Ellacotts
Chartered Accountants & Business Advisers

AGRICULTURE & PROPERTY

AUTUMN 2022 NEWSLETTER

In this edition....

The outlook for profits, cash flow and tax

In this article, Ed Nichols reflects on what we are currently seeing with our farming clients.

In the farming industry, this time of year tends to see an influx of cash, whether it be lambs and cereals sold, or revenues expected in the next few months from finished cattle or grain in store awaiting sale. We can also expect the remaining BPS payments and cash from environmental schemes to arrive soon.

With cash inflows comes the inevitable cash outflows. Given the current economic climate the majority of running costs are likely to increase in the coming year. We have already seen increases in the cost of fuel, fertilisers and feed. This makes managing cash flow more important than ever.

We have seen relatively strong profits from the 2021 harvest as shown by our benchmarking highlights on the back page. This has resulted in increased tax labilities payable in January 2023. January 2023 tax payments include payments on account for the current (2022/23) tax year.

We are expecting our arable farmers to see even higher levels of profit from the 2022 harvest. The year's input costs were relatively low and market prices remain high. Whilst this is good from a cash flow point of view, higher taxable profits mean a higher tax bill. Profits from harvest 2022 will be reported on 2023 tax returns with balancing tax payments due in January 2024. This time delay gives us opportunities to plan to reduce those liabilities as well as managing cash to ensure there are still funds available to meet these liabilities. This is especially important if the 2023 harvest is not as lucrative as the 2022 harvest.

Something which was glossed over by commentators on the Government's mini budget was the announcement that the Annual Investment Allowance will be permanently set at £1m. This provides certainty and ongoing scope to reduce tax liabilities through the purchase of machinery. Consideration needs to be given to how these purchases will be financed. Rising interest rates mean hire purchase terms will be less favourable.

Personal pension contributions are also useful for tax planning. Tax relief can generally be gained on contributions up to the annual allowance of £40,000 per tax year. You can also carry over any unused annual allowance from the previous three tax years, if you already have a personal pension plan. More information can be given by colleagues in the Ellacotts Wealth Planning team.

A tool which is incredibly useful to us is Farmer's Averaging Relief. This allows farming profits to be averaged over two or five years, reducing exposure to higher rates of tax. This option is not open to everyone as certain qualification criteria need to be met. We consider whether a Famer's Averaging claim can be made on every relevant tax return. Unlike investing in machinery, or into your pension, a Farmer's Averaging claim does not involve spending cash.

The 2023 harvest profit is becoming harder to predict. The cost of harvest inputs are higher than ever and while sales prices are strong, they remain uncertain. Retaining as much cash as possible for working capital may be a useful strategy.

HM Revenue & Customs' "Making Tax Digital" regulations resulted in bookkeeping going online which means we no longer have to wait until after your year end to see your financial position. We can provide additional services including forecasting, budgets and interim accounts. These are essential tools for effective cashflow management. If you require any help please get in touch.

The challenges of managing farming business cash flow are nothing new but in the context of volatile markets and rising interest rates, planning ahead becomes even more important. Your usual Ellacotts contact will be pleased to help.

Could you benefit from making voluntary National Insurance contributions?

If asked, "Do you wish to make a voluntary National Insurance contribution" you would be forgiven if your first thought were "No! Why would I pay more than I'm required to?". The question is however more complex than it may appear, most notably from a State Pension perspective. Here, Kerry O'Reilley, partner within our Agriculture and Property team, examines further.

Currently, the full State Pension is £185.15 per week and the amount you receive is based on your National Insurance (NI) record. Broadly speaking, in order to be eligible for the full State Pension, you need 35 qualifying years on your NI record. You can get qualifying years in many situations including:

1. If you're working, you pay NI and get a qualifying year if:
   - You're employed and earning over £242 a week from one employer.
   - You're self-employed and paying NI contributions.

2. If you're not working, you get NI credits if for example:
   - You are registered for Child Benefit for a child under 12 (or under 16 before 2010). Due to high income, you may decide not to claim Child Benefit, but registering into the system is still worthwhile for the associated NI credits. [https://www.gov.uk/child-benefit-tax-charge]
   - You get Carer's Allowance.

If you are employed and earning less than £242 a week, you may still get a qualifying year if you earn between £123 and £242 a week from one employer.

If you are unsure how many qualifying years you have on your NI record, you can check your NI record online at https://www.gov.uk/check-national-insurance-record. This will show whether there are any gaps in contributions or credits, which could affect State Pension entitlement. This knowledge can help determine whether voluntary contributions should be considered. Check your record carefully: contributions don't always make it onto the correct NI record, for example if the wrong NI number is entered into a payroll. Your State Pension entitlement could be affected by "Contracting out" of the State Pension years ago.

For self-employed individuals, gaps in NI record can occur in years where taxable losses are made or where the share of profits received falls below the small profits threshold for Class 2 NIC purposes. For the 2022/23 tax year, the small profits threshold is £6,725. This means that if self-employed profits are below £6,725, there is no requirement to pay Class 2 NIC. Voluntary Class 2 NIC can however be made to achieve a qualifying year. For the 2022/23 tax year, the Class 2 NIC rate is £3.15 per week.

There is not necessarily a 'right' answer when it comes to determining if a voluntary Class 2 NIC contribution should be made and we always recommend that specialist advice from a financial adviser is sought. There are however steps that can be taken to aid the decision:

1. Review of NI record to establish how many qualifying years currently exist. How many more qualifying years are needed?
2. Check when State Pension Age (SPA) will be reached - https://www.gov.uk/state-pension-age. How many more years are available to achieve further qualifying years?

Having established the above, the decision may be simple. For example, if 35 qualifying years have been reached or will be reached by SPA, the maximum years for the full State Pension will be achieved and so making a voluntary contribution would have no effect.

Other situations are not so simple and may require further thought; your usual Ellacotts contact would be pleased to discuss further with you. Alternatively, if you would like specialist financial planning advice, Chris Slatter of Ellacotts Wealth Planning Limited would be pleased to consider your bespoke requirements.

The evolution of the farm and business

As families evolve, and businesses change, we are often asked to assist and advise in connection with rearranging property ownership and business structure. Change may be prompted by gradual development, different talents and interests. The trigger could be more abrupt, for example a death, the provisions of a Will, or perhaps a divorce or disagreement.

Open and honest conversations, and mediation, can make the process easier, or perhaps find a way of modifying the current arrangement to the benefit of all. For example:

- Separate businesses may be created, perhaps working closely together, or perhaps entirely separately;
- If one party wishes to extract cash for other purposes, assets may need to be sold, or the ongoing owners may borrow to buy out the outgoing owner;
- The "leavers" may be happy with achieving sole ownership of part of the property, rented to the business to provide them with an income, and knowing they can borrow against that in the short term, or sell at a time of their choosing.
- Separating the business from asset ownership may enable a wider group to run the business, without giving them property. A company with various classes of shares could be the solution.
- A pre-nuptial or post-nuptial agreement can offer useful reassurance and protect family wealth.

Taking advice early is key. Our long-term and detailed knowledge of business and personal finances is key, balancing assets, cashflow, fairness and various relevant taxes. We are often called upon to help clients navigate the business and tax implications of a relationship or ownership split, working closely with other advisers including bankers and lawyers. Holistic advice is needed, to ensure the best outcome.

In a farming family the close links between lifestyle and business, and tensions between income and capital, add to the complexity.

Whilst the tax system includes many concessions for married couples and civil partnerships, these generally end at the end of the tax year when the couple ceased living together.

The parties may have agreed the value of an asset, but for tax calculations and reporting, we are concerned with open market value. The period when a former home can be sold completely free of Capital Gains Tax now generally ends nine months after leaving it. If any Capital Gains Tax is payable on the sale of residential property, this is due sixty days after the disposal. Gains on residential property are taxed at 18% or 28% depending on your income levels.

Business agreements should be reviewed regularly to ensure that they still meet the needs of the business and the family. Depending on the structure of the business, this may be in the form of a partnership agreement, or a shareholder agreement for a corporate business. A correctly worded partnership agreement should maximise the Inheritance Tax reliefs available. The partnership agreement and Wills should be reviewed together, as a partnership agreement will override a Will if they are not aligned.

Life assurance should be considered to ensure borrowings are covered on death, and any Inheritance Tax can be paid without straining the family. We recommend clients consider "key person" cover to protect the business from the financial impact of losing a key employee/owner/manager whose death or illness would have a significant impact on business finances.

In conclusion the best outcome will likely come from taking early advice from a combination of your valuer, solicitor, tax adviser and also potentially your bank manager. Tax advice is key to achieving the best outcome in challenging times. If this brief summary strikes home for you, or your family, the team at Ellacotts will be here to talk you through the decisions you face. We would be delighted to meet with you.

Highlights from our benchmarking of the 2021 harvest

Outputs

Drilling conditions for the 2021 crop were promisingly dry but ended with a wet harvest. The strength of grain prices masked the poor weather come August and resulted in gross output for our average farm increasing £178 per acre from £414/acre to £592/acre.

Wheat yield for our top performers increased to 3.63t from 3.47t and impressively across all farms the yield rose to 3.41t from 2.88t. With the price of wheat up by £24 to £210 per tonne this resulted in a strong gross output of £716/acre up £180/acre from the 2020 harvest.

Oilseed rape output showed an increase of £342/acre to £789/acre for our top performers, with the result for our average farm reflecting a similar trend.

Barley yields have increased from the 2020 harvest but not quite as significantly as wheat and oilseed rape. The barley price for top performers increased by £71/t to £210/t. The strength of the grain market allowed the overall gross output for both our top performers and average farm to rise significantly compared to the 2020 harvest.

Inputs

Wet weather meant much of the 2021 harvest had to be dried. The increase in 2021 variable costs was predominantly due to drying costs.

All other inputs remained consistent with the 2020 harvest. Higher fertiliser costs didn't affect the 2021 harvest but will be a significant factor for the 2022 harvest.

Fixed costs

Farmers have been looking at fixed costs and reducing these where possible although it is difficult to see where any significant savings can be made.

Labour costs were up £7/acre mainly due to cost of living increases having a knock on effect on wages payable to both full-time and temporary workers.

Agricultural rents appear to have reduced slightly.

Conclusion

In the short term, buying and selling in volatile markets makes for an uncertain future and will be crucial to the financial success of the business. Longer term, the impact of the gradual removal of the Basic Payment is known, but the support thereafter is still uncertain. Significant reductions in support are inevitable. Our farmers are facing changes which will have a huge impact on future farming strategy. Good advice and business planning will be key.

Laurence Edmunds in our Kettering office would be pleased to discuss our findings with you. To view the benchmarking tables for 2021 visit our website www.ellacotts.co.uk/news/benchmarking-2021-harvest/

Meet some of the team

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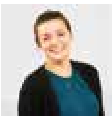

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