Farming Group News

From the Institute of Chartered Accountants in England & Wales

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The light at the end of the tunnel?

The biblical parable of the seven fat cattle and the seven lean cattle has been made previously in this publication, but when the simile was first broached it seemed unlikely that it would prove so literally true as regards timescale.

It now seems that there will indeed be at least seven years of poor agricultural results following on from the profitable 1989 to 1996 period. At long last however, there seems to be a few glimmers of hope for the future.

At the time of writing the ex–farm price of feed wheat is almost £18 per tonne higher than that of a year ago (almost 30%), milling wheat has improved £27 (40%), feed barley is up £16 (30%), oil seed rape is up almost £50 (38%) and pulses are up by some £20 (26%).
The pig trade has been profitable now for perhaps the last six months and the lamb price is also well up on this time last year. Admittedly there is still little improvement in the dairy or beef sectors and potato prices are also down on last year. It should of course also be stressed that these prices only reflect a twelve month movement and are probably still well behind the level at which farms can truly be profitable, and one would never want to be accused of "talking up trouble". Nevertheless set against a backdrop of a weakening currency and shrinking world food stocks perhaps we are just seeing the first signs of an upturn.

With this in mind the impact of the current Mid Term Review (MTR) negotiations will be hugely important to our farming clients. Some whose balance sheets have been drastically weakened over the last few years may well decide that now is the time to call it a day and leave the industry. Others may see the decoupling of subsidies and production as being the signal which they need to take on more land, perhaps at very low rents, and produce high quality crops on a strict commercial basis without having to worry about whether or not the crop is subsidy supported. Others may decide to go down the agri–environment route, putting large areas of land, effectively, into permanent set–aside and adopting a strict "low input low output" regime.

Overall after a fourteen year roller–coaster ride, irrespective of what happens to agricultural and commodity prices in the next few years, it seems probable that we are likely to see continuing fundamental change in the industry. Insolvency practitioners will remind us that the most dangerous days of a business are when recovery comes to a business with a weak balance sheet since that is the time at which it can easily over–extend itself. With that in mind we need to be able to help our clients to see the bigger picture and help guide their businesses in the direction they want to go for the next generation.

IN THIS ISSUE

Herd basis

A recent release in issue 64 of Tax Bulletin has clarified the interpretation of a situation where there is a small reduction within a herd.

There has always been some uncertainty as to how the "cost" of the disposal should be taken out of the herd and hence how much profit will fall into tax on the disposals. The Revenue revised view of the situation is that where a farmer sells part of the herd without replacement, the profit should be computed with reference to the actual cost of the animal disposed of rather than on a "first in first out" basis.
An example of the practical effect of this can be found in Tax Bulletin 64.

Plant hire businesses & FYAs

The Revenue has changed its view on the application of First Year Allowances to Plant Hire businesses. It is now accepted that where, at the time the plant is purchased, it is intended that the asset will predominantly be supplied to the customer with an operator, the business is one of the supply of a 'service'. Hence FYA's will be available. This is in contrast with the previous view that FYA's were denied as the business was one of 'hire'.

SFP – more questions than answers

At the time of going to press outline proposals for the reform of the common agricultural policy have just been agreed by EU ministers but detail remains thin. The initial proposals are that the bulk of subsidy income will be "decoupled" from agricultural production into a "single farm payment" (SFP). The decoupled payments are based on average subsidy payments for the 2000–2002 period and will then be paid to claimants in future years subject to environmental, plant health and animal welfare conditions, together with a requirement to keep farm land in good agricultural condition. Member states can opt to link a limited part of the payment to production in order to prevent abandonment of the land. There will also be a "modulation" of payments for those farms receiving more than €5,000, such modulation being phased in between 2003–2005. In this way the linkage between production and subsidy will be broken and payments will become "environmental" in nature.

Clearly there are likely to be considerable interest in the detail when this is announced. Many states were opposed to aspects of the decoupling principle and it may ultimately be that has been reflected in the final scheme, which will be rather different to the initial proposals. However it seems that the following areas will be of considerable importance to our clients:

Recognition

Unlike set–aside and area aid payments the decoupled payments will have no linkage to production. Prima facie this would seem to make them recognisable for accounting and tax purposes as soon as the necessary conditions have been met rather than, as is the case with current payments, when the crop is sold. Where clients habitually "carry over" a large proportion of their crop into the succeeding accounting period this could well mean that two years subsidy income will fall into assessment together.

Tenants v Landlords

It is anticipated that the current subsidy claimant will be the farmer who can collect the decoupled payments. Moreover, it is also anticipated that the entitlement to payment will be transferable independently of the underlying land. If this is the case it will potentially mean that tenants can sell away entitlement (typically but not necessarily on retirement) irrespective of the wishes of their landlord. The implications of this will be significant and could involve:–

- A permanent and significant reduction in the value of freehold land
- Very low or negative rents for land without SFP entitlement
- A significant acceleration in "the flight from the land" as tenants capitalise the SFP receipts on retirement.
- A "value" being put in tenancies in landlord/tenant negotiations, where landlords wish to retain the SFP on tenant retirements.
- Potential conflicts of interest between landlords/tenants/trustees where SFP entitlement is concerned.
- A new and fascinating set of scenarios in divorce/partnership splits.

Taxation

Until the detail of the proposals in known the taxation consequences must remain uncertain. The Farming & Rural Business Group has already arranged a meeting with the Revenue to discuss this in the autumn but certainly the key areas for which clarification is required will be

- Will the capital sum from the sale of the SFP rights be considered income or capital? In some ways there are analogies to existing quotas but they could also be interpreted in the same way as sugar beet contracts which are considered a Schedule D Case VI receipt.
- As mentioned above the recognition point for annual SFP payments will need to be clarified.
- Where SFP rights are purchased can they be amortised? If the sale is treated under Schedule D Case VI this amortisation of the purchase would seem logical.
- If the payments are considered capital will there be a base cost?

The main proposals are set to become operative in 2005 (although there is scope for transitional arrangements until 2007) with dairy payments being brought in in 2008. Taken together all the aspects of the scheme it seems likely that there will be a major impact on the industry – possibly at a level even greater than that which has been caused by the agricultural slump of the last six years.

David Missen – Larking Gowen

New publications

We are pleased to report that two regular contributors to Farming Group News have produced important technical publications.

Butterworth Tolley have recently published "Tax Planning for Farm and Land Diversification" by Julie Butler. "Incorporating a Business" by Roger Jones is also a Butterworth Tolley publication and is scheduled for release in mid August.

Both Roger and Julie have written numerous articles for Farming & Rural Group News in the past and we are sure that both books will be essential reading for practitioners.

Protective claims for the new tax credits

Why should I claim?

Many clients may not have made an initial claim for 2003/04 because a combination of their income level for the year ended 5 April 2002 and personal circumstances indicated no award of tax credits would be made.

That is not the end of the story, however. Such claims, even a "nil" claim, fall to be revised after the year end, i.e. 5 April 2004, to reflect any credits due based on actual income for 2003/04.

In addition, there is the facility during the year to amend an initial claim by providing an estimate of your income for the current year 2003/04. Tax credits are then increased or reduced to take account of the change in income, thus preventing a large overpayment or underpayment of credits.

Who will be affected?

If your income is broadly the same year in/year out, then an initial nil claim may not be worthwhile. On the other hand, if the nature of your work could mean that your income will fluctuate, it may still be prudent to register a claim now.

This protects your right to have the final claim adjusted for the whole year. If no claim is made now, you can only backdate any later claim by 3 months.

So, if you know in December 2003 that your income for the current year will be considerably lower than in the year ended 5 April 2002, you can only backdate your claim to September 2003 rather than 6 April 2003.

The self employed, especially in certain types of businesses, are particularly at risk and, for the employed, there is the threat of a drop in income due to a variety of reasons, even redundancy.

Why must I decide now?

Initial claims must be made by 6 July 2003, so do not delay. If you think your clients are likely to be affected, they can make their claim via the internet on ww.inlandrevenue.gov.uk/taxcredits or by obtaining the application pack via the Inland Revenue helpline (0845 300 3900).

The Irish equine tax advantages – putting the hoof into the UK system

There are many tax advisers that might not be aware of the impact that the bloodstock industry could have on their client base. The good news that the VAT scheme for racehorse owners will stay to 2005 reminds advisers to check that their owners are taking advantage of this relief.

The Irish tax advantage of stud fees

With Sir Alex Ferguson (the manager of Manchester United) owning the leading flat race horse of 2002 Rock of Gibraltar and then sending him away to stud in Ireland the Irish tax position on stud fees/nominations has been given a lot of publicity. Stud fees are treated as "tax free" in Ireland and do not have to be declared on tax returns. Irish VAT treatment is also favourable, by comparison to the UK position, as are the "business rating" rules. These tax breaks are the envy of the UK TBA (Thoroughbred Breeders' Association)

The UK tax position

The Revenue's Inspector's Manual at paragraph IM2350h states:

'Since the cost of buying a successful stallion outright is prohibitive for some bloodstock breeders, ownership may be shared in a syndicate. The usual form of syndication is into forty equal shares, representing the number of mares which, traditionally, was regarded as the standard for a stallion to cover in one season. Each syndicate member contributes towards the costs of keeping the stallion and is entitled to one "nomination" each season per share owned. The member may use the nomination to cover one of his own mares, or it may be sold on the open market. The shareholders appoint a committee which deals with the day to day management of the stallion.'

It goes on to say that where the occupier of a stud farm owns a share in a stallion for the purpose of obtaining service for his own mares, the tax treatment will depend on whether he has made an election for the herd basis.

The proceeds of any sales of nominations are treated as trading receipts. Any contribution by the stud farmer towards syndicate expenses will be an allowable trading expense. However, in the following situations the sales of nomination are assessable under Schedule D, Case VI:

- The owner of the stallion share is not carrying on a trade of stud farming or horse breeding;
- The owner is carrying on such a trade but does not use the stallion share for the purpose of obtaining service for his own mares.

So how would Sir Alex's stallion nominations income from Rock of Gibraltar be treated in the UK? As it is assumed that

Sir Alex does not own a UK stud farm the fees would be taxed under Schedule D Case VI. Clearly there would be minimal expense claims. The tax saving by standing the horse in Ireland is considerable.

It is understood that the Rock of Gibraltar was an extremely good buy and at one point Sir Alex's share was valued at over £30 million. So what is the UK tax treatment of the racing profits? Is the position all doom and gloom too?

Horse racing is tax free

Guidance is given in Inspector's Manual IM2350b. It states:

'Horse racing, however, is not a taxable activity. Where, as is often the case, a stud farmer also races horses, considerable care may therefore be needed to ensure that the division between the two activities has been correctly made. In particular, attention should be given to any transfers of animals from the stud farm to training (that is, being kept for the purpose of racing) or vice versa.' If a breeder transfers an animal to training and it is then returned to stud at a higher value after a successful racing career, then the uplift in the market value while it was in training is tax free. Furthermore the value at which the animal is returned to stud is relieved over the rest of its life. The valuations of animals at the dates of transfer to or from training are, therefore, significant.

Racehorse owners VAT scheme

Racehorse owners received some excellent news in December 2002 when the Treasury informed the BHB that the current VAT scheme will continue until a further review by Customs and Excise in 2005. Nobody should underestimate the importance of the VAT scheme not only to owners, but to the whole racing industry. Continuation of the scheme beyond 2005 will depend on a lot of factors, but both the level of sponsorship attracted by owners and how closely owners are deemed to be complying with the Code of Conduct relating to sponsorship are two very important issues.

In the coming months the ROA (Racehorse Owners Association), working with the BHB (British Horseracing Board), will be putting the whole area of VAT and sponsorship under the microscope. In the meantime, it is very important that owners who are VAT registered, under the terms of the VAT scheme for Racehorse Owners, ensure they earn business income from either sponsorship or appearance money.

The tax advantage of the UK stud farm

The UK stud farms do have distinct UK tax advantages which should not be overlooked whilst envying the Irish position.

- A stud farm is farming (s.31(1) Taxes Act 1988) and has all the associated reliefs of farming, APR on land, stables and possibly the stud house (but note recent cases of Antrobus and Higginson), Lloyds TSB (personal representative of Antrobus Deceased) v IRC SPC 336.
- **Eleven** year loss rules (improvement on the 5 year rule).
- Business reliefs for CGT, especially BATR and rollover.
- Potential BPR on cottages and outbuildings, see Farmer (Farmer's Executors) v IRC (1999) STC SCD 321.
- But note stud farming has problems on qualifying for EIS relief – other equine activities might qualify.

Julie Butler – Butler & Co

Need updating?

CCH's Business Briefing on farming was updated in March 2003. The Briefing includes a snapshot section on grants, such as arable area payments and Compulsory Slaughter, as well as considering problem accounting areas. Interested? Then contact the Library & Information Service for details.
Tel: 020 7920 8620, Fax 020 7920 8621,
Email: library@ icaew.co.uk.

On a lighter note

Readers may be aware that there is an arable disease known as "take–all". One farming client who has recently been through a particularly expensive divorce commented recently he had managed to avoid take–all but had been particularly hit in his divorce settlement by "take half".

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