# The grapevine

Julie Butler and Fred Butler consider the tax implications for clients wishing to establish a vineyard.

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The rapid successful growth of the English sparkling wine industry has presented tantalising opportunities for farmers in the possibly lucrative world of vineyards. But with this investment comes a large number of tax, cashflow and legal alternatives that must all be considered.

## English 'champagne' and tax planning

English wine has enjoyed a renaissance, with numerous vineyards being planted in recent years. Sparkling wine (English champagne) has proved very fashionable, especially along the south coast. This is due to its favourable geology and a warming climate that has made grape growing much more feasible in most of southern England.

The number of wineries has increased markedly, but as demand for English wine apparently still outstrips supply, they are seeking to secure a steady supply of grapes, which opens a unique opportunity for farmers to cultivate vineyards on their land. While such collaborations can bring advantages, significant upfront investment is generally required, given the long lead-in time; three or four years from initial planting of a new grapevine through to first harvest. For own-label wines, a further two years can be added for the maturation process which means a delay in income streams.

The rise of wine tourism also means farmers can attract large numbers of visitors to their land to taste their wines, so benefit from an additional income stream. There are also opportunities for retail outlets with further tax complexities. Farmers considering producing their own labelled wines should consider trade marking their brand names or logos to protect their intellectual property.

Tax advisers can identify possible tax concerns in every sentence written so far. Perhaps the focus of much of the tax work to date has focused on inheritance tax with the definition of agriculture being extended for wine and cider making. There is a lot to consider in proving an intention to trade and not to operate a 'lifestyle hobby' from the outset, as some of the initial vineyards were – and still can be – loss making if not structured correctly. Immediate attention must be given to business plans, the use of controlling overheads, use of initial year losses, capital allowances, particularly the annual investment allowance (AIA) on the vast amount of equipment needed, together with defining of the trade with the existing farming operation.

**Key points**

- It is likely to be five or six years before a new vineyard will generate income.
- There must be an intention to trade from the outset.
- Business owners must consider insurance, VAT registration, and the structure of the entity.
- Where the vineyard is part of a farm it could be treated as either a standalone operation or part of the farm.

## Start-up considerations

There are daunting considerations in the current market for someone about to set up a vineyard. The market price of the English sparkling wine can be more than twice the price of supermarket champagne. The English marketplace is strong with Gatwick Airport selling a very recognised brand but how long will this wave of support and fashion last?

The first years of a new vineyard as a standalone enterprise will inevitably show losses. This is as a result of both the delayed income stream as vines develop, and the initial cash outlay required for set-up costs and capital investment. The business plan must include risks and provisions for future changes in the market, which is very difficult to predict. The choices of business structure is very real. The protection of incorporation might be analysed as the greatest benefit.

From an administrative perspective, all vineyards over 0.1 hectares need to register with the Food Standards Agency (tinyurl.com/fsavineyard) within six months of planting the first vines. The purpose of this registration – which is free of charge – is to monitor yields and production levels, in addition to helping establish the authenticity of wine. Business owners must consider insurance, VAT registration, and the structure of the entity – sole trader, limited liability partnership or company – which carries on the trade: there are advantages and disadvantages to different operating vehicles.

The offset of sideways loss relief might be the biggest driver as these are so substantial and financially significant. The limited company would therefore be a disadvantage as the losses are trapped. On a positive note, assuming profitability is achieved, limited companies might need to review the most efficient method of cash extraction by shareholders. There is a difference between the integrated diversified farm operation and standalone operation in terms of losses.

## Using income tax losses

The vineyard as a standalone operation or as a farm diversification must produce business plans or cashflow forecasts to show that the operation is commercial and not a hobby business, given that some HMRC employees might see it as a hobby or a vanity project. It must be remembered that just because someone 'enjoys what they do' does not make the venture a hobby. However, HMRC usually asks for evidence of commercial intent which must be well researched business plans showing when and how a profit can be achieved despite the initial outlay, ongoing overheads and possible changes in the current positive market. Staff expenditure can be one of the largest costs, along with buying in management and industry expertise as well as the plant and machinery needed for production.

Establishing a vineyard requires a long-term commitment and an alternative approach. Vineyards necessitate consistent care and maintenance over several years so farmers and standalone vineyards must be prepared to dedicate their land exclusively to grape production, accepting a period of reduced crop yield before their grapes become commercially viable. Returns will likely take over five years to materialise which involves vast tax loss planning and use, with specific consideration given to the complex legislation found at ITA 2007, s 68(3) regarding the competent farmer and their reasonable expectation of profit.

Moving from traditional farm practices or other enterprises to viticulture requires meticulous planning and forensic understanding. Where the vineyard is a standalone vineyard, not attached to a farm or landed estate, the tax losses can be offset sideways against total income provided commerciality and intent to trade is proven. Where the vineyard is part of a farm or landed estate it could be treated as either a standalone operation or part of the farm. Either way detailed enterprise accounts and forecasts must be prepared, particularly if it anticipated that profits will take over six years to realise – contemporaneous evidence will be key in proving ITA 2007, s 68 applies should HMRC make an enquiry.

## Diversification spin-offs of viticulture

Many vineyards seek to bring their customers to their cellar doors to sell direct and maximise profits. Such action brings costs and opportunities, as producers may look to open tasting rooms or restaurants and offer visitors a chance to tour the vineyard, with some offering on-site accommodation where guests enjoy 'views of the vines' over breakfast.

Opportunities to boost revenues extend beyond the wine, depending on the producer's desire to expand the business and bring in new customers directly and maximise income streams. Again the tax treatment of farm diversification viticulture as opposed to a standalone vineyard impacts on the tax planning opportunities and understanding.

## Capital allowances and upfront costs

Viticulture is an investment that requires a big outlay – as mentioned, the upfront costs of establishing a vineyard are significant and it takes up to five years before the vines reach full productivity, so cash flow needs careful planning.

The maximum tax relief on input VAT claims on the set up costs together with capital allowances must be understood. As we are all aware, the annual investment allowance (AIA) of £1m is critical as to timing of expenditure. Likewise, the input VAT claims on new buildings and restoration can be complex. It will also be necessary to consider the VAT option to tax.

Despite the challenges, there seems to be no shortage of investors seeking land on which to establish vines. The continued success of English sparkling wines at the international awards has put the sector under the spotlight, sales are on the rise and there is a real sense of hope about the future but all business plans must prepare for a change in the market for English sparkling wine.

Where residences are to be built, the problems of input VAT claims on listed buildings can arise, as in *Richmond Hill Developments (Jersey) Ltd* (TC8232) and *Northchurch Homes Ltd* (TC8526).

## The future

Many would say that these are exciting and interesting times but the huge risks cannot be ignored. It is reported that over £400m has been invested over the past five years which is a lot of tax planning at so many levels.

Such fascinating ventures can involve inter-generational gifting of suitable land so as to 'ring-fence' the venture to ensure that every form of tax will have to be considered. While many tax advisers were pleased when HMRC confirmed that land used to grow grapes to produce wine would be eligible for agricultural property relief (*Inheritance Tax Manual* IHTM24061), business property relief has greater advantage with IHTA 1984, s 160 applying to market value as opposed to being restricted to agricultural value when looking at viticulture in the round.

All accountants and tax advisers connected with viticulture set-up have to be mindful of the risks, caution and protective tax planning. No one can deny that there are some amazing success stories, so it is understandable that clients would like to achieve similar results. However, market saturation, changes and sustainability cannot be ignored with such a high-end production. The answer has to be to admire the passion and to respect the successful, but to analyse the detail of future projects with professional independence.

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