



Introduction & Welcome

Increasing commodity prices, inflation running higher than wage increases (Mervyn King predicts annual inflation at 5%), and an increase in VAT means the UK will be an expensive place to live. The Chinese economy grew by 10.3% in 2010, and we hear that in their country, demand is outstripping supply of food and food prices have increased by 10% this year above last year. This sounds like good news for UK farmers, but cost of production is rising in terms of feed and fertiliser putting pressure on particularly the dairy and livestock sector.

Let's hope that for farmers these, in some cases record breaking prices, find their way

into cash surpluses and wise investments. As I write, we are aware of an increase in machinery purchases which in a lot of cases is a tax-driven short term strategy. I would be pleased if businesses used this time to look at their plans for succession, business structure and matters such as off-farm investment thereby facilitating a way for the business to prosper in the long term.

I hope that you find some of the contents included in our newsletter interesting, thought provoking and topical. Should you need any advice please say.

John Thame

Restructuring to reduce tax

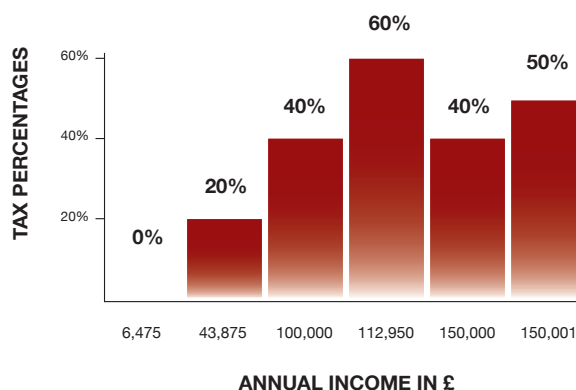
The improvement in profitability over recent years has turned attention to resulting tax liabilities. This is especially topical at the moment due to the price of wheat and oilseed rape.

Your choice of business structure will have an impact on the amount of tax you pay, but a decision to restructure should not be made lightly. Other aspects need to be considered, not least the wider objectives of the family. Most farming businesses trade as partnerships. This is a flexible structure and allows profits to be shared over a number of individuals in order to reduce tax. However, individuals now face an eye-watering 60% income tax rate on profits between £100,000 and £112,950 as can be seen in the opposite graph. This compares with a 21% rate of tax on profits up to £300,000 in a limited company.

Is the answer therefore to transfer your business to a company? Well, in the case of a farm contracting business or tenant farmer, the answer is probably yes. But, when land is involved this complicates matters. Generally, it is not good for companies to own land and so other structures need to be considered.

One solution might be for a company to act as contractor and provide power and machinery to the farm partnership. This would divert some profits into a lower tax environment. Over time it might be that the contracting company becomes a partner in the farm, which would then provide further flexibility.

We would be happy to review your business structures and quantify where business tax savings can be made. This is the easy bit. The wider issues also need to be considered, not least inheritance tax. It would be a false economy to save tax on income at 40%, only to pay inheritance tax later at 40%. Good planning is therefore essential.



Benefits of effective financial record keeping

We all know the importance of having good financial records for your farming business, not only to comply with current legislation but also to monitor and manage business performance.

Effective financial record keeping relies on a well structured system. Three signs of a good accounts system are:

1. **Accurate Records.** To give you a true picture of the financial position of your business. Recording financial information accurately can save your accountants time, which could mean you save money on your accountancy fees.
2. **Current view of your cash flow.** Spending when you don't necessarily need to can be costly, particularly if the unnecessary expenditure comes out of a loan or overdraft. If you know the exact details of your cash flow, you can reduce the risk of any problems at a later date.
3. **Bank reconciliation.** The ability to easily reconcile what has happened in your business with what goes through your bank account is critical, particularly if you have to undergo, an income tax, PAYE or VAT inspection.



Farmplan is just one of a range of specialist software suppliers for the farming industry that we work closely with. They offer a range of accounting software packages starting from £345. Ellacotts' clients are eligible for up to 12.5% discount on all Farmplan accounts packages, which includes 12 months support, bespoke training opportunities and regular updates.

For more information, or a free, no obligation demonstration, contact Farmplan on 01594 545000 or email sales@farmplan.co.uk

Don't wait too long to buy



Farmers need to be thinking now about how to best use their Annual Investment Allowance (AIA) before the tax relief is slashed by 75% in less than 14 months.

With time rapidly ticking away before the AIA is cut from £100,000 to £25,000 in April 2012, farmers and farm businesses must plan expenditure on machinery carefully to optimise the tax benefits.

The Annual Investment Allowance allows businesses to spend up to the specified limit, £100,000 at present, on new or used plant and machinery. Businesses can then deduct that sum from their taxable profits. This makes it an attractive relief for farming businesses, where a new tractor typically costs ten of thousands of pounds and a combine could run into hundreds of thousands.

Commodity prices have been favourable recently; particularly grain. This makes the AIA a valuable tool for reducing tax on the resulting profits, while allowing tax-efficient investment in plant and machinery that will benefit farm businesses in the future.

Farmers who have not yet made the most of this year's AIA need to think about doing so now, as well as starting to plan for AIA spending in 2011-2012. Although there is no sign yet of the farm machinery shortage of 2008, it can't be ruled out next year as clients rush to buy before the AIA ends. Whatever you decide, this kind of large scale investment requires careful planning so it's worth sitting down with your accountant as soon as possible to start putting the wheels in motion.

The availability of the relief can be complicated by your accounting year end or your business structure. Please discuss your specific circumstances with your accountant.

Security given - planning to minimise potential exposure to Inheritance Tax

On death, assets are valued for probate purposes and totalled, net of any available Inheritance Tax reliefs. It is important to be aware when calculating assets chargeable to Inheritance Tax that a mortgage is deductible firstly from the property against which it is charged.

This may seem a rather dry point of law, but the implications can be substantial. With Inheritance Tax charged at 40% on the chargeable estate, a saving in Inheritance Tax of up to 40% of the value of the mortgage could be possible with careful planning of security. When arranging or rearranging borrowings, always ensure that debt is secured against assets most likely to suffer Inheritance Tax - normally let properties or the farmhouse, and finally as a last resort, farmland.



How planning can save you interest

Expenses incurred wholly or exclusively for the business are allowable deductions for tax purposes. Where a loan is partly for business and partly for non-business purposes, a reasonable apportionment of the interest should be made based on the extent of business use of the asset. The security given to the bank is not relevant here, only the purpose of the loan.

When a loan is taken out to purchase a farm, an apportionment is needed to disallow that proportion of the interest relating to the non-business use of the farmhouse - see example below.

The majority of the interest paid on the house element of the loan will therefore not achieve tax relief.

Simply by arranging separate loans for the two elements of the farm, the debt on the farmhouse with its limited tax relief can be repaid first, thus minimising the after-tax interest cost. The use of separate purchase contracts supports this, and also aids Capital Gains Tax and Inheritance Tax computations in the future.

Also, bear in mind that where interest has been incurred to enable the proprietor to withdraw capital from the business, tax relief may possibly not be available on the interest. Careful planning is needed here.

	Finance	Allocation of loan	Interest charged
	£	£	£/per annum
Cost-land and buildings	700,000	560,000	28,000
Cost-farmhouse	300,000	240,000	12,000
Funds introduced	-200,000		
Total - loan required	800,000	800,000	40,000
Interest disallowance re farmhouse (See below *)			-10,500
Interest allowed for tax purposes			29,500

* HM Revenue & Customs would seek to calculate allowable interest related to the house based on the number of rooms in the house, and their business use. For example, if 1 room out of 8 is used entirely for business, 1/8 of the interest on the house would be relievable:
 - Total interest on house = £12,000pa; interest disallowance = £12,000 x 7/8 = £10,500.

Q & A

- exposure to rate fluctuation

Q: Should I talk to my bank about fixing the rates charged on my loans?

A: The Bank of England's official Bank Rate remains at 0.5%, where it has languished since March 2009. Actual rates available to borrowers are substantially above this, and are likely to increase.

You should check the effect on your business of an interest rate rise of say 2%, 5% or more, by some basic maths. Would such a rate rise be affordable? Indeed, all borrowers should be asking themselves what the effect on their business would be.

Protection from interest rate rises are a form of insurance, with costs attached. Whether these costs are worthwhile for the peace of mind achieved is a matter of personal preference. However, it would be wise to at least contact your bank to discuss the products they may be able to offer, and their costs. A fixed rate, an interest rate collar, or similar product may be available from your current lender, or another provider.



Next Issue

In our spring issue, due out in mid April, we will include a review of the Budget, clearly illustrating how any changes will affect farmers and the farming industry. We will also look at the risk of the VAT man attacking separate businesses carried on by the same family, along with the inheritance tax risk of horses occupying your land.

For further advice and information on any of the above, or ideas on how to save money right now, call 01295 250401 and speak to a member of our specialist agriculture team.



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