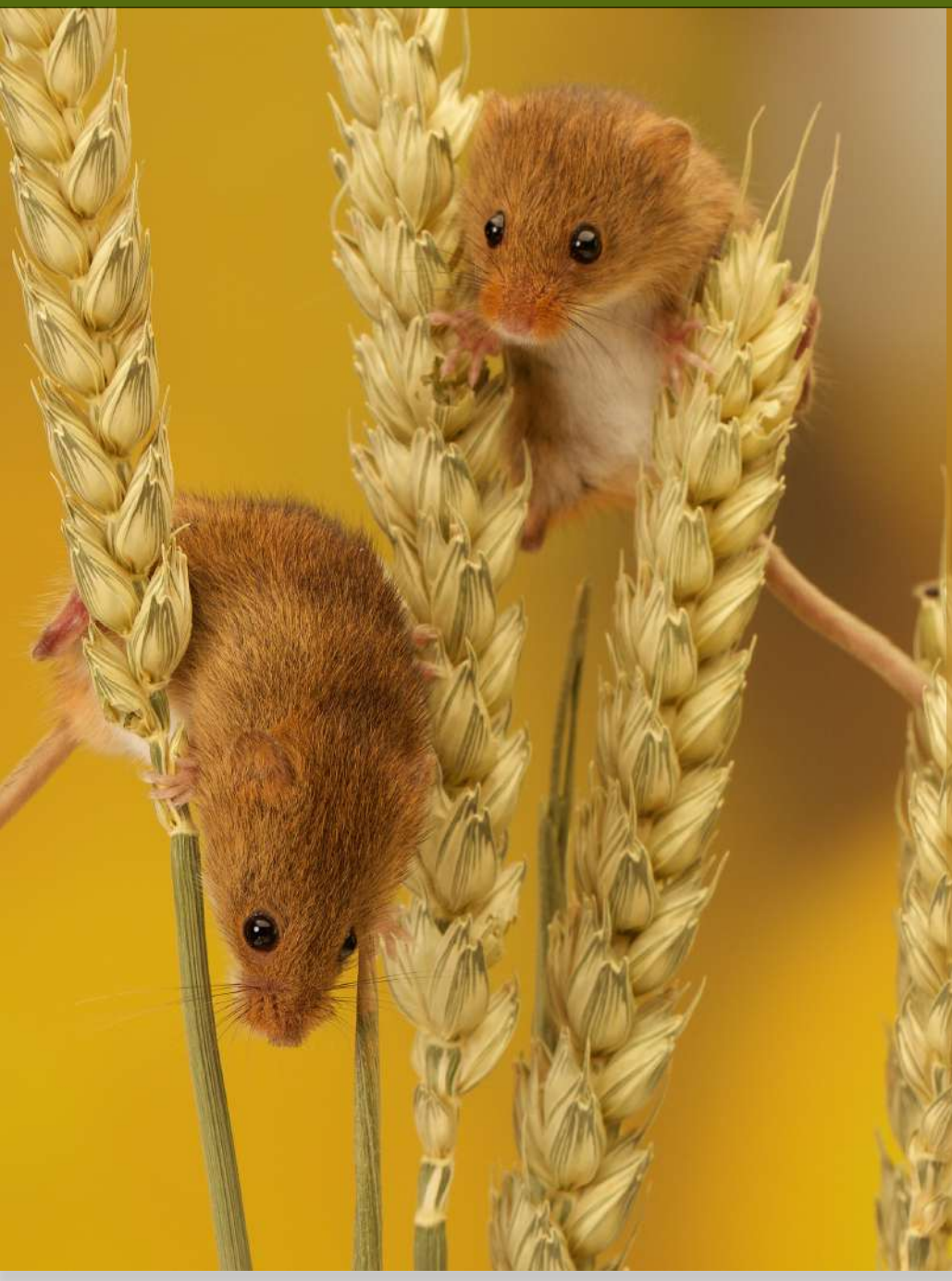
PKF FRANCISCLARK

Chartered accountants & business advisers

# Farming Matters

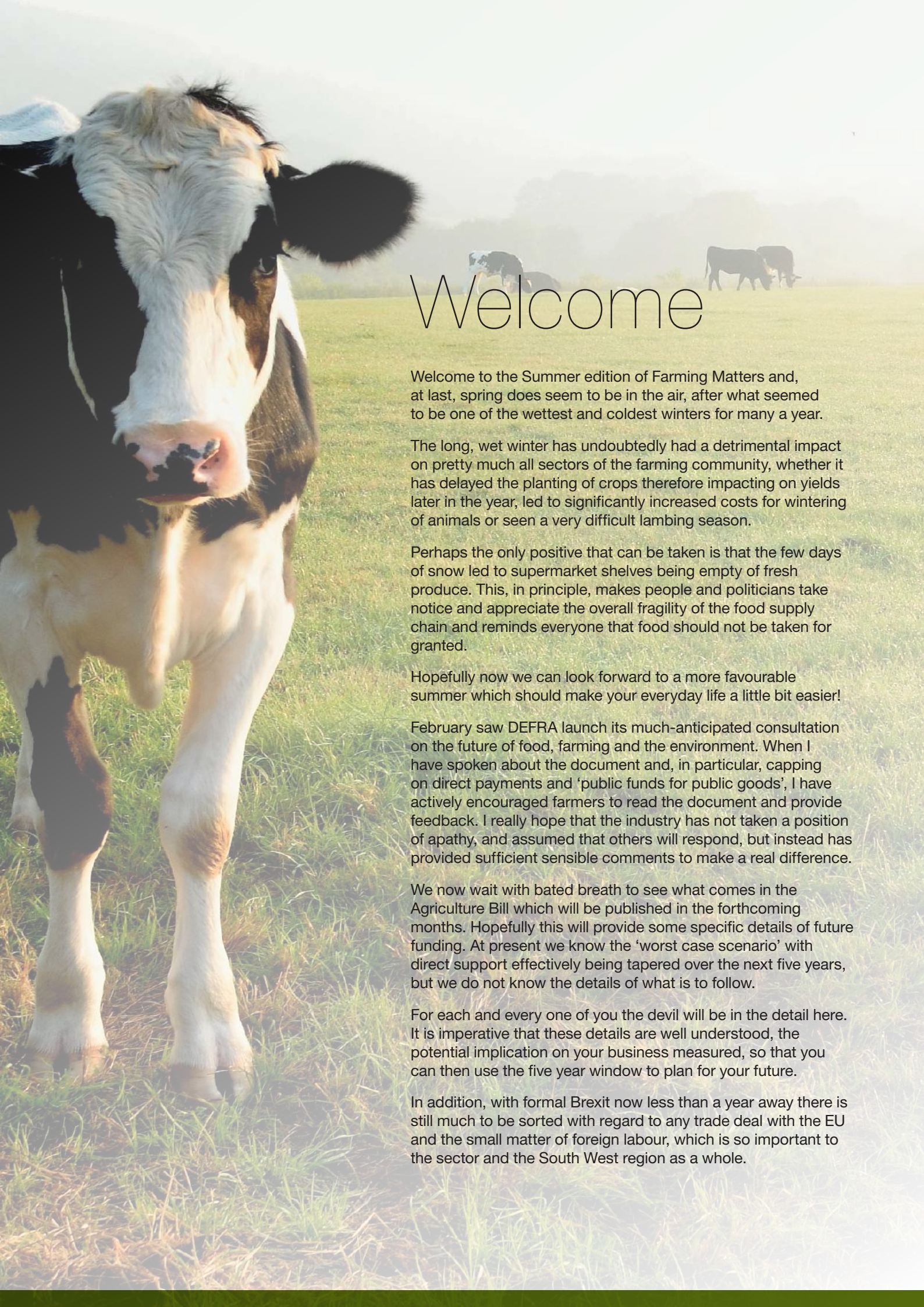
Summer 2018



## In this issue



supporting you and your business



# Welcome

Welcome to the Summer edition of Farming Matters and, at last, spring does seem to be in the air, after what seemed to be one of the wettest and coldest winters for many a year.

The long, wet winter has undoubtedly had a detrimental impact on pretty much all sectors of the farming community, whether it has delayed the planting of crops therefore impacting on yields later in the year, led to significantly increased costs for wintering of animals or seen a very difficult lambing season.

Perhaps the only positive that can be taken is that the few days of snow led to supermarket shelves being empty of fresh produce. This, in principle, makes people and politicians take notice and appreciate the overall fragility of the food supply chain and reminds everyone that food should not be taken for granted.

Hopefully now we can look forward to a more favourable summer which should make your everyday life a little bit easier!

February saw DEFRA launch its much-anticipated consultation on the future of food, farming and the environment. When I have spoken about the document and, in particular, capping on direct payments and 'public funds for public goods', I have actively encouraged farmers to read the document and provide feedback. I really hope that the industry has not taken a position of apathy, and assumed that others will respond, but instead has provided sufficient sensible comments to make a real difference.

We now wait with bated breath to see what comes in the Agriculture Bill which will be published in the forthcoming months. Hopefully this will provide some specific details of future funding. At present we know the 'worst case scenario' with direct support effectively being tapered over the next five years, but we do not know the details of what is to follow.

For each and every one of you the devil will be in the detail here. It is imperative that these details are well understood, the potential implication on your business measured, so that you can then use the five year window to plan for your future.

In addition, with formal Brexit now less than a year away there is still much to be sorted with regard to any trade deal with the EU and the small matter of foreign labour, which is so important to the sector and the South West region as a whole.

Rest assured, we will be keeping a close eye on this and looking at how this will affect our clients and the sector in general going forward. There are interesting and busy times ahead!

On a separate note we have been making, and will be continuing to make, our clients aware of the impending implications of Making Tax Digital (MTD). The first phase of this will be Making Tax Digital for VAT (MTDfV) which will change the way that most businesses submit their VAT return from April 2019. For VAT return periods starting on or after 1 April 2019, businesses with a taxable turnover above the VAT registration threshold of £85,000 will have to maintain their VAT records in a digital format.

It will be acceptable to maintain VAT records on a spreadsheet but MTD compatible software must be used to submit the figures to HMRC directly from the software. For those using accounting software, submission of VAT returns will be made directly from that software. PKF Francis Clark has produced a Q&A on MTDfV which can be found on our website at **https://www.pkf-francisclark.co.uk/resources/factsheets/mtd-for-vat-questions-and-answers/** See the separate article in this newsletter for more information on cloud based systems.

If you have not yet done so, I urge every business to speak to us about how MTD will affect your business and whether or not your current bookkeeping system will be compliant. Please don't assume that you will be OK or that this won't affect you. There is just about enough time to do something, **but** the clock is ticking.

Finally, my colleagues and I look forward to seeing many of you at a good number of agricultural shows over the forthcoming summer months. These are some of my favourite days of the year, a great chance to showcase what is so good about the farming sector, stop and chew the fat and (fingers crossed) enjoy the sunshine!

Brian

**Brian Harvey,**
**Head of Agriculture**

# AGRICULTURE...
# meet making tax digital

Making Tax Digital (MTD) is the Government's new initiative to assist businesses in keeping timely and more accurate records. From April 2019 businesses with a taxable turnover above the VAT threshold (currently £85,000) will have to keep their records digitally and provide their VAT return information to HMRC through MTD compatible software. We are keen that our clients don't just see this as an onerous compliance issue, those that have moved to a cloud based system have found numerous additional benefits to them and their business.

*"The software is so easy to use and extremely user-friendly, offering real-time information at anytime from anywhere providing there is an internet connection.*

*"Reconciliations are made easy as the import and download of your bank statements can be automated. This provides you with the ability to efficiently manage cash flow and the financial status of your business on a daily basis. The improved link with our accountant has been a great asset to our financial management."*

Andrea Semmens,
Trendrennan Farm & Accommodation

The transition from manual VAT records to cloud based accounting systems has seen a decrease in the errors made in clients' VAT returns, especially when it comes to slightly more complicated transactions such as buying machinery which has included a part exchange. With the ability to upload documents into the systems, as advisers we are able to assist with ensuring these are all set up correctly and the correct VAT reclaimed and paid.

*"Having used an Excel spreadsheet for many years just to do the bare minimum and claim back VAT I felt it was time to do something more useful for the business. With the MTD rules coming into force it made sense to move to Xero.*

*"The team from PKF Francis Clark were a big help getting it all up and running and were always available to sort out any queries I had, and being able to log-in and directly sort any problems has been great!"*

David Murley,
Higher Bojewyan Farm

Many clients have seen the benefits in terms of tax planning. With the rise in farm gate prices in the financial year to March 2018, we anticipate some better results for the farming industry this year, so tax planning has never been more important. Cloud based software allows you access to timely, up to date and accurate information giving you feedback to make informed decisions on farm expenditure at the touch of the button.

*"In the past completing farm accounts was quite an onerous task which involved a fair bit of duplication of data from Excel spreadsheets to VAT records to cash flows. I found this time consuming and would often put off the task.*

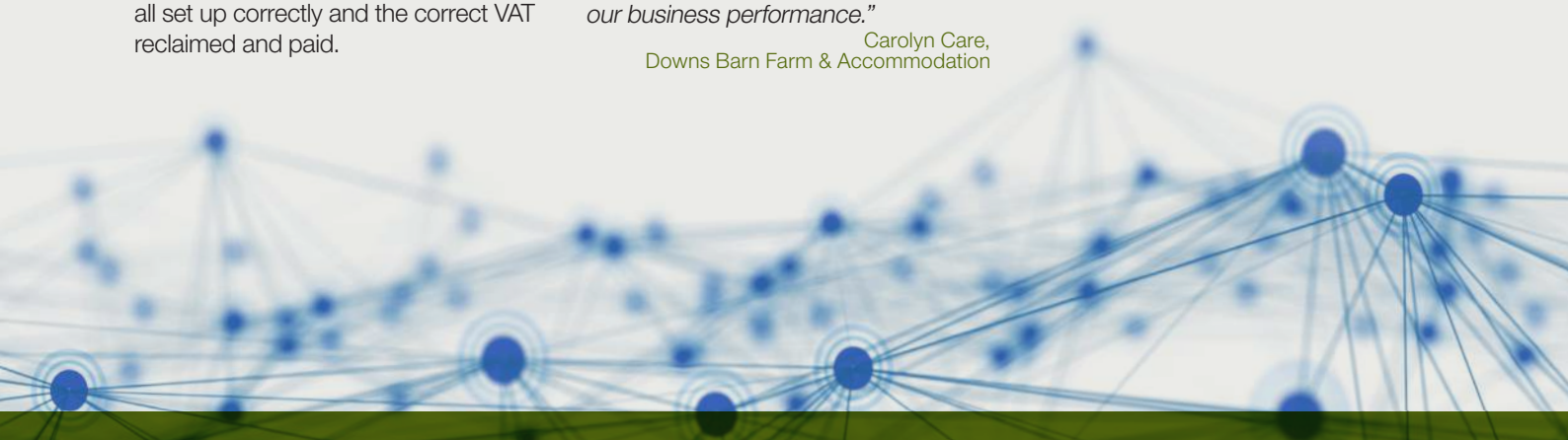
*"I was then introduced to Xero cloud-based software. It has certainly made my accounting so much easier. It automatically works out my VAT and I can file my returns with the click of a button. I can access reports on cash flow, profit and loss and anything else I need to keep my finger on the pulse of our business performance."*

Carolyn Care,
Downs Barn Farm & Accommodation

Many of our larger farming enterprises have an agricultural consultancy practise working with them to aid in their financial, nutritional and stocking decisions. With the option to have read-only access to your software, much analysis and data extraction can be done prior to the meeting, saving everyone precious time.

There are many advantages to moving to a cloud based accounts system, as well as making your business future proof and MTD compliant. There is a word of warning: please do not assume that just because you are currently using an accounts software package that you will be MTD compliant. Desktop based software such as QuickBooks will not be MTD compatible. They have invested resources into making MTD compliant software, but this is only available as a separate package.

If you have any doubts about your current software, or if you would to like talk to someone about moving your business finances to the cloud, please contact your local PKF Francis Clark adviser and we will be able to help you make the right decision for your business needs.



# Is your Contract Farming Agreement fit for purpose?

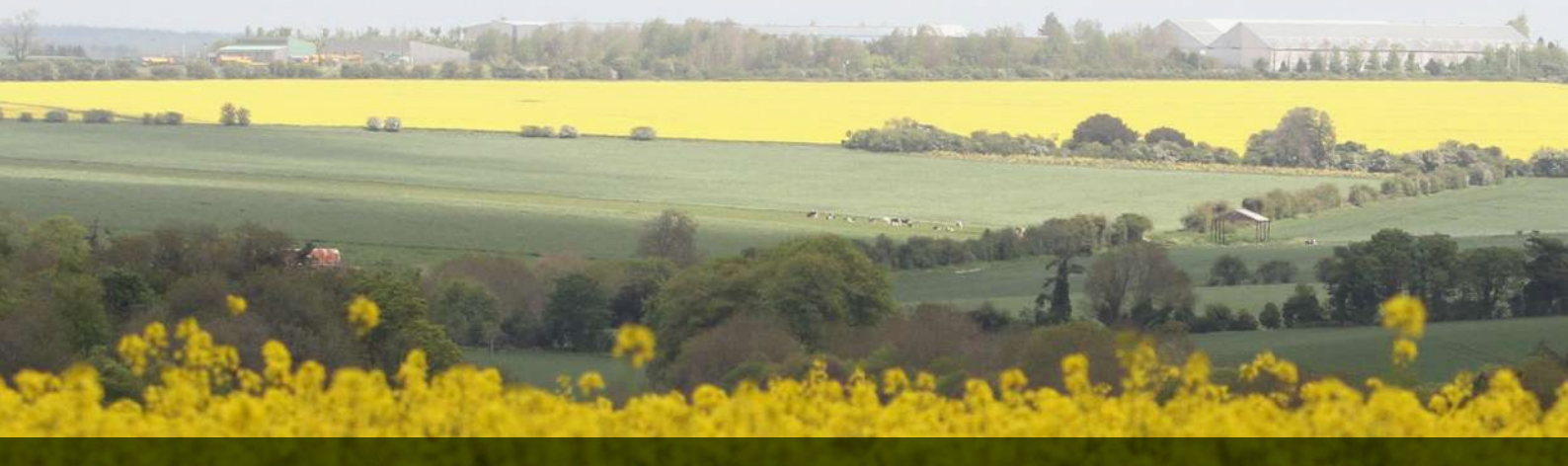
**Over the years we have been presented with many Contract Farming Agreements to cast our eyes over and give comments. In most cases the farmers are seeking comfort that they can place reliance upon these agreements to meet the 'Active Farmer' test. This is particularly relevant where a farmer is looking to claim entrepreneur's relief for capital gains tax purposes on the sale of land on retirement or where the Executors of a farmer's estate are looking to claim agricultural property relief for inheritance tax purposes on death.**

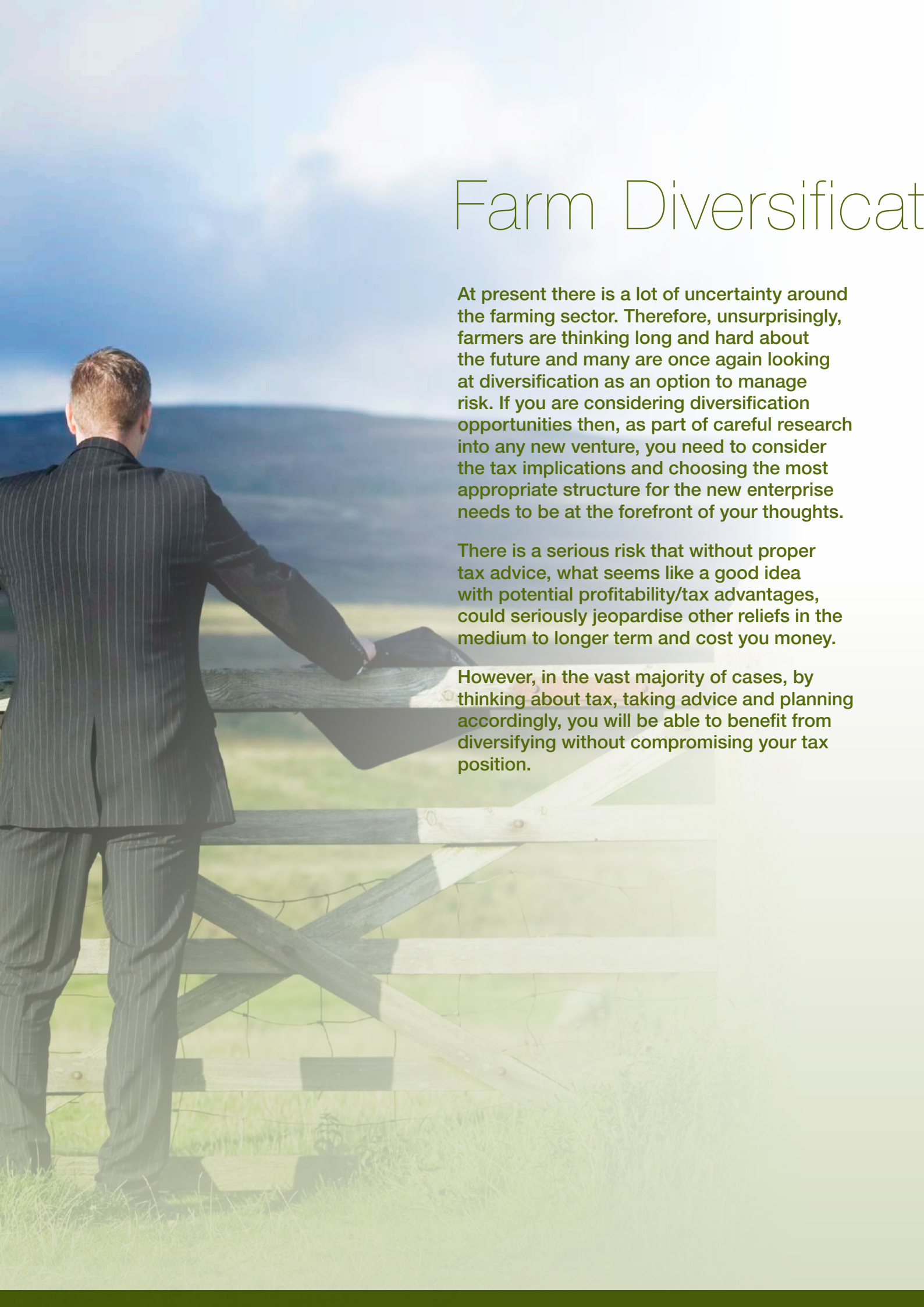
The quality of the documents we see varies massively, but at times, and more often than you might expect, the agreement in terms of protecting the farmer from a tax perspective is, to put it simply, not fit for purpose.

Find our top ten points which should be included in such an agreement below, in no particular order:

1. The farmer must be seen to be active in business, e.g. have a bank account, be VAT registered, have a proper bookkeeping system.
2. The farmer must prepare full accounts showing sales and purchases individually and not netted off. Accounts wording is important - this is NOT rental income.
3. Arable farming is seasonal and the cash flows attached to the contract farming arrangements must correlate with those of a working farmer. Capital must be employed and be at risk to the farmer, cash flow cannot be positive before crops are harvested unless there is a legitimate commercial argument for this.
4. Invoicing from the contractor should be regular, at least quarterly, and invoices must be paid on normal commercial terms.
5. Input should ideally be invoiced by the merchant direct to the farmer.
6. The contractor carries out operations of husbandry as agent for the landowner. The farmer must be involved in making all key decisions about cropping and strategy. Minutes of meetings and diaries should be kept.
7. The farmer cannot have a guaranteed return, he or she must take risk. The contractor's bonus or penalty must be defensible. No risk equals rent!
8. The harvested crop must be sold after due commercial consideration. The crop can be sold standing or 'off the combine', but evidence should be available of the reasons behind any decision.
9. Any written agreements must be adhered to and both the farmer's and contractor's accounts must reflect this.
10. Does the arrangement look real? Does it make commercial sense? If the answer is no then HMRC is likely to reach the same conclusion.

The tax at stake here, if the farmer is deemed not to be farming the land, can be very significant and, as such, if you have any concerns as to any agreements that you have entered into, and that you might ultimately rely on then please get in contact without delay.





# Farm Diversificat

At present there is a lot of uncertainty around the farming sector. Therefore, unsurprisingly, farmers are thinking long and hard about the future and many are once again looking at diversification as an option to manage risk. If you are considering diversification opportunities then, as part of careful research into any new venture, you need to consider the tax implications and choosing the most appropriate structure for the new enterprise needs to be at the forefront of your thoughts.

There is a serious risk that without proper tax advice, what seems like a good idea with potential profitability/tax advantages, could seriously jeopardise other reliefs in the medium to longer term and cost you money.

However, in the vast majority of cases, by thinking about tax, taking advice and planning accordingly, you will be able to benefit from diversifying without compromising your tax position.

# ion - THINK TAX

## Some things to consider...

**THINK capital allowances...**

Any plant and machinery purchased for a new enterprise should qualify for 100% tax allowances which could well generate taxable losses in the first year of trading. These losses can often be carried back and offset or carried forward which may often prove beneficial.

**THINK balancing charges...**

Care needs to be taken if trading in any plant and machinery from the existing farm business that might no longer be needed as a balancing charge could well arise, increasing your tax bill.

**THINK loss offset issues...**

Generally, each distinct activity of a taxpayer is taxed separately and rules govern the offsetting of tax losses from one activity against the profit of another, and it should not be assumed that a loss in one activity will automatically reduce the tax payable on the other.

**THINK VAT...**

Depending on the nature and scale of the diversified activity, there may be advantages to separating it from the main farming activity to avoid the need to register for VAT.

For this to be effective care needs to be taken, and advice sought, as it is vital that there is a clear and distinct separation of the new activity. This will extend to different ownership of the new enterprise - perhaps by running it through a separate limited company - as well as different bank accounts, ideally separate premises and offices and minimal shared facilities such as telephone and insurance.

**THINK inheritance tax (IHT) issues...**

Assets used in agriculture will generally qualify for agricultural property relief (APR). However, once an asset is used in a non-agricultural diversified activity, the risk of taxation on death will increase, with the obvious issue being APR on the farm house. Any reduction in farming activity potentially compromises the likelihood of an APR claim on the farmhouse being successful, potentially leading to your house, previously protected from APR, falling into your estate leaving your beneficiaries with a significant tax bill.

While APR would be jeopardised by the use of a farm asset for non-agricultural purposes, as long as the activity is still a trading business, the assets used in it are likely to be eligible for business property relief (BPR), however if the new activity is of an investment nature such as furnished holiday lettings then this could compromise the BPR position of the whole business.

**THINK business rates...**

A point of caution, farms are exempt, other businesses are not, expect a hike in your rates!

## Conclusion

If you are thinking of diversifying, you need to be aware if these actions could compromise your tax position, and whilst not the only consideration, tax implications need to have a major influence in your decision making process.

Thinking of Diversifying? **THINK tax** and get proper advice.

# Permitted Development Rights for Agricultural Buildings

From 6 April 2018 government changes mean agricultural buildings can be converted into residential properties as outlined below:

- **Up to three larger homes to a maximum of 465sqm; or**
- **Up to five smaller homes each to a maximum of 100sqm; or**
- **A mix of both to a total of five homes, of which no more than three can be larger homes.**

This has replaced the previous rights for up to three dwellings to a maximum of 450sqm and is hoped to be a step towards meeting local housing needs in rural communities. It should also be noted that larger agricultural buildings of up to 1,000sqm can now be built, rather than the 465sqm previously.

Converting agricultural buildings into residential properties might be an attractive form of diversification to help create a regular source of income in an uncertain agricultural climate.

However, diversification can generate many taxation issues, as well as commercial ones, and here at PKF Francis Clark we think you should be aware of the following:

## Income tax

There are slightly different rules surrounding property loan expenses. Any interest incurred on borrowed funds is no longer fully available for higher rate tax relief. From 6 April 2018 only 50% is available for tax relief at 40% and the remainder reduces your tax bill at 20% only. This is set to reduce further in the next two tax years with 100% of the cost available only as a tax reducer at 20% from 6 April 2020.

## Capital gains tax

If it was intended to sell developed residential property rather than let it, the CGT rate applied is either 18% or 28%. This might be reduced to as little as 10% with appropriate planning.

## VAT

Barn conversions covered by Permitted Development Rights may attract a 5% VAT charge. There are various ways of recovering this depending on what you intend to do with the property once complete.

Furthermore, residential rental income is exempt from VAT and so investment in residential property could mean the agricultural business becomes 'partially exempt' leading to a restriction in VAT recovery. We have a dedicated team of VAT specialists who can assist with any specific questions.

## Inheritance tax

Agricultural land and buildings usually qualify for APR at 100% providing certain conditions are met. However, converting agricultural buildings into residential properties means APR is lost and potentially the buildings are subject to IHT at 40%.

A common solution is for the residential property to be included as part of the agricultural business. This could potentially achieve BPR at 50% or 100%. Careful tax planning should be taken to ensure that BPR is not lost on the business as a whole.

The above taxation issues all need to be considered and tailored to your individual situation, so please get in touch with your local PKF Francis Clark adviser.

# Never been a better time to act on succession

In November 2017 research entitled 'the influence of inheritance tax reliefs and exemptions on estate planning and inheritances' was published. Commissioned by HMRC, the outcome was broadly positive and the findings reinforced the use of APR and BPR in succession planning.

The research concluded that the objectives for the use of APR and BPR was to avoid the breaking up of estates or businesses and keep them as viable entities within families, and that minimise inheritance tax liabilities was a secondary consideration. The report said that most instances of applying APR and BPR appeared to be 'genuine, and in keeping with policy objectives'.

Spending a lot of time on advising on succession, we were pleased with these findings albeit we noted with caution that the research did state that there is still a limited understanding of inheritance tax and that many had misconceptions about how reliefs would apply to their estate.

Earlier this year the Chancellor, Philip Hammond, wrote to the Office for Tax Simplification (OTS) instructing a review of the inheritance tax system and it has subsequently published the scoping document for that process. The OTS is tasked with identifying opportunities for simplification of inheritance tax (supported by evidence and analysis) and to offer recommendations for government to consider. It will publish its report in the autumn and the document will cover administrative and practical issues around estate planning, complexity surrounding reliefs and the impact of taxpayer decisions on investments they make as a result of the current inheritance tax rules.

We will put forward our own views as part of the consultation process and keep you advised of developments in this area as we hear of them. However, in the meantime whilst the rules around both CGT and IHT and the respective reliefs available maybe considered complex by HMRC, they are nonetheless well understood by us and for that part they are more generous than they have been in the past.

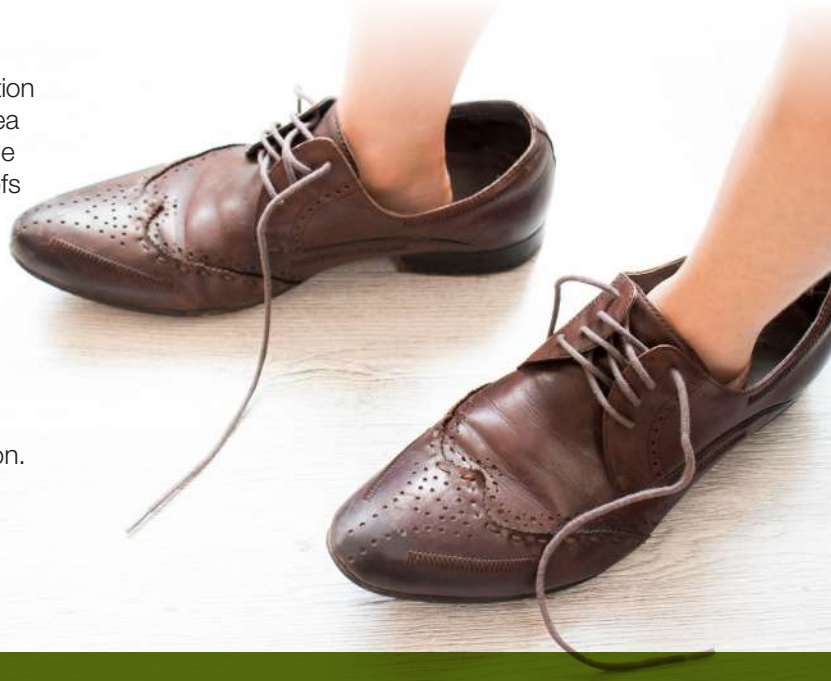
However, such reliefs should not be taken for granted and are always subject to potential change where this be as a directly result of the OTS review or especially if there is a new government of a more socialist persuasion.

We are already hearing things on the grapevine of 'think tank' findings that set out proposals to restrict business property and agricultural reliefs (which together cost the Exchequer over £1bn a year) by introducing a so-called 'farmer test'. Such a test is already in place in Ireland and France, and requires that the assets being passed on are at least 80% agricultural property.

While for many farmers the topic of succession remains the 'elephant in the room' it really shouldn't be. We spend a lot of time working with farmers concerned with protecting the family farm and it is rewarding for all parties when successful succession is achieved. There are very few cases where successful planning in this area cannot improve the situation.

Given everything, it would seem that there has never been a better time to put the issue of succession on the agenda, consider your position and potentially take advantage of the current rules before things change!

If you have any questions relating to succession, protecting the family farm and your inheritance tax position, please do not hesitate to contact your usual PKF Francis Clark adviser.



# The changing benefits environment -

## the switch to Universal Credit

**The problem with Universal Credit (UC) is just that; it makes universal assumptions that don't fit neatly into the farming business model. Most importantly it is assumed that claimants will have regular earnings and that those income levels remain more or less constant. The system is simply not designed for those who have fluctuating and potentially sporadic earnings.**

The most onerous of the conditions is that of the minimum income floor (MIF), which is an assumption that claimants work a minimum of 35 hours a week and are paid at least the minimum wage, less a notional amount of income tax and national insurance payments and you have to meet this minimum income floor regardless of whether you are employed or self-employed. Currently this is £1,137.50 per month for those aged over 25. For farmers, during those months where there may be little or no income, they are still deemed to have earned the MIF. Compared to the Child Tax and Working Tax Credit system this severely reduces the amount of money that can be claimed. Conversely during those months when income is received, payments may cease completely because the income will be deemed too high. There is no averaging available and there will be no relief at all for any businesses where trading losses are incurred.

The NFU, in their evidence to the Work and Pensions Select Committee on 17 January, compared how extreme the differences between those who are employed and a farming family might be:

A claimant with a gross income of £13,650, but working as a paid employee and therefore getting a regular monthly income, would be eligible for a monthly UC payment of £895 taking their annual net income to £23,296.

However, a farmer with the same level of gross earnings (£13,650/year) might only be eligible for UC in eight out of 12 months because of their fluctuating cashflow and would not be eligible for the full amount in some of those months.

As a result, their total annual net income would only be £18,089 - a shortfall of more than £5,200 compared with the employee earning a regular wage.

There will also be a switch from providing income figures to support their claim twice a year - currently 31 January and 31 July, to a system of supplying monthly income and expenditure accounts, which will undoubtedly add to the administrative burden.

So, where is the positive news? All we can do is to hope that common sense will prevail and, as a minimum, there will be a realisation that for this benefit to be in any way 'fair' for farmers, and indeed other self-employed workers, there is a need to at least average income over a financial year.

We will, of course, keep you up-to-date with developments.

# Tax round up

The following are a run through of the main taxes and allowances affecting farmers that you should be aware of. As always when it comes to any questions you might have about tax, we are here to help.

| Update | Commentary |
|---|---|
| **Dividends**<br>From April 2018 the dividend allowance is now £2,000. | Anything in excess of the dividend allowance will be taxed at: 7.5% (basic rate), 32.5% (higher rate), or 38.1% (additional rate). |
| **Capital allowances**<br>The annual investment allowance (AIA) of £200,000 is a 100% allowance for capital expenditure and should be utilised where possible. | Plant and machinery is eligible for the AIA. However, if plant has a life of less than eight years, a short life asset election can be made instead to preserve the AIA for other capital expenditure. |
| **Farmers' averaging**<br>It is possible for farming trade profits to be averaged over two or five years. | Averaging may enable a reduction in tax owed to HMRC, and it can help in periods of fluctuating weather and market prices. |
| **Pension contributions**<br>Income tax relief can be claimed when contributions are made into personal pension schemes. | There is however an annual allowance and a lifetime allowance which can restrict the amount of relief available. Take advice. |
| **Marriage allowance**<br>Anyone who is married or in a civil partnership can elect to transfer 10% of their personal allowance to their other half, providing that they are both basic rate taxpayers. | The 10% is transferred to the higher earner and is used as a basic rate tax reducer.<br>This can reduce the tax liability by up to £237. |
| **Finance costs on rental residential property**<br>From April 2017 finance costs, including mortgage interest and fees changed from an allowable rental expense to a basic rate tax reducer. This will be fully phased in by April 2020.<br>**It is important to note that this will not apply to commercial property or furnished holiday lets.** | Basic rate taxpayers should see no change to overall tax liability relating to the property.<br>This is something to plan for if your property profits before interest relief will impact on your marginal rate of tax, child benefit, personal allowance, or student loan repayments. |
| **Self-employed**<br>From April 2019 Class 2 National Insurance Contributions (NIC) will be abolished. Only Class 4 NIC will be payable. | There will be a reform to the Class 4 NIC threshold, however there are no details so far. Voluntary Class 3 NIC will remain available. |
| **National living wage**<br>From April 2018 this is £7.83 per hour for those 25 and over. | This will rise again in April 2019, so plan ahead for future increases in labour costs. |
| **Workplace pension**<br>From April 2018 the minimum employer pension contribution is 2%. **Also from this date the minimum employee pension contribution is 3%.** | Consider how and when you communicate these changes to your staff. **Note that these percentages will rise again in April 2019, to 3% for employers and 5% for employees.** |
| **Capital gains tax**<br>Residential property and carried interests are taxed at: 18% (basic rate), or 28% (higher and additional rate).<br>All other assets are taxed at: 10% (basic rate), or 20% (higher and additional rate). | Care should be taken to identify any residential property or carried interest disposals. |
| **Business tax reliefs**<br>Entrepreneurs' relief: a flat rate of 10% capital gains tax on the sale of all or part of the business, and can extend to assets used for trading activity.<br>Roll-over relief: capital gains tax may delayed until a future sale if certain business assets are sold and replaced within three years.<br>Holdover relief: shift the liability of capital gains tax to those you gift business assets to. | All of these can reduce or delay the amount of capital gains tax due.<br>If you are selling or gifting an asset it is always wise to take advice. |
| **Inheritance tax - residential nil rate band**<br>From April 2017 each person will have a 'main residence' allowance in addition to the £325,000 nil rate band for inheritance tax purposes.<br>This will be fully phased in by April 2020. This 'main residence' allowance is given, when a residence is passed on death to a lineal descendant. | It should be noted that estates with a net value over £2million will have this allowance restricted.<br>It may be beneficial to consider transferring some assets which qualify for reliefs (e.g. agricultural property reliefs or business property reliefs) during your lifetime. |

# And finally...

## Cornwall Farm Business Awards success


**We are delighted that PKF Francis Clark clients have once again proved successful at the Cornwall Farm Business Awards held on 26 April in aid of the Addington Fund.**

PKF Francis Clark is proud to have supported the awards since their inception and we continue to sponsor a category each year. This year it was 'Livestock Farmer of the Year', which was won by David Turner from Mendennick Farm, Torpoint. We would like to congratulate him on his well earned success.

We are particularly delighted that PKF Francis Clark clients David, Sue and Tom Simmons of Riviera Produce were recognised as the overall 'Cornwall Farmer of the Year' having been named 'Best Commercial Farmer of the Year' earlier in the evening.

The Simmons family farm at Higher Trevsakis Farm, Hayle, Cornwall. The business has achieved incredible growth since the 1980s, evolving from a 160-acre mixed farm to one of the country's leading brassica growers, covering 5,500 acres and supplying the UK's major supermarkets. The combined business employs 200 people in Cornwall and a further 250 Eastern European staff at peak times of year, with robotic and GPS technology to maximise efficiency.

David Simmons was delighted with his success and said that "It is all very much a team effort, this award is recognition for the continued effort and support all of our staff have given us over the years", noting that "winning the award makes the strains of modern farming worthwhile".

We saw even more client success with John Heller, Acland Farm, Blackwater, Truro collecting the 'Dairy Farmer of the Year' along with Tom Nicholls. Since joining the team, Tom has worked together with John to transform the dairy enterprise to a highly efficient unit with seven robotic milking machines.

Brian Harvey, Head of Agriculture at PKF Francis Clark noted "We are proud to support the farm business awards in both Devon and Cornwall. As a firm, we work closely with our clients and to that extent we are always delighted to see their hard work and forward thinking approach rewarded in success at these awards."

We are also pleased to announce that the Simmons family have agreed to host the third Farm Professionals' Walk event, in what is fast becoming a tradition, being both clients of the firm and 'Cornwall Farmer of the Year' (2016 - Paul George, 2017 - Andrew and Claire Brewer). The walk will take place later in the year, full details will be released shortly. A must attend event for all farm professionals!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