Autumn 2015

agriculture news

regular news from our specialist agriculture team

Don't miss out on R&D tax relief

Since 2000, the Government has attempted to support innovation in British business through additional tax relief for Research and Development (R&D) expenditure.

Currently companies which qualify (claimants must be limited companies) can receive a £2.30 reduction to their taxable profits for every £1 they spend on innovation related activity.

The latest statistics published by HMRC show that only around 10% of eligible companies are actually claiming the tax credits which are available, and of the claimants, only 0.44% were claims from the combined agriculture, forestry and fishing sector - actually only 70 claims in 2012/13. This suggests that a large number of innovative farming and agriculture related businesses are missing out. Could you be one of them?

Agriculture is a sector that continues to innovate in many areas. Some examples we have listed show the type of activity which may qualify for additional tax relief:

- Development of new crop strains or animal breeding programmes to improve nutritional value.
- Introduction of better or safer chemicals to agricultural processes.
- Advances in animal husbandry techniques or methods of livestock production and feed.
- Improvements to waste handling processes.
- Developments in irrigation systems or packaging technology.
- Design and/or manufacture of bespoke equipment.
- Experimentation with techniques to improve crop yields, harvest or store crops.

This list is not exhaustive. EQ have undertaken many R&D reviews and lodged successful claims for companies across a range of sectors. If you think you may have a project or expenditure which falls within R&D, please speak to your usual EQ contact, or contact our R&D specialist **Sarah Gillie at** sarah.gillie@eqaccountants.co.uk.

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Management matters – machinery costs

On many arable farms power and machinery costs will represent one of the biggest single cost areas. Successfully managing this cost can therefore have a big impact on the financial success of a business.

Machinery costs typically include:-

- Depreciation
- Book gain/loss on disposal
- Machinery repairs
- Fuel and oil

To gauge whether your machinery costs are in the right ball park a useful starting point is to express them as a percentage of output, based on an average over the last three years. A figure of 15-18% is considered normal, although this may be higher in some businesses where there has been a conscious investment in machinery as a means of reducing labour costs.

Other associated costs include insurance and potentially an interest charge of some sort, depending on how the purchase of machinery is financed.

Another useful way to look at machinery costs is to add in your labour costs and then compare your combined labour/machinery cost against the theoretical cost of using a contractor. Although most businesses are willing to incur additional costs for the convenience of having their own labour and machinery, if actual costs are significantly above this informal benchmark then this should be a cause for concern.

Potential strategies to manage machinery costs include:

Strategy	Description
Scale	Spread costs over bigger area to reduce unit costs
Sharing	Joint ownership with neighbours to spread costs
Out source	Make use of contractors if costs lower
Focus	Concentrate on enterprises that use the same machinery
Technical efficiency	Investment in new machinery to reduce repairs, down time, labour and fuel. May also result in improved crop quality and reduced input costs

Next time you review your farm accounts take a moment to consider your machinery costs. Are your costs reasonable? If not what can be done to reduce them?

Extension of averaging period for farmers

We have highlighted in a previous bulletin that HMRC have issued consultation in relation to the Chancellor's Budget announcement that farmers' averaging would be extended from 2 years to 5 years from 2016/17.

As anticipated, the devil is in the detail and we do not believe that the proposals set out in the consultation document are helpful to farmers. The consultation starts from the premise that an extension of averaging to 5 years is a good idea, rather than asking the question "Is it a good idea?"

The result is that the consultation document goes on to present rules which we believe will be unattractive and unhelpful for farmers who would like to benefit from a mechanism to smooth out volatile profits over a number of tax years.

We believe that a more desirable outcome could be achieved by relatively small changes to the existing averaging rules.

The consultation document can be viewed at: http://www.eqaccountants.co.uk/uploads/1159.pdf.

We have submitted a response to the consultation to HMRC and this can be viewed at: http://www.eqaccountants.co.uk/uploads/1157.pdf

We will, of course, provide an update when new rules are issued for implementation.

Sector focus – sheep

Strengths	Weaknesses
• Lower capital requirements compared to beef • Natural/free range image • Effective means of utilising grass break crop • Short production cycle	• Small scale of many flocks • Often regarded as a "hobby" enterprise • Alternative land uses often more profitable • Requires investment in good fences
Opportunities	**Threats**
• Better use of grass • Promotion to stimulate demand/exports • Improved technical efficiency • Reintroduction of direct support payments • Lower bought in feed costs	• Competition from other meats • Weak Euro reducing export price • Declining consumption • Declining sheep numbers threatening industry viability

Sheep numbers across Scotland have been in decline over the past decade with breeding ewe numbers declining from 3.179m in 2004 to 2.604m in 2014. The ending of direct support payments in 2005 with the introduction of the SFP is likely to have played a significant part in this decline and it remains to be seen whether the introduction of the Scottish Upland Sheep Support scheme will help to reverse/halt this trend. This will pay c. €100 per ewe hogg to qualifying producers in upland/hill areas.

Like many other agricultural sectors, sheep producers are suffering from falling prices. The current price of a finished lamb at c. £68 is £8 per head down on where it was a year ago, representing a fall of 11%. On a 1,000 head ewe flock, with a lambing percentage of 160%, this represents a £12,800 drop in sales revenue. Producers will need to become more productive and/or seek ways to reduce costs in order to try to limit the damage to net profitability.

Gross margins should still be positive for efficient producers, but low ground farmers with alternative land uses need to carefully appraise whether or not a sheep flock still justifies a place in their business.

Tax planning to boost your cash flow

With profitability under pressure in many sectors the temptation may well be to put off the preparation of accounts and associated tax returns to the last minute, in order to defer costs. This is likely to prove to be a false economy in many instances. By undertaking some basic tax planning we are currently securing significant cash flow benefits for our clients, often amounting to tens of thousands of pounds.

Examples include:-

- Offsetting current year trading losses against other income or capital gains in either the current or previous year to reduce the overall tax due or secure a repayment of tax.
- Making a farmers' averaging election to average profits over two years to make best use of the personal allowance and the basic rate tax band. If applicable, this reduces tax payable and in many cases will secure a tax repayment.
- Making a claim to reduce payments on account going forward, where it is clear that the taxable profits of the business are falling.
- Negotiating "time to pay agreements" with HMRC where cash flow constraints make it difficult to pay any tax owing on the due date.

If your cash flow is under pressure it is vital that your tax affairs are kept up to date and all options are explored to either reduce tax payable, secure a repayment of tax already made or defer payment of tax due.

Is diversification exposing you to IHT?

A major aspect of the advice we deliver to clients surrounds succession and Inheritance Tax (IHT) planning. No one wants to spend their working life building up wealth and a successful business only for a large proportion of it to disappear in the direction of the tax man on their death, when some simple planning would have retained more of that wealth for their family.

Amongst our farming clients many are familiar with the idea that Agricultural Property Relief (APR) may well apply to the value of their estate on death, in so far as it relates to their interest in the farming business (if they are still a partner/shareholder on death) and their ownership of land and buildings used for agriculture. If all an individual has on death is their interest in agricultural assets, APR may protect their estate from any IHT charge.

Increasingly, however, farming businesses diversify, to create additional income streams and to provide protection from volatile agricultural commodity prices. Creating non farming assets or business enterprises which will not attract APR potentially expose the owner's estate to an IHT charge.

Business Property Relief (BPR) may be available on these non farming assets, but certain land and property based enterprises may not qualify. If property is being let or occupied for business purposes by unrelated parties then BPR may not apply.

An IHT review will flush out the potential exposure your estate has and where relief may apply. Simple changes may enable additional assets to qualify for APR or BPR, and thus save considerable sums of tax on death. Lifetime transfers may also help to reduce IHT exposure.

Your EQ contacts are always happy to speak to you about your IHT position and any steps that can be taken to help protect your wealth.

Beware of the AIA trap

Eligible businesses who invest in qualifying plant and equipment are currently able to take advantage of the 100% Annual Investment Allowance (AIA) write off against taxable profits for such expenditure up to £500,000 per annum.

We knew that the £500,000 AIA limit would be in place until 31 December 2015. The Chancellor announced in his Summer Budget that the AIA limit will be £200,000 from 1 January 2016.

It's great news that a relatively high AIA limit will remain in place at a level which most eligible businesses expect will cover their annual plant and equipment expenditure. Transitional rules apply and if your business year end is not 31 December great care is needed to ensure that the timing of expenditure enables it to attract AIA.

For example, if a business has a year end of 31 March the maximum AIA available to it in the year to 31 March 2016 will be:

1 April 2015 to 31 December 2015 –
9/12ths x £500,000 = £375,000

1 January 2016 to 31 March 2016 –
3/12ths x £200,000 = £50,000

Total £425,000

If this business invests between 1 January and 31 March 2016 the maximum they will get AIA on is £50,000, even if they have not invested in any plant and equipment previously in the financial year.

Bizarrely, they can get relief up to £425,000 if the qualifying expenditure is incurred in the period between 1 April and 31 December 2015, the restriction of £375,000 for that period does not apply.

If you are considering investing in plant and equipment over the next 12 to 18 months, please contact us for an explanation of how the AIA will impact on your business.

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