday 7 March 2017 – Langport Arms, Langport

Contributing most to our clients' success

Our aim is to work closely with our clients. Our practical agricultural knowledge, accounting and tax expertise and enthusiasm mean that we are well placed to do this. We believe that we bring a proactive approach and fresh perspective to our clients' businesses. This means that we can give the best possible advice, enabling businesses to have the most suitable structure, pay the least amount of tax and effectively plan for the future.