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Practical VAT Newsletter

VAT and Farming and Diversification

Julie Butler considers the VAT implications of farming.

Further to the article "All Change on the Farm – VAT Protection" in Volume 25, December 2011 it is fair to say that the complexity of VAT and farming has intensified rather than become more simple. There has been more focus on horses and self storage.

Most farms have a number of cottages that are let out and this is an exempt supply causing partial exemption problems. If the farm has a pony or two or maybe more as liveries, the VAT position can be complicated. A livery with a dedicated stable can be exempt, grass liveries can be zero rated. As if this is not complex enough, the VAT status can then change with the degree of service provided by the trader.

There has been much written about VAT and liveries since the VAT Tribunal case of *John Window v Commissioners of Customs and Excise* (17186), and 2001's Business Brief (Customs and Excise Brief 21/01).

The basic interpretation by the equine and farming industry was that all liveries are VAT free, i.e. they are exempt. The understanding failed to emphasise the need for conditions to be met and the VAT status of special purpose yards. It also failed to point out that a genuine grass livery, where the grass livery is the predominant supply and any minor amount of services is ancillary, is actually zero rated. Business Brief 21/01 has now been withdrawn and guidance is given in HMRC's Notice 701/15 of December 2011 and VFOOD 3140.

The essential point of the John Window Tribunal was that the supply of the stable was the main VAT supply. All the services could not have been provided without a stable. There is a focus on a special purpose yard, such as dressage, eventing, show jumping, showing etc, if a horse owner and livery user has gone to the yard for that special purpose, (i.e. not just a livery yard), then it cannot be argued that the stable is the principal supply. Therefore the overall supply is standard rated.

That partial exemption problem

However, the exempt supply creates a lot of partial exemption problems, particularly for farmers who are perhaps diversifying with a few liveries. These farmers are not charging VAT on the livery because it is an exempt supply and therefore their VAT returns should reflect the partial exemption element of restriction on input VAT to be claimed.

A supply of livery services which goes beyond the right to occupy a stable may include feeding, turning the animal out to graze, mucking out, worming and clipping, grooming and plaiting and taking on any responsibilities for the welfare of the animal including arranging for veterinary treatment.

For VAT purposes these ancillary services follow the liability of the supply of stabling, i.e. it is the supply of stabling which is the principal supply and can still be an exempt supply – the other services just follow the main supply.

Public notice 701/15 states the VAT

liability of the care of animals is:

- Standard rated where there is a "special purpose" yard;
- Zero rated where it is a supply of grazing; or
- Exempt from VAT where it is a supply of stabling, unless there is an option to tax in place, because this is considered a licence to occupy land.

Commercial Consideration

The ability to be able to deal with livery as an exempt supply for VAT is very important for a large number of livery yards – a 20% increase in the livery charge would seriously impact on their profit as so many of their customers are private as opposed to businesses. It appears that very little protection work has been taken by the livery yards to make sure that the exempt status can be achieved. There should be a "licence to occupy" agreement included in the terms and conditions for the livery, and there should be clear evidence of a dedicated stable, for example the name of the horse or the customer on the stable, clearly showing that the principal supply is the supply of the stable.

It has always been that racehorse training and the supply of livery and nomination when going to visit a stallion has been standard rated. Many have misinterpreted the importance of the schooling and breaking side that was mentioned in the original business briefs. A lot of yards do supply special schooling of the horse in their part or full livery and this can become a very grey area.

The action plan for all livery yards is to review their VAT status. Are they charging the correct exempt supply and are the conditions in place that would help them through a VAT investigation? Is the zero rate being correctly charged and, again is the standard rate being correctly charged if indeed the turnover is above the limit? If the yard is VAT registered is the partial exemption calculation being carried out correctly?

Self Storage

Self storage has been in the news. Many farmers have placed large metal storage containers in barns as part of diversification and the industry is thriving.

With effect from 1 October 2012, the rules are now based on the use of space for the self storage of goods. The changes aim to ensure that the provision of space used for the self storage of goods (by the customer of the provider of the self storage space) in structures ('relevant structures') such as containers, units or buildings is standard rated, although there will be certain exceptions.

The self storage industry is now resigned to the fact that there has to be a VAT charge, the key point is now being able to maximise input VAT on the original cost of the container and general expenses therewith.

The changes to the VAT treatment of self storage of goods mean that self storage providers that have not previously opted to tax their supplies will, subject to the normal rules, be able to deduct VAT incurred on their related expenses.

Some providers that have not previously opted to tax their supplies will have incurred VAT bearing expenditure of £250,000 or more on land, civil engineering projects or buildings, which may fall within the Capital Goods Scheme (CGS). Unfortunately, the purchase and conversion of containers themselves does not qualify for this scheme, but any conversion costs of land and buildings specifically relating to self storage are now eligible. The effect of the change of the VAT liability of provision of facilities for the self storage of goods will be to change the use of the capital items, with effect from 1 October 2012, from making exempt to making taxable supplies. Consequently, the owners may be able to make some VAT adjustments in their favour over the remaining economic life of the capital items (up to a maximum of nine years) under the CGS. This calculation is complicated, however, and professional advice may need to be taken."

To put smaller businesses in the same position, self storage providers will be able to 'opt in' to the CGS for capital goods items with values below the £250,000 threshold where such items are owned by taxpayers affected by the change in the VAT treatment of supplies of self storage and will, after 1 October 2012, be used to make taxable supplies.

Farmers Flat Rate Addition (FRA)

With effect from 1 January 1993, VAT registered farmers have had the alternative of deregistering and becoming a 'flat rate' farmer (VATA 1994 s 54).

The 20th anniversary is fast approaching and there have been changes in farming since then. Tractors, for example, have approximately doubled in size and output and that involves a lot of input VAT! With the capital intensity of farming it is rare in practice for farmers to use the FRA.

There is, however, an advantage to stud farms and horse breeding where the supply is to non-VAT registered businesses and there is little input VAT.

The principal consequence is that a deregistered farmer then does not need to account for VAT on the sale of his farming goods or services nor is he able to recover VAT paid on inputs, including input VAT on capital expenditure. To compensate for this exclusion, he is able to charge VAT registered persons a fixed flat rate percentage as an addition to the price paid to him for goods and services, and he is permitted to retain the amount he receives. The current FRA addition is 4%; those who pay this flat rate addition to the farmer are able to reclaim it as input VAT in their VAT returns, providing they themselves are registered for VAT. When a flat rate farmer sells to a non-VAT registered person, and this includes another flat rate farmer, he is not able to add the flat rate addition to the sale price of his goods or services, nor charge VAT. HMRC Reference: Notice 700/46 (October 2012) sets this out in detail. Stock Farming includes stud farming and horse breeding, and thus a 4% addition could be charged on these sales to VAT registered persons. Stock minding services include livery, and thus a 4% addition could be charged on these sales to VAT registered persons. No money needs to be sent to HMRC, and no VAT is due to be paid over. HMRC officers may still visit to check on records, so accurate invoices and records will need to be kept. Non farming VATable services must be below the VAT registration threshold of £77,000 per year, as these are outside the scope of the FRA. Any specialist training is also

outside the scope of the FRA and thus cannot qualify.

The farming/equine lobby moves to business

Many equine and diversification projects can start as a hobby and move to business status and this can bring a VAT problem.

Where a business has recovered no VAT on the basis that the initial intention was to use the goods or services for wholly non-business or private use the expense is not a business cost. No input tax can ever be recovered regardless of any subsequent business use. This principle was confirmed in the case of *Waterschap Zeeuws Vlaanderen* (see VIT62520).

Second hand horses

A farmer landowner can only sell horses and ponies which are "second-hand" under the margin scheme. A horse or pony which has previously been owned by somebody else is second-hand. A horse or pony which you have bred and are selling for the first time is not second-hand, regardless or how much work or experience you have put in to preparing it for sale. If VAT is shown separately on the purchase invoice for a horse or pony you have bought, you can't use the Margin Scheme when you sell the animal on.

Option to Tax

Farmers need to find a use for "redundant" cottages and old farm buildings and the obvious commercial choice in the current economic climate is to create income from letting and of course this creates VAT problems! Whilst the letting income is a valuable contribution to the farming operation, the VAT strategy has to be considered. Residential letting is an exempt supply creating "partial exemption" problems. In order to create commercial letting income there is generally a lot of work to be carried out to the buildings and this has a lot of associated input tax. The solution is to "opt to tax" the buildings, claim the input VAT back and then charge output VAT on the rental income.

This process was introduced in the Finance Act 1989 as a new sub-system specifically designed to allow the recovery of input tax, and thus reduce the tax burden on the agricultural sector. HM Revenue and Customs consider an option to tax as a tax relief, as the input VAT suffered is relieved directly from the farmer's, or landowner's operating expenses. In today's competitive market place, and the pressing need to diversify in order for rural business to survive, increasing numbers of farmers are electing to utilise the option to tax in order to maximise potential tax savings and maintain a profitable business.

By opting to tax the business must charge 20% VAT on the letting or disposal of the opted property. As the option is largely irrevocable it must be exercised with great care. Once an option to tax has been elected, the exemption from VAT is lost from the specified date onwards. The decision on whether to opt to tax land needs careful consideration of all the potential factors involved; withdrawals from the scheme are only available in the specified circumstances listed below:

(1) Within three months of the specified date, providing no input tax has been recovered, no VAT has been charged to any customers and there has been no sale of property;
(2) After six years if no interest in a property has been held within that time;
(3) After twenty years, regardless of surrounding circumstances.

When making a decision to opt to tax, considerations must be made as to whether the making of an exempt supply will give rise to significant VAT loss on costs and administration. Further considerations have to be made in regards to deterring potential tenants or purchasers through choosing to opt to tax as they must pay VAT. The ability for them to recover this VAT will depend upon whether they are VAT registered and whether they are fully taxable.

The main benefit of opting to tax is that it negates the need to make exempt supplies thus removing the need to carry out complicated partial exemption calculations. Securing input VAT is another beneficial factor because a previously exempt supply is a loss in the amount of input VAT that can be recovered.

Table 1

Sales of freehold See notes on "Opt to Tax"		**Rate**
1	New dwelling-houses sold by developer	Zero
2	'New' commercial buildings	Standard
3	Dwelling converted from non-residential building, first time after conversion only	Zero
4	All other domestic and commercial buildings	Exempt
Diversification activities and miscellaneous		**Rate**
5	Sporting rights	Standard
6	Private shoots	Exempt
7	Timber	Standard
8	Holiday accommodation (including bed and breakfast)	Standard
9	Drainage	Zero or Standard
10	Fish (for human consumption) farming	Zero
11	Sale of land with standing timber	Exempt
12	Grant of a right to fell and remove timber	Standard
13	Straw – animal feed	Zero
14	Manure and straw for bedding	Standard
15	Freshwater fish farming for human consumption	Zero
16	Supply of fuel and power: – domestic/charitable – business use	 reduced standard
17	Self storage	Standard (from 1 October 2012)

VAT planning needs to be undertaken before the conversion of any farm buildings. The "fact find" carried out by the adviser must include understanding the short and long term plans for the building and the farm, for example who are the buildings to be let to? (e.g. can they reclaim the VAT on the let? Are they VAT registered?) Will the building be sold? (e.g. will output VAT on the sale of the buildings that have been "opted" cause a problem?)

Woodlands and Firewood and Land Drainage

A sale of land with standing timber is exempt from VAT. However, sales of timber itself are standard rated, and a grant of a right to fell and remove timber is also standard rated (VATA 1994 Sch 9 Group 1 Item 1(j)).

A supply of firewood in the form and at a price that is compatible for the wood to be held out as firewood to a domestic user is subject to the reduced rate of 5%. A supply to a wholesaler is not considered as a supply for domestic use and is therefore standard rated.

With the recent flooding, land drainage is in the headlines again. Certain systems used to be eligible for zero rating before FA 1989. Now, however, zero rating applies only in special cases where the supplies are made in the course of construction of dwellings or civil engineering work necessary for the development of a permanent park for residential caravans (VATA 1994 Sch 8, Group 5, Item 2). Otherwise agricultural drainage schemes are standard rated. This appears to be so even where the drainage might be correctly regarded as a farming input.

Checklist of VAT rates

Diversification is a maze of different rates and below is a checklist of a sample of the variety of rates and this gives an understanding of the need for a clear and robust fact find of what is being supplied by the farmer/landowner (see Table 1).

VAT must not be looked at in isolation

All diversification activities must be reviewed for VAT compliance and VAT planning, but this cannot take place in fiscal isolation; all work must consider the ability to claim other tax reliefs. Consideration must be given to the need to register for VAT where there is no registration currently in place. Consideration must also be given to the possible attack by HMRC on "artificial business splitting" with different diversification activities being established. All supplies must be reviewed to ensure the correct identification of VAT treatment and the impact on both partial exemption and overall planning.

All farm and legal agreements should be reviewed to ensure that they protect all tax angles. Farming contracts, together with the facts supporting the contract, must meet the criteria in both tax and VAT compliance and tax and VAT planning

terms. With high land values, the risks of errors are significant in tax and VAT terms.

Potential liabilities and who is responsible

There can be huge complexities within the VAT return of a mixed farm and landed estate. Many farms have not been subject to a VAT inspection for, say, a decade. There can be problems with partial exemption and confusion as to whose responsibility it is to actually check upon the possible VAT errors. If the accountant looks through the books to produce the accounts they often do not consider it their responsibility to check the VAT, and some engagement letters even state that they have no responsibility for these matters. However, some rather big VAT liabilities can build up through errors and misunderstandings of the correct VAT treatment. Has an internal VAT "audit" been undertaken? Should such a review be the New Years Resolution for all farming operations? **TPV**

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