

# Single farm payments

**JULIE BUTLER** provides a practical guide to the tax implications of the new single payment scheme.

**T**HE INTRODUCTION OF the Single Farm Payment is considered by many to be the most fundamental change to farming since the repeal of the 'corn laws'. It essentially means that farming subsidies are no longer 'coupled' to production, but are based on area and historical entitlement. The burning question has been: how will this impact upon the taxation of farmers and landowners?

HMRC's *Tax Bulletin Special Edition* has arrived at last (June 2005 and on the Internet at [www.hmrc.gov.uk/bulletins/tb-se-june05.pdf](http://www.hmrc.gov.uk/bulletins/tb-se-june05.pdf)) and the farmers who diligently completed their grant applications by 16 May can now officially find out how they will be treated for tax, and it is not good news for any farmers ceasing to trade.

## 1. Income tax

For income tax purposes there are essentially three types of recipient that have been identified, and the tax treatment is as follows.

- Farmer: ITTOIA 2005, s 9 (Schedule D, Case I as was).
- Non-farmer: ITTOIA 2005, s 10 (Schedule D, Case I).
- Non-trader: ITTOIA 2005, Pt 5, Ch 8 (Schedule D, Case VI).

The 'farmer' is clearly someone who continues the trade of farming and receives the entitlement to the Single Payment (SP). This entitlement is normally referred to within the farming community as the Single Farm Payment (SFP).

The 'non-farmer' is someone who trades using the land as a business asset, but who carries out a different trade from farming; e.g. operates a horse activity on the land.

A non-trader is someone who has retired from farming and trading.

The existence of a trade is based on fact, and the receipt of the SFP is not enough to justify a trade.

## 2. Accounting treatment

The accounting treatment is based on the ICAS/ICAEW guidance issued in May 2005 (see [www.icas.org.uk/site/cms/download/aa\\_singlepaymentguidelines.pdf](http://www.icas.org.uk/site/cms/download/aa_singlepaymentguidelines.pdf)).

The payment entitlement (PE) is described in this guideline as 'essentially receiving an intangible asset and it will be tradable when definitely established, say at the end of 2005'. The period to which an SFP claim relates is the calendar year from 1 January to 31 December.

In order to receive the SFP, the land must be kept in 'good agricultural and environmental condition' (GAEC), and 'cross compliance' conditions must be met.

'Cross compliance' conditions must be maintained for at least the chosen ten-month period. The ten-month period can commence at any time between 1 October prior to the year of the claim and 30 April within the year of the claim. If no specific period is taken, it is assumed to be 1 February to 30 November. The choice of the ten-month period is imperative for tax planning purposes, as will be seen later.

Failure to comply with the 'cross-compliance' conditions can result in a reduction of between 3% to 5%, building up to 15% for repeated non-compliance. Any penalty arising from non-compliance will be applied to the whole claim, and not just the part relating to the non-compliance. There will be claw-back provisions.

SSAP 4 (Accounting for government grants) which explains accounting for grants, states that the grant should not be recognised in the profit and loss until the grant conditions of receipt are complied with. The recognition trigger should be the end of the ten-month basis period. The end of the ten-month period is *not* an adjusting post-balance sheet event and if the farmer retains the same ten-month period and year end, each set of accounts is the same. However, 2005 and 2006 will be the difficult years in establishing the correct allocation of the payment.

## 3. Some examples

For the examples and illustrations below, eligibility and 'cross-compliance' are assumed and the entitlement payment for 2005, 2006, and 2007 is anticipated to be £48,000 p.a.

If the ten-month period starts on 30 April 2005, the latest possible date, the ten-month basis period would be ending on 28 February 2006 for the 2005 year of claim (i.e. where the claim had to have been made by 16 May 2005 and is due for payment between 1 December 2005 and 30 June 2006). Therefore the SFP claim is triggered on 28 February 2006.

The physical payment of the SFP is expected to be made between 1 December and 30 June following the claim in the previous May; i.e. for the claim made on 16 May 2005, payment should be received by 30 June 2006 at the latest and 1 December 2005 at the earliest.

### Example 1

If the recipient above has an accounting year that ends on 31 October, the SFP would fall into the following accounting periods.

Ten-month period ending	Accounts Year End	Allocated payment
No ten-month period	31 October 2005	£Nil
February 2006	31 October 2006	£48,000
February 2007	31 October 2007	£48,000
February 2008	31 October 2008	£48,000



SSAP 4 indicates that the SFP should be recognised in the profit and loss account of the calendar year in respect of which it is paid, and this is to be recognised evenly on a time basis.

The 2005 claim date is 16 May 2005 and the ten-month period can start between 1 October 2004 to 30 April 2005 and it can therefore finish between 1 August 2005 and 28 February 2006. Therefore, in **Example 1** above for the year ending 31 October 2005, the ten-month period will have to have begun by 1 January 2005 in order to include any entitlement to the payment in the 31 October 2005 accounts. For **Example 2**, with the accounting year ending 31 December 2005, the ten-month period will have to have begun by 1 March 2005 in order to include any entitlement in the accounts for the year ending 31 December 2005. If the ten-month period starts after these dates, all entitlement will be included in 2006 as the trigger point (i.e. the end of the ten-month period) will not fall within the year end.

Essentially, the ten-month period has to start within two months of the accounting period to be included in that accounting period.

## 4. Change of ten-month period

If the ten-month period is changed to January; for example, the 2006 claim (claim date 16 May 2006) specifies a ten-month period starting on 1 January 2006 and ending on 31 October 2006, then the accounts to 31 December 2006 in **Example 2** above will receive both the 2005 and 2006 payments of £48,000.

Financial Reporting Standard FRS 18, paragraph 16 states that 'an entity will not depart from the requirement of an accounting standard ... where a true and fair view can be achieved by additional disclosure'.

Therefore, SSAP 4 compliance allows SFP for two years to be included in the same year, but disclosure must be made in the notes to the accounts for the unincorporated body. This disclosure should also be made in the additional information or 'white box' of the individual tax return.

## 5. Early receipt of single payment

What happens if there is an early receipt? (This suggestion might produce lots of giggling from the DEFRA sceptics.) An example of this would be the 2006 calculation in the previous example showing the 31 December year-end scenario. The £48,000 for the 2006 claim made on 16 May 2006 could be received in December 2006 (wishful thinking here). It would be carried forward in the balance sheet as a deferred income creditor.

## 6. Non-compliance provisions

Once the ten-month period sets the trigger, 100% of the SFP for the year of the claim should be recognised as receivable. This recognition should only be deferred where there are reasons for believing the farmer will not be able to comply.

## 7. BEN 19 – Stock valuation

Business Economic Notes 19 are *not* being revoked at this stage. This is not as originally anticipated. All farming activities are now 'unsupported', so the unsupported farming activity will come within the confines of BEN 19 regardless of the SFP position.

## 8. Capital gains tax

In principle, for unincorporated businesses the payment entitlement (PE) is an asset for capital gains tax purposes and it is a business asset if it is charged to income tax under ITTOIA 2005, ss 9 or 10. The 'date of birth' for the PE with historic entitlement is 1 January 2005 for tax purposes.

It has been said that there has been a lack of activity with regard to farm sales due to uncertainty surrounding not just the receipt of the SFP, but also the tax treatment. Some land agents predict that sales will be slow until 31 December 2006 to achieve full business asset taper relief on the PE, but they may consider this insignificant compared to current farm values. This could bring more new farmers into the marketplace with some complex capital gains tax computations on disposal for the tax adviser and some complex 'new farmer' structures to ensure trading is achieved.

The business PE will be eligible for rollover relief, holdover relief, and business asset taper relief, providing the specific capital gains tax requirements are met. Care must be taken within sales prior to 31 December 2006 as they would not qualify for full business asset taper relief.

## 9. Inheritance tax

The *Tax Bulletin* simply states 'the transfer of PE by someone who is not carrying on a trading business will not qualify for business property relief'. So if there is no trade, then there is no inheritance tax relief. That does go slightly against the 'tabloids' view of 'fat cat' farmers ceasing to

### Example 2

What figure is taken to the profit and loss account if the recipient has an accounting year that ends on 31 December instead?

Ten-month period ending	Accounts Year End	Allocated payment
No ten-month period	31 December 2005	£Nil
February 2006	31 December 2006	£48,000
February 2007	31 December 2007	£48,000
February 2008	31 December 2008	£48,000

farm, receiving a lump sum, and being 'park keepers'. Land takes a lot of looking after and the best way of achieving that is via some form of farming both for practical and tax reasons. If alternative land use is pursued, then business property relief, not agricultural property relief, will apply for inheritance tax purposes, which could put the agricultural property relief on the farm house at risk.

The good news is that the PE business asset will achieve inheritance tax relief from 1 January 2005 (i.e. the taxpayer will not have to wait the two years to achieve entitlement to inheritance tax relief). The basis of tax logics here is that it will be required for 'future use' in the business.

## 10. VAT

The SFP is outside the scope of VAT. However, there are situations where VAT is payable, e.g. on the sale of the entitlement without land. If a farmer is not trading, a VAT deregistration will have to take place and there will be no opportunity to claim VAT.

## 11. The limited company

PE should generally not be recognised as an asset (or should be recognised at nil cost). However, purchased entitlement could be capitalised and shown as an intangible fixed asset and recognised at the lower of cost and net realisable value assuming that it is intended to be held so as to match with eligible land and generate entitlement to annual SFP.

## 12. Sales of entitlements within the company

The sale of entitlements will come within the scope of the intangible assets régime (FA 2002, Sch 29). Rollover relief will be available for the disposal into another asset within the régime. Where entitlements are shown as intangible assets, then receipts will be taxable credits within the régime.

## 13. Planning the ten-month period

One point not mentioned in the *Tax Bulletin* is that the timing of the tax treatment of the entitlement will be able to be used for tax planning purposes around issues such as the six-year rule for hobby farming. The bulletin does not cover the scenario where the tax planner carefully organises ten-month period choices to ensure a profit is achieved, so that losses can continue to be offset against TA 1988, s 380 and not carried forward under TA 1988, s 385 due to a restriction under TA 1988, ss 384 and 397.



## 14. Do not give up farming

The *Tax Bulletin* confirms that the combination of collecting the SFP and ceasing to trade is very unattractive for tax purposes. This would result in the potential loss of business property relief for inheritance tax purposes, the business asset taper relief for capital gains tax, and the other business capital gains tax reliefs of roll over and hold over, plus income tax treatment under ITTOIA 2005, Pt 5, Ch 8 (Schedule D, Case VI) with restricted claims for expenses as not qualifying under the 'wholly and exclusively' rule, no VAT registration and no claims for input VAT.

There is going to be much greater emphasis on the need for contract farming (see 'The rebirth of contract farming', *Taxation*, 10 July 2004).

## 15. Taxation and the landowner

Another practical point not covered by the *Tax Bulletin* is the link of the ownership and taxation of the entitlement. The SFP Scheme replaces 'direct aid' schemes which by definition were linked to production. In practical terms the payment was linked to the trading vehicle that generated the farm product.

Historically, farm ownership and trading has been very muddled with a lack of 'tax marriage' between the owner of the land and the trading vehicle. The applications that were submitted on 16 May highlighted a lot of these weaknesses, such as to whom does the entitlement belong? This is of particular importance when there are partners and limited companies combined with the trading activity. This is an ideal opportunity to try to rectify tax structures where there are inefficient or muddled farming structures.

## 16. Action bullet points

The following is a checklist of action that could be required by practitioners with regard to payments made under the Single Payment Scheme.

1. Physically check the DEFRA application and paperwork to ensure who the entitlement belongs to, the impact on the trading accounts, and the tax returns.
2. Review tax planning around the ten-month period.
3. Make clients aware of problems surrounding any future (even distant) plans of ceasing to trade – avoid the non-trader status, consider contract and share farming arrangements.
4. Carefully consider any tax planning surrounding the SFP before making any business structure changes; e.g. changes in the partnership, a move towards incorporation, etc.
5. Check the 'hobby farming' or 'six-year rule' status of each client and see if a tax advantage can be achieved.

With the need to continue farming (or trading in some form), it is clear that taxation will direct the future of farming and the landscape (see 'What future lies ahead?', *Taxation*, 15 July 2004).

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