Edwards & Keeping

Farming Newsletter

Autumn / Winter 2021-22

The latest news, views, and announcements

INSIDE

Making Tax Digital – Final Reminder

A good deal of attention has already been paid to Making Tax Digital (MTD) and most farms with turnover exceeding £85,000 have already converted to cloud accounting software.

If you have not, please take steps to arrange this now. Although Government announced a delay on 23 September, that delay is for income tax reporting only. If you are VAT registered and have not moved to MTD, you will be unable to submit your VAT returns from Spring 2022 – just when the new HMRC penalty regime is introduced.

Modern cloud accounting packages are much easier to use than previous generations of accounts software, but still require some familiarisation and practice, so conversion should not be left too late.

At present, the MTD requirements can be met by using spreadsheets and inexpensive bridging software.

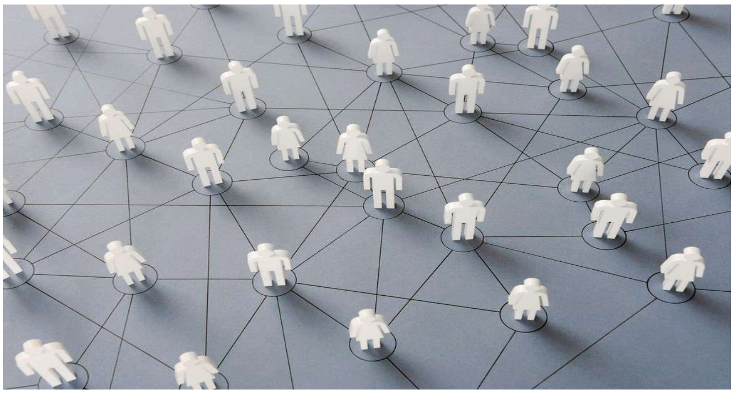
We do not know whether that solution will still be available when the MTD income tax regime starts from Spring 2024 and, even if it is, we anticipate that managing deadlines and multiple returns (eg where a taxpayer has multiple sources to report) will be challenging using spreadsheets.

For these (and other) reasons, we recommend that most businesses should adopt cloud accounting software if annual turnover exceeds £10,000.

The main cloud accounting software options are Xero, QuickBooks Online and Sage, although there are many alternatives; some designed specifically for the farming industry.

Over the last few years, we have been impressed by how well many farmers (or their spouses) have taken to maintaining computer accounting records.

We can support you with set-up and training.



Health and Social Care Levy

On 7 September 2021, the Prime Minister announced that a new tax, the Health and Social Care Levy (HSCL), will be introduced from Spring 2023.

In the interim, the employer, employee and self-employed rates of National Insurance (NIC) will all be temporarily increased by 1.25% for 2022/23.

The HSCL will tax a wider base than NIC. It will apply to all earnings (including those of pensioners, and those which are above the limit for the standard rates of NIC) and dividend income.

Alongside the new tax, the Prime Minister announced a proposed cap of £86,000 for lifetime contributions to care costs for all individuals entering care from October 2023, and a means tested, partial state contribution to care costs for individuals with assets between £20,000 and £100,000.

The latter announcement was widely welcomed by farming families who had long been terrified by the massive costs which sometimes decimate inheritances, and many viewed the new HSCL tax as a fair price for that protection.

However, the picture is not yet so clear:

- The HSCL is being hypothecated to fund “health care and social care”, with the Treasury to determine the split. Some commentators have suggested that the HSCL may be used predominantly to help fund the NHS, rather than social care.
- And Government’s proposed cap is specifically for “care” costs. Crippling charges for “accommodation” (outside the £86,000 cap) in care homes might continue to be imposed.

All we really know so far is that a new, widely based tax on income will cost 1.25% (or effectively 2.5% on businesses’ employment costs) from April 2022.

Please speak to us if you would like an estimate of the likely impact on your tax position.

Planning To Sell a House?

New capital gains tax rules were introduced in 2020 for residential property disposals.

Where a UK resident has a capital gains tax (CGT) liability on residential property (or where the taxpayer is a non-resident), a special new CGT return must be submitted to HMRC within 30 days of sale completion. The CGT must also be paid by that deadline.

This regime most commonly applies to houses and flats that have previously been let out, but it sometimes also applies to family homes.

As soon as you appoint the estate agent, please let us know. We will be able to guide you on tax aspects and to make arrangements to ensure that the CGT return will be filed in time.

Farm Stock Valuation

Stock value used to be perceived by some farmers as a balancing figure to achieve 'the right' profit… although the tax saving achieved from reducing stock always backfired the following year. Nowadays, stock valuation is more scientific and there are several sets of rules to be considered.

Growing crops and purchased youngstock and stores

The basic principle is that the stock figure should be the cost of the stock held at the balance sheet date. For growing crops, that is the sum of the planting and establishment costs (cultivation, seed, fertiliser, spray, contracting, etc) incurred up to the balance sheet date. For purchased youngstock, it is the purchase cost plus an estimate for feed and rearing. Stores of consumables are also carried at purchase cost – and please remember that fertiliser for the following season's grazing must always be included even if it sown before the balance sheet date.

Home-reared livestock and home-grown crops

Accurate costing becomes more difficult where animals or crops have been growing on the farm for longer; particularly across different accounting years. Therefore, HMRC sometimes allow a 'deemed cost' basis to be used; i.e. the cost is deemed to be a certain percentage of the full open market value of the livestock or crop.

These percentages are:

- 60% of market value for home-reared cattle
- 75% of market value for home-reared sheep and pigs
- 75% of market value for harvested homegrown crops

Deemed cost can be used for animals purchased more than 12 months before the accounts date, but it cannot be used for other class of stock, or in any case where the actual cost can be determined.

Tax herd basis election for production livestock

A tax herd basis election can be made within 2 years of a farmer starting to keep a particular class of animals (or within 2 years of a change in partnership members). The election applies only to production animals (typically cows and bulls) and its effect is that the production herd is costed for tax purposes like a homogenous fixed asset (i.e. as if old and young cows are the same). For example, a herd remaining static at 100 cows would be costed at the original amount paid for the first 100 cows; as cows are culled and replaced, the tax herd cost would remain static, and inflation in cow prices would not feed into the profit (although any extra cows brought into the herd – e.g. if increased from 100 to 110 cows – would have to be costed at their current price).

In other words, where animal values increase over time, the herd basis allows the cost of maintaining a herd at its current size to be charged against tax. Secondly, with the herd basis, a profit or loss on permanent disposal or a significant reduction in the herd is tax-free.

The herd basis election tends to be advantageous for animals that tend to rise in value over time (as often seen with cows – albeit not over all time horizons), and disadvantageous if animal values decline. It should also be noted that animals often enter a tax herd at their peak value (eg dairy herd increasing with extra maiden heifers), while a herd disposal may contain animals later in their lifecycle. For these reasons, the herd basis election is not always advantageous although, over the years, it has often been beneficial for cows.

FRS 102 valuation of production livestock

The accounting standard, FRS 102, introduced a new valuation basis for production livestock. Unincorporated business accounts do not normally have to follow accounting standards, except where they affect the calculation of taxable profit.

Therefore, where a tax herd basis election is in place, there is no need to follow the FRS 102 rules but doing so often achieves a higher accounts valuation (helpful in a banking context) without increasing the taxable profit.

Under FRS 102, production animals are treated as a fixed asset which is not homogenous (i.e. as if each cow is an individual). Therefore, as animals are culled and replaced, the replacements (as well as any extras) are costed at the current price; not the historic cost of their predecessors. Secondly, the accounts valuation under FRS 102 is progressively written down to cull value over the predicted economic life of the animal.

Conclusion

The valuation of stock is a traditional area for tax inspectors to seek uplift when enquiring into farm accounts. To help safeguard against that risk, it is important that the accounts stock figure is robustly calculated from an accurate count and correctly determined values.

Please speak to us if you would like help with your stock information.

Claiming The Same Tax Allowanace Again,Again And Again…

The inheritance tax (IHT) nil rate band has been frozen at £325,000 since 2009, and is due to remain frozen until at least 2026, despite major increases in property values over the years.

Less well known is that an individual can utilise the IHT nil rate band on multiple occasions over a lifetime, and not just once at death. This is done by gifting £325,000 into a new trust every 7 years.

A gift into trust is immediately chargeable to IHT, but with a deduction available for the settlor's (i.e. donor's) nil rate band. The gift reduces (or eliminates) the settlor's nil rate band for subsequent gifts (or on death), but only for the next 7 years. After 7 years, the settlor regains a full nil rate band

Trust planning is a complex subject requiring bespoke advice, but can be particularly tax efficient where a number of the following factors are present:

- The gift comprises land or buildings.
- The property is standing at a substantial capital gain and business holdover relief is unavailable.
- The value of the property is wholly or partly exposed to IHT; perhaps because it is a non-agricultural let (e.g. former farm cottage), or because it is not used in the owner's trade and the market value exceeds the agricultural value (e.g. old stone barns).
- The value of the property is currently sheltered from IHT but is expected to become exposed in future (e.g. due to a cessation of business use).
- The value of the property is expected to increase substantially in future (eg due to planning potential).
- The settlor has grandchildren and would like to contribute to their school fees.
- The settlor and their spouse are content to forego any personal income, capital receipt or other benefit.

If you would like advice on your IHT position and possible planning measures, please speak to us.

The BPS Lump Sum Dilemma

Responses on Defra's consultation on the phasing out of the Basic Payment Scheme should be received soon. Government have proposed that a lump sum be offered to retiring farmers in 2022 in substitution for all later annual direct payments. Ongoing farmers will face progressive reductions in BPS until it is phased out entirely in 2027.

We have estimated the BPS receivable between 2020 and 2027 at different levels of farm size:

Ongoing farmers									
2020 claim	2021	2022	2023	2024	2025	2026	2027	Total	Discounted at 5%pa
£10,000	£9,500	£8,000	£6,500	£5,000	£3,750	£2,500	£1,250	£46,500	£41,503
£30,000	£28,500	£24,000	£19,500	£15,000	£11,250	£7,500	£3,750	£139,500	£124,508
£50,000	£46,500	£39,000	£31,500	£24,000	£18,000	£12,000	£6,000	£227,000	£202,867
£100,000	£86,500	£71,500	£56,500	£41,500	£31,125	£20,750	£10,375	£418,250	£375,530
£150,000	£126,500	£104,000	£81,500	£59,000	£44,250	£29,500	£14,750	£609,500	£548,192

Note: Reductions to 2024 are from DEFRA's consultation document. Later years' reductions are assumed.

Retirement scheme									
2020 claim	2021	2022	2023	2024	2025	2026	2027	Total	Discounted at 5%pa
£10,000	£9,500	£23,500	-	-	-	-	-	£43,000	£40,234
£30,000	£28,500	£70,500	-	-	-	-	-	£129,000	£120,701
£50,000	£46,500	£100,000	-	-	-	-	-	£196,500	£184,425
£100,000	£86,500	£100,000	-	-	-	-	-	£286,500	£272,425
£150,000	£126,500	£100,000	-	-	-	-	-	£376,500	£360,425

For farmers who previously claimed up to £42,500pa, these projections show no real difference in the value of the lump sum retirement payment compared with expected ongoing BPS to 2027. Larger farmers are penalised by a £100,000 cap. Government have not yet made clear how the retirement payment will be taxed, although it is hoped that it might be subject to capital gains tax rather than income tax.

We anticipate that decisions to adopt the proposed lump sum will be driven more by a motivation to retire from farming (if farmers ever do that!), rather than any inherent attractiveness in the scheme. Claimants will be required to dispose of their land or rent it out for at least 5 years and, where the business has been run by a partnership or company, no partnership members or company directors will be able to claim direct payments subsequently.

Retirement decisions have much wider financial and tax consequences. Please speak to us if you are considering the retirement scheme. And if you are not, please consider how you plan to replace the income currently received from Basic Payment. One ELM scheme, the Sustainable Farming Incentive, has already moved into a pilot phase, and two others (Local Nature Recovery and Landscape Recovery) are due to begin pilots in 2022. These schemes will be developing and we recommend that you keep abreast of DEFRA's guidance (available from https://www.gov.uk/government/publications/environmental-land-management-schemes-overview/environmental-land-management-scheme-overview)

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