DEDICATED NEWS AND SUPPORT FOR FARMING FAMILY BUSINESSES FROM
ENSORS CHARTERED ACCOUNTANTS

SPRING/SUMMER 2023
EPISODE 16

LIFE ON THE FARM

Change of basis period

George, Henry and Mary are in the kitchen having lunch when David walks in and sits down.

Meet the Barleymow family

Every issue we will be following the fortunes of the Barleymow family and the issues they face as a family farming business.

- George
  - Henry *m* Mary
    - David *m* Carolyn
      - Mark
      - Emma
  - John *m* Sarah

Henry: *How did it go with Ensors?*

David: *Well dad, it's good news and difficult news really…*

George: *Ha, it's never good news when it comes to money…*

David: *Actually grandad, Ensors took me through the accounts, and despite the higher input prices, we've actually made a reasonable profit…*

Mary: *That is good news!*

George: *Now for the bad bit… more bloomin' tax to pay, no doubt!*

David *(reads notes): Well, thanks to Ensors' sterling advice regarding the timing of replacing our machinery, the capital allowances mean that our taxable profit is quite a lot lower than the accounting profit. The farmers averaging helps to keep things more consistent year to year…*

George: *And?*

David: *Well, it's all about HMRC changing the way taxable profits are recorded on tax returns. It's a drive to 'simplify tax.'*

George: *Here we go, just as you get used to something they start complicating it all…*

David: *And unfortunately, this is going to affect us, as the farm's year end is different from the tax year. Unincorporated businesses currently include the taxable profits on a financial year basis – not a tax year basis – but the change will result in non-companies needing to report on a tax year basis…*

George: *What do you mean? Speak in English lad!*

Henry: *Shush Dad, he's trying to explain!*

Continued overleaf ➤

David: *So our partnership has a financial year end of 30th September. For the tax year ending April 5th 2023, our tax returns include the profits arising in the year to September 2022 as this year end falls in the 2022/23 tax year. In future, if we keep the same year end date, we will have to essentially include half the profits from one year, so April to September, plus half the profits from the following year, October to March. Is that clear?*

George: *As mud.*

David *(smiles): To complicate matters, when we move into the tax year basis during 2023/24, we will have the profits for the full year to September 30th 2023 plus half of the profits from the year to September 30th 2024, so basically 18-months worth.*

Mary groans.

David: *There is a deduction though mum, for profits that we were taxed on twice when self-assessment was first introduced in the late 1990s, or in my case, when I first became a partner. So that's something…*

Henry: *Blimey, that could result in a very nasty tax liability!*

David: *It could. However, Ensors says you can pay the liability that arises from the extra bit of the period over five years, so it won't all fall due at once.*

Henry: *That's a relief. Any other news?*

David: *Well, this affects you, me and mum, as we make pension contributions to extend our basic rate band for tax. It's going to be much more difficult to predict how much we can make each year…*

Henry: *Why's that?*

David: *Because we need to pay the pension contribution by April 5th, but we're not going to know what the results for the second year are going to be by that point. The spring crops will barely be in the ground by then, let alone being able to assess how they're going to do. And if we pay too much into the pension we could be taxed on the excess…*

Henry: *Right. And I suppose the same is true for tax planning in terms of capital expenditure or repair work as well? If we don't know the profit for the tax year because it's made up of results from two years, how can we manage the expenditure as effectively?*

Mary: *Yes and will that make the tax returns more complicated.*

George *(groans): Thought this was all about "simplifying" things!*

Mary: *So, if we need to include part of the results for two accounting years, there won't be much time to have the final results for the second year by the time our tax returns need to be completed?*

David: *That's right mum. Ensors gave me the example for 2024/25 – it would be half the profits from the year to September 30th 2024 plus half the profits from the year to September 30th 2025. The problem being, the figures from the second year are unlikely to be finalised by 31st January 2026, which is when the tax returns need filing, because apart from anything else, we won't have final contract agreement divisible surplus figures by then.*

Mary: *So how do Ensors include the figures if they're not final?*

David: *They said they'd need to include provisional figures and then update the position when they do the following year's return…*

George: *We must be able to make this easier somehow?*

Henry *(to David): You said earlier son, we could keep the same year end date?*

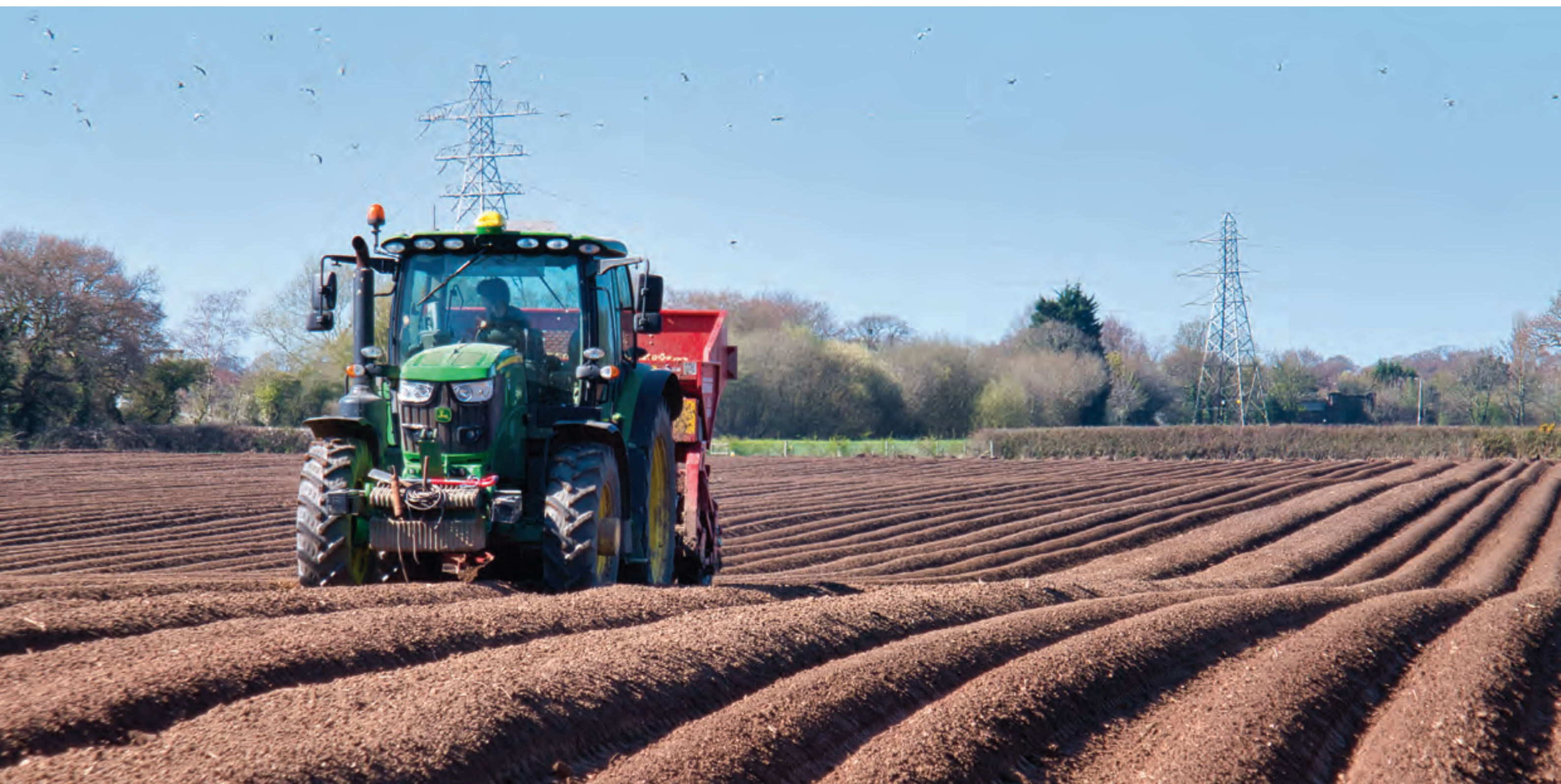
David: *That is one option dad; we could change our year end to March 31st / April 5th which will mean everything is on the same date in future, so apart from the initial change, that'll make things easier from a timing perspective…*

George: *Hang on lad! Our year end lines up with the harvest year and has done for decades! The value of closing stock is much easier to determine on September 30th as it'll all be harvested and in the store, on March 31st there will be some previous harvest left to sell and the value of crops for the new harvest in the ground. Why should we move away from all this just to line up with the bloomin' HMRC?*

David: *Well we could keep the year end by incorporating the business but there's lots we need to consider.*

Mary: *One thing's for sure – we need to follow up with Ensors to make sure we fully understand all our options.*

They all nod in agreement.



To incorporate or not?

Most farming businesses tend to operate as sole traders or partnerships, however, several are now asking if it would be more beneficial to operate as a company. This article looks at some of the important points to consider before incorporating your farming business.

One of the initial considerations is what should be incorporated. The whole business can be transferred into a company, or just part of it could be incorporated. This could be just the machinery and labour to form a contracting arm of the business (that could also be the contractor to the in-hand farming operations, or other diversification venture where it can operate as an independent business).

The differences

It is important to understand the key differences between operating your business as a limited company, compared to an unincorporated sole trade or partnership.

A limited company is a separate legal entity owned by shareholders and controlled by directors. Any withdrawals from the company (usually by way of a salary or dividends) need to be formalised. This is in stark contrast to an unincorporated business where drawings can be taken as and when needed, without any formalisation or particular tax considerations.

Unincorporated business owners are taxed on the full amount of profit each year, regardless of how much is actually taken as drawings. For incorporated businesses, the company will pay corporation tax on the profits, and the individuals will pay income tax on their salary and dividends paid from the company. It is important to note that any salaries paid are deductible when calculating the profit of the company.

Pros & Cons

Tax savings are available where individuals are regularly exposed to profits that are taxed at the higher rates of income tax (40/45%). These savings are highlighted when the individuals do not need to withdraw all the income. The company would pay corporation tax at a lower rate on profits, and then income tax would only be paid on the amounts drawn from the company. As such, the undrawn portion of income would only suffer tax at the corporation tax rates. Structuring your income between salaries and dividends can also create savings in National Insurance.

Whilst it is still possible for there to be tax savings available when operating as a limited company, these have narrowed over recent years. From 1 April 2023, the corporation tax rate increased from 19% to 25% where taxable profits are greater than £250,000. Companies with profits under £50,000 continue to pay tax at 19%, with profits between £50,000 and £250,000 being taxed at the marginal rate of 26.5%; yes, the marginal rate is higher than the main rate!

There can be reliefs available to companies that are not available to unincorporated businesses. These include Research & Development claims and the 'Full Expensing' from 1 April 2023. Full expensing is a capital allowance which will allow for full deduction from taxable profits, for the cost of new and unused plant and machinery purchased each year, this is in addition to the more familiar Annual Investment Allowance.

A limited company does come with more administrative requirements than an unincorporated business. Annual accounts must comply with the relevant financial standards and the accounts are published on Companies House (the level of publishing depends on the size of the business). There are ongoing declarations to be made, for example potential Annual Tax on Enveloped Dwellings (ATED) returns to be filed if the company owns residential property valued in excess of £500,000, this would include farmhouses. There would also need to be a Pay As You Earn Scheme (PAYE) set up to pay salaries.

Wider consideration

IHT Incorporating your business will not just affect how the income is taxed, it can also impact the inheritance tax position. Currently a farming business trading through a limited company that holds the land outside of the company, loses some of the reliefs that would potentially be available if they were trading as an unincorporated business.

Whilst Agricultural Property Relief (APR) should still be available at 100%, this only covers the agricultural value of the land. For any value above the agricultural value (e.g. development hope value) to qualify for relief from inheritance tax, the business would also need to qualify for Business Property Relief (BPR).

Land held outside of the company and owned by the farmer individually, would only qualify for BPR at a maximum rate of 50%. Furthermore, BPR would not be available if the land is owned by a minority shareholder, this being someone that owns less than 50% of the company. This means that if the land is jointly owned by more than 2 individuals, no BPR would be available.

BPR could be available at 100% for unincorporated businesses where the land is jointly owned within a partnership structure. This can be an important consideration in your decision of whether to incorporate.

CGT Transferring land and property into a company would be a deemed disposal for the individuals and fall under the scope of Capital Gains Tax. The gain is calculated by using the market value of the assets as the proceeds, and deducting the initial purchase and any other relevant costs in the usual way.

Incorporation relief can be utilised if the business and all its assets, except cash, are transferred in return for shares in the company. This means that incorporation relief can't be used in part incorporation.

It is also important to note that incorporation relief does not remove the gain, but defers the gain until such point that the shares in the company are sold.

Stamp Duty Without going into detail here, it is worth noting that Stamp Duty may also be payable where land and property are transferred into a company.

Ultimately, the answer of whether you should incorporate, depends on your individual circumstances. It is important to consider the wider implications of incorporation and we at Ensors are here to help.

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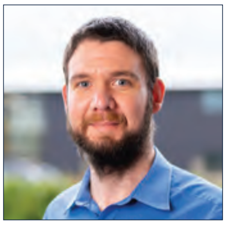

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> "Ensors have an excellent understanding of how a rural agricultural estate operates and as such are able to work closely with clients and fellow professional advisors to ensure maximum benefit."
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