Ellacotts

AGRICULTURAL NEWSLETTER
Autumn 2020 edition

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Annual Investment Allowance decrease from January 2022

With the 2020 harvest behind us and autumn drilling underway, you may be thinking ahead to machinery requirements and potential purchases. With this in mind, it is important to take into account the changes to the Annual Investment Allowance (AIA) which will be effective from 1 January 2022.

The Annual Investment Allowance (AIA) is a key tax planning tool. It allows a 100% allowance for qualifying plant and machinery expenditure incurred in an accounting period up to a specified annual amount each year.

AIA was capped at £200,000 per year up to 31 December 2018 with the limit being temporarily increased to £1 million per year for each of the following three years, ending 31 December 2021. As of 1 January 2022, the AIA limit will revert back to £200,000.

There are transitional rules in place to deal with the reduction in AIA, however these rules can mean that allowances could be lost where a business has an accounting period that straddles 31 December 2021. The timing of expenditure is therefore important.

For business with a 31 December 2020 year end, the relief is straightforward. However, for year ends which span 1 January 2022, transitional rules will apply and the AIA entitlement before and after 1 January is considered as follows:

A) Based on the £1,000,000 allowance pre 1 January 2022, apportioned for the number of months making up the accounting period falling before 1 January 2022.

B) Based on the £200,000 allowance post 1 January 2022, apportioned for the number of months making up the accounting period falling after 1 January 2022.

A + B are then added together to calculate the maximum potential AIA for the accounting period subject to the transitional rules.

For example, a business with a 31 March 2022 year end would have the following AIA entitlement:

A) £1,000,000 x 9 months = £750,000 (1 April 2021 - 31 December 2021)

B) £200,000 x 3 months = £50,000 (1 January 2022 - 31 March 2022)

A + B = Maximum potential AIA = £800,000

In addition to the above, the actual AIA claim is also determined by the date on which the expenditure is incurred. There is a further cap when the limit reduces, that restricts the AIA limit to the proportion of the AIA in that part of the accounting period.

In the above example, if the business purchased an item of machinery costing £400,000 on 30 September 2021, and then another costing £400,000 on 28 February 2022, it could appear that the total allowable expenditure of £800,000 would qualify for AIA at 100%.

However, as the second item of machinery was purchased in the period after 31 December 2021, the claim for that period is restricted to the AIA limit applying to 1 January 2022 – 31 March 2022 i.e. £50,000.

Therefore the AIA claim for the period is £450,000, (£400,000 for the first machine and £50,000 for the second). The remaining £350,000 of expenditure will qualify for Capital Allowances at the standard rate (18%).

If both pieces of machinery had been purchased before 31 December 2021, the maximum AIA of £800,000 could have been claimed.

The timing of expenditure is therefore crucial, with purchasing and contract decisions being made as soon as possible in order to get the most benefit from the AIA. An additional complication arises when assets are brought on hire purchase or when payment is otherwise deferred by four months or more. In these circumstances AIA cannot be claimed on deferred payments until the asset is brought into use. This rule is typically relevant for out of season purchases of combines, balers etc.

Please ask us before you commit to a particular significant purchase or finance deal. If you are unsure of your limits or would like further advice on how to best utilise your AIA fully, please get in touch with your usual Ellacotts contact.

Do you have development land? Things to consider before selling

If you are one of the lucky landowners with either residential or commercial development possibilities, then you may be looking to sell. Although this can be a good idea, it's important to be cautious. The number of approaches by developers and promoters continues to rise and we are carrying out increasing amounts of tax planning work to ensure our farming clients keep as much of the proceeds as possible.

This task may prove harder with possible future tax increases driven by the Treasury's COVID-19 related expenditure.

There is clearly an incentive to get on with the deal whether that be an option or promotion agreement, a hybrid or an outright sale or conditional sale. However, you should approach with caution. We have put together some key points to be aware of below.

Capital Gains Tax v Income Tax
Unless the land is in a corporate structure where the rate of tax is currently 19%, do not enter into a build/development deal to "earn out" a profit. HMRC may challenge that you have entered into a business and seek to tax your proceeds at the higher Income Tax rate, as opposed to the headline Capital Gains Tax rate of 20%.

Tax freezer clauses
These have never been more important. Write into the contract that if rates of Capital Gains Tax increase by way of future legislative changes, then the cost is passed on by way of increased proceeds for the sale of the land.

Option to tax
If you need to recover large amounts of VAT (typically on promoter's fees) then you will need to Opt to Tax your land well before completion. This adds VAT to your land sale, but means you can recover associated input VAT. You will need a contract that allows you to do this or it will become expensive. Often developers dislike this as they pay Stamp Duty Land Tax on the gross of VAT price.

The contract date
Make sure you know when this is – for tax purposes it is when the contract becomes unconditional and not necessarily at completion. Make sure your tax adviser is kept informed otherwise well- structured tax planning may fall at the last hurdle. This is particularly important when claims for Entrepreneurs' Relief (now known as Business Asset Disposal Relief) and Rollover Relief are involved.

Deferred payments
Remember that the tax point is upon unconditional contract, so deferred monies received, perhaps in annual instalments, will be taxed before you receive them. Make sure you receive enough money, early enough, to pay the tax.

Keep farming the land right up to sale, even if the crop may not be harvested Evidence such as photographs, cropping plans and invoices should be kept to record the activity taking place "on the ground". This is key to robust tax relief claims.

These are just but a few points that you need to consider if you have land with development potential and depending on your specific situation, there may well be more. It is a complicated process and professional advice from our expert team could mean a huge difference in the tax you pay. Speak to your normal Ellacotts contact for more advice on selling land.

Ellacotts top tax tips for farming families

Following on from the five tax tips we included in our summer newsletter, here are our next five tax tips. In these challenging times with tax changes a possibility, please do speak to us and keep your tax planning up to date.

1. Pensions
Tax relief on pension contributions can reduce tax liabilities for higher rate tax payers. At the same time pensions can also be used to minimise Inheritance Tax (IHT) now that unused pension funds can be passed down the generations. Pension funds can be used to support the business. Holding commercial property or farmland in a pension fund means that the asset grows free of any Capital Gains Tax. Rent paid to the pension fund is an expense in your accounts, reducing taxable profits.

2. Farmers' averaging
Profits can be averaged over two or five years. This allows you to spread the volatility of farming profits, minimising your tax liability. Ensure that this is being reviewed on an annual basis when your tax return is prepared.

3. Non-farming family members
Ensure that all members of the family are fully utilising their personal allowances and basic rate bands. Can any family members be paid a salary for their administration and bookkeeping help?

Don't forget children also have a personal allowance; a rented property gifted by grandparents to a trust can be a tax efficient way to pay grandchildren's school fees.

4. Capital Gains Tax
In addition to your personal allowance, which can be deducted against income, you also have an annual exemption of £12,300 which can be used against Capital Gains. The deadline to pay Capital Gains Tax on residential property sales has however been cut to 30 days from the date of sale rather than the normal tax payment deadlines. So ensure that you have spoken to Ellacotts before you sell a residential property. Gains on residential property are taxed at 18% or 28% depending on your income levels.

5. Entrepreneurs' Relief (now Business Asset Disposal Relief)
This relief can reduce the Capital Gains Tax rate from 20% to 10%. However, from 6 April 2020 the lifetime cap reduced to £1,000,000. The relevant qualifying conditions must be met throughout a period of at least 24 months. Ensure that all conditions are met before unconditional contracts are exchanged, otherwise the relief may be lost. Early discussions with us are crucial.

Please contact the team at Ellacotts to discuss how we can help your business and family to maximise the wealth your business earns in the short term, and that the family retains in the longer term. We would be delighted to talk with you.

Know your Inheritance Tax exemptions

In 2019/20 Inheritance Tax (IHT) accounted for less than 1% of total Government revenue. This is due to some generous IHT reliefs, which can prove very valuable with careful planning.

Since the COVID19 pandemic has significantly increased Government spending on support schemes, the Government is under pressure to find additional funding in order to pay for it. It is therefore likely that the IHT rate could be increased or reliefs cut back.

In past newsletters we have discussed Business Property Relief and Agricultural Property Relief, two very worthwhile reliefs which protect many farms from IHT. Many faming businesses and estates are still exposed to IHT due to diversification or the structure of the business and therefore need to rely on other IHT exemptions, notably relating to gifts.

Lifetime gifts are generally subject to IHT if they exceed the £325,000 nil rate band and do not qualify for either Agricultural Property Relief or Business Property Relief.

However, some gifts are automatically exempt from IHT and do not require you to survive seven years for the value of the gift to fall outside your estate. An important thing to remember when you gift an asset is that you are no longer able to benefit from any income it produces.

1) Gifts to your spouse or civil partner
Gifts between married couples are normally exempt from IHT. Leaving everything in your Will to your spouse means that your estate may not incur any Inheritance Tax liability. All assets inherited by the surviving spouse will pass at market value, washing away any capital gain. If the surviving spouse then subsequently gifts the assets and survives seven years, there is no Capital Gains Tax or Inheritance Tax charged.

2) Gifts to organisations
Gifts to charities, political parties, housing associations or national heritage bodies such as museums are completely exempt from IHT. There are no limits on how much you can gift to these organisations. All these exemptions apply to transfers both during lifetime and on death.

3) Small gift exemption
Lifetime gifts of up to £250 to any person in a tax year are completely exempt. This is, however, an all or nothing exemption and this is the maximum that can be given. For example, if you make a birthday gift of £275 to a grandchild, none of the gift would be exempt from IHT.

There are no limits on the number of small gifts you can make. Therefore if a grandparent has 15 grandchildren they could give each of them a gift of up to £250.

4) Marriage exemption
Gifts for a marriage are also exempt from tax up to certain limits depending on your relationship to the bride and groom. A mother or father can gift up to £5,000 to a son or daughter as a wedding gift and the whole amount is exempt. Grandparents and great-grandparents can gift £2,500, the bride and groom £2,500, and any other person £1,000.

These exemptions apply per marriage. So if a mother gives £5,000 to her daughter she cannot gift £1,000 to her son in law. These are not all or nothing exemptions, so only the excess amount will be deemed a transfer for IHT.

5) Gifts out of excess income
Gifts out of "normal expenditure out of income" are exempt from IHT. "Normal" in this case means habitual or typical, e.g. a gift that happens year after year. The gift will be treated as having to be made out of excess income if you are left with sufficient income to maintain your normal standard of living.

There is no monetary limit on this exemption because different individuals have different levels of income and what is classified as normal expenditure varies from person to person.

6) Annual exemption
Every person can gift £3,000 per tax year without incurring an IHT charge. Any unused amount can be carried forward for one tax year only.

It is important to understand which gift reliefs you are using. You should keep detailed records, so your executors can make the necessary claims when you are no longer around to ask.

If you would like to discuss any of the above, or ways to minimise potential Inheritance Tax charges, please do get in touch.

Planning for any Inheritance Tax due

When we consider Inheritance Tax (IHT) planning for clients, generally there are both agricultural and non-agricultural assets.

Once we have established what assets may qualify for Agricultural Property Relief and Business Property Relief, there may be further assets on which IHT will be charged. Gifts may be appropriate to further reduce IHT - see above.

Sometimes, the only way of dealing with a potential liability is to accept that the tax is going to be due at some stage and to make provision for your beneficiaries to be able to pay the tax without having to sell family assets.

Taking out an insurance policy to cover the IHT can be a simple, cost-effective way of dealing with the issue. Whole of Life Assurance is designed to provide cover for the rest of your life, as long as you continue to pay the premiums.

For a married couple, the plan would be set up on a second death basis. This is by far the most cost-effective way of writing the cover, as premiums are a lot less than for two single life plans. The plan should be written in trust: otherwise benefits will be paid to the estate, which makes the overall problem worse. Another advantage of using a trust is that the insurance company do not need to wait until probate has been issued before paying out benefits.

This type of plan would be medically underwritten. Because clients considering this cover are generally older, the underwriting is quite stringent.

In summary, taking out an insurance policy to plan for IHT due provides your beneficiaries with a lump sum to pay the tax when it becomes due without having to sell assets. Please remember, this type of insurance will not mitigate the tax due.

Your usual Ellacotts contact, and Chris Slatter in the Ellacotts Wealth Planning team, would be pleased to discuss how insurance could help you plan for potential Inheritance Tax liabilities.

Team growth and development

We're now looking for an Agriculture and Property Accounts Manager to join our growing team in Kettering. You can see more details about this exciting opportunity on our website **www.ellacotts.co.uk/careers/jobs** or contact **careers@ellacotts.co.uk** to discuss further. This is a great opportunity to further develop a career in a forward thinking, client focussed business.

Do you share our interest in agriculture and enjoy working with farmers and landowners? We are always keen to meet talented individuals with accounts and/or tax skills and experience, for our teams in Banbury and Kettering. Please get in touch!

Oxford Farming Conference

We're delighted to be sponsoring the Oxford Union Debate at the first ever online Oxford Farming Conference. Taking place on Wednesday 8 January 2021, you can book your place here: **www.ofc.org.uk/conference/2021**

Meet some of our team

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