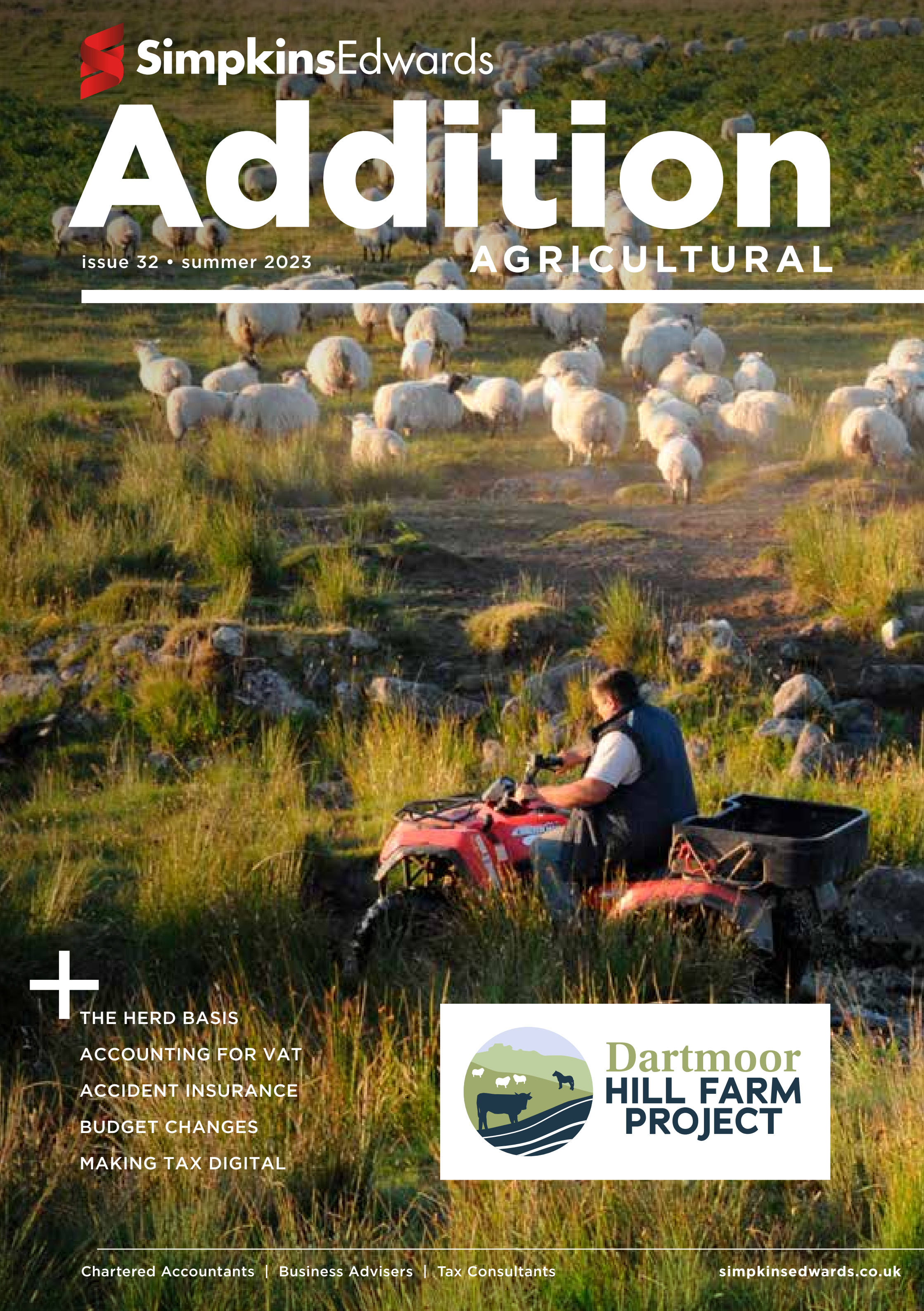

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Addition

AGRICULTURAL

issue 32 • summer 2023

- THE HERD BASIS
- ACCOUNTING FOR VAT
- ACCIDENT INSURANCE
- BUDGET CHANGES
- MAKING TAX DIGITAL

Dartmoor HILL FARM PROJECT

GETTING YOUR VAT RIGHT

The use of software to comply with Making Tax Digital requirements has considerably increased the transparency of VAT accounting. This makes it more important than ever for farmers to get the detail right, even though HMRC VAT inspections are less frequent than they used to be.

Cash basis or invoice basis

VAT accounting is normally on the 'invoice basis', meaning that VAT is accounted for at the invoice date.

Under the alternative, cash basis, VAT is accounted for when monies are paid or received.

The cash basis is simpler (and more basic software versions only offer it) but, for farmers, the cash basis has the disadvantage of delaying input VAT reclaim.

The use of invoice basis or cash basis is set in the software.

Transaction categories and VAT rates

There are three broad VAT categories of transactions:

- Taxable supplies – including standard rate, reduced rate and zero rate
- Exempt supplies
- Transactions outside the scope of VAT

Both taxable and exempt supplies should be included within VAT return submissions, but transactions that are outside the scope of VAT should not.

When entering transactions in accounting software, tax codes are used to differentiate VAT categories and rates.

The VAT categories and rates for common farm transactions are:

Category	VAT rate (which may not all be reclaimable)	Examples
1. Taxable	Standard rate (20%)	'Non-food' livestock (eg dogs, alpacas)
		Wool
		Straw for bedding
		Scrap metal
		Machinery
		Seeds, sprays and fertilisers
		Contracting and professional services
		Rents and sale proceeds from 'opted' property
		Storage
		Off-street car parking
		Sporting rents (eg fishing, shooting)
		Road fuel (petrol and DERV)
		Non-domestic fuel in large quantities, including: • Over 2,300 litres gas oil or kerosene • Over 1,000kWh per month electricity • Large quantities gas
		Timber (excluding some firewood)
		BPS entitlements sold without land
	Reduced rate (5%)	Gas oil, electricity and heating oil in small quantities or for domestic use
		Ready-cut firewood sold for domestic use
	Zero rate (0%)	'Food' livestock (eg cattle)
		Crops for food or fodder
		Animal fodder (eg hay/straw/silage)
		Water
		Newspapers, books and periodicals
2. Exempt	Exempt (0%)	Most other property rents and sales
		Insurance
		Finance
		Bank interest and charges
		DVLA road tax
		Royal Mail postage
3. Outside scope	Outside scope (0%)	Subsidies, including BPS grants
		Drawings and cash introduced
		Repayments on loans and HP
		Council tax
		Employee wages

Partial exemption

Where a business makes both taxable and exempt supplies, the tax coding of inputs also needs to distinguish between:

- Inputs incurred in pursuit of taxable supplies only (eg fertiliser)
- Inputs incurred in pursuit of exempt supplies only (eg let property repairs)
- Mixed inputs (eg motor expenses and accountancy)

Each period end, calculations are required to apportion the mixed inputs between the taxable and exempt categories and then to ascertain whether exempt input VAT can be reclaimed. Generally, exempt input VAT can be reclaimed only where it is less than £7,500 per VAT year and less than half of total input VAT. Otherwise, exempt input VAT is irrecoverable.

Reverse charge procedure

Contractors need to follow special 'reverse charge' rules when undertaking construction work for UK VAT registered businesses that are within the Construction Industry Scheme. This affects few farmers; please contact us if you require advice.

Reclaiming input VAT

Evidence

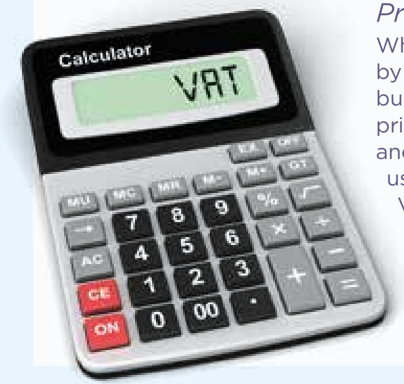
Every claim for input VAT must be supported by a proper VAT invoice showing the VAT number of the supplier. Where payments are made monthly (eg utilities or finance lease), the supplier should issue VAT invoices periodically to support VAT reclaim. When equipment is acquired on hire purchase, the VAT invoice is within the HP agreement.

Eligibility

VAT can only be reclaimed on inputs incurred by a VAT registered business in pursuit of its supplies of goods and services. Input VAT cannot be reclaimed by a farm partnership on costs incurred by entities other than the partnership (eg on costs incurred by a partner personally in relation to his or her property or drawings).

Private proportions

Where costs are incurred by the VAT registered business, but there is some private usage (eg heating and utilities), the private use proportion of input VAT must be disclaimed. Appropriate proportions can be set up for this in the accounting software.



Motor expenses

Motor repairs are an exception to the usual private proportions rule. It is permitted to reclaim all input VAT on repairs and maintenance of a business motor vehicle, despite partial private use. This enables farmers to pay and reclaim the VAT on insurance-funded repairs.

No VAT can be reclaimed on car fuel used partly for private motoring unless scale charges are paid. It is permitted to reclaim VAT on the business proportion of car fuel without paying scale charges, but only if sufficiently detailed mileage records prove that the claim relates wholly to business motoring; most farmers find this impractical.

Farmhouses

Up to 70% of input VAT can be reclaimed on repairs to the fabric of a full-time working farmhouse (or up to 40% on extensions or improvements), but not on repairs to private areas (eg bedrooms and bathrooms).

No input VAT can be reclaimed within a business registration for costs relating to a new family home. Such VAT can only be claimed within the DIY Housebuilder Scheme and is subject to a tight time limit and detailed disclosure to HMRC.

If you are unsure about any aspect of your VAT accounting, please contact us for a VAT health check-up.

PAY YOUR MONEY AND MAKE YOUR CHOICE

Statistically, farming is one of the UK's most dangerous industries to work in. Nothing can compensate for the premature death of a loved one, but injuries from accidents can also cause prolonged personal and financial hardship.

Personal accident insurance

Some farmers hold personal accident insurance. These policies are designed to pay compensation following serious injury or death from a work-related accident. They differ from life insurance in that they do not protect against illness or old age.

There is a statutory exemption from income tax on payouts from personal injury policies but it is subject to a number of conditions, including that 'no part of any premiums under the policy has been deductible in calculating the income of the insured for income tax purposes'.

This condition is failed if the premium paid for the policy in any past year has had tax relief claimed; it is not sufficient simply to disallow premiums for the year of a claim and perhaps the previous year.

Effectively, as taxpayer, you can choose to claim tax relief on premiums and have any future payout taxed, or to disclaim tax relief and have any future payout tax free.

There are two planning points:

- If you would like any future payout to be tax-free, but the existing policy is tainted by a past claim for tax relief, the existing policy could be discontinued and a new policy taken out.
- Please make sure to inform us if you take out a new policy and want to disclaim income tax relief on its premiums. Frequently, personal accident cover is included within a larger business policy and we are not alerted to it.

Employment and support allowance

Self-employed farmers under pension age may be entitled to claim employment and support allowance (ESA) if they have a disability or health condition that affects how much they can work.

Eligibility is subject to having paid class 2 national insurance (compulsory or voluntary contributions) for the previous 2 or 3 years.

Contributions based ESA is not means tested, but it is taxable and needs to be included in your personal Self-Assessment tax return.

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FARMING FOR THE FUTURE ON DARTMOOR

Guest article by Dartmoor Hill Farm Project

The Agricultural Transition is challenging for most, but recent Industry data suggests livestock farmers and more particularly upland livestock farmers are already dealing with significant impacts to their farm business. The gradual reduction and ultimate loss of the Basic Payment Scheme (BPS) by 2028 brings business planning into sharp focus for many.

Dartmoor Hill Farm Project (DHFP) are a farm support group, hosted by Dartmoor National Park Authority, who operate as a point of contact, information and advice for anyone farming in the area. Currently part of a network working with the Prince's Countryside Fund to deliver the Farm for the Future programme, designed to help farmers understand, navigate and proactively adapt to changes in policy due to the Agricultural Transition. It offers locally tailored events relevant to the area and access to free consultation time with a specialist. Ultimately funded by Defra as part of the Future Farming Resilience Fund, anyone in receipt of BPS is eligible to take part, with activity continuing up until March 2025.

Over 100 Dartmoor farm businesses have engaged to date, with another two years of delivery in the pipeline. Farmers are directly involved with their feedback incorporated into the design of future events and subjects of interest, to ensure that it meets their needs.

Topics have included everything from core themes of optimising healthy soils and productive grassland underpinning efficiencies in day-to-day operations, understanding the different aspects of Carbon in farming, best use of technology to streamline record keeping or support decision making eg. Electronic ear tag data tracking live weight gains, or succession and future planning across multi-generational farms.

This is just one of a range of activities and events developed and run by the Dartmoor Hill Farm Project team; currently planning a series of complementary events for 2023 which offer skills and training, Industry speakers, practical insights based on host farm experiences, plus crucial updates around Environmental Land Management (ELM) schemes as these start to emerge. 2023 coincidentally marks the 20th Anniversary of DHFP which originally came about following the Foot & Mouth outbreak, a significant milestone which impacted upland livestock farmers, their livelihoods and families – leading to a remit to help support a sustainable future for farming on Dartmoor and all the wider benefits it delivers as a result.

To learn more about the work of the Dartmoor Hill Farm Project, get involved or subscribe to newsletter updates, please visit Dartmoor Hill Farm Project | Support for Dartmoor farmers or email hfp@dartmoor.gov.uk

Dartmoor HILL FARM PROJECT

Working with THE PRINCE'S COUNTRYSIDE FUND

SimpkinsEdwards

THE HERD BASIS

Whenever a new farming business is set up, one important decision is whether to adopt the tax herd basis. The deadline for a herd basis election is 1 year after the filing date for the first tax return and, once made, the election is irrevocable.

In practice, choices can often be made later because a fresh opportunity to go on or off the herd basis is triggered by the appointment or retirement of a partner.

Basic principle

A herd basis election can only cover mature production animals (eg cows, bulls, ewes and rams).

The basic principle of the tax herd basis is that the animals in a production herd are treated as a homogenous fixed asset, so that the tax cost of (eg) a herd that always comprises 100 cows is the cost of the first 100 cows that formed the herd.

By contrast, under accounting standards (or without a herd basis election), the cost of the herd is the cost of the current 100 cows that are in the herd.

As cows are sold and replaced, the tax herd basis cost remains static (assuming no change in overall number of cows), whereas the cost under accounting standards increases as cow prices rise.

Advantages and possible disadvantage

Assuming prices increase over time, a herd basis election has the following advantages:

- As production animals are culled and replaced, herd basis treatment achieves an income tax deduction for the amount by which the replacement animals cost more than their predecessors. The extra cost is claimed as a tax-deductible expense, instead of an increase in value of the asset. This is an advantage from year to year.
- On selling out the herd, or at least 20% of it, the profit or loss on the sale is tax-free.

If prices do not increase over time, a herd basis election may be disadvantageous because animals joining the herd are often at peak value (eg first calving heifers or first lambing ewes) whereas, on selling out the herd, the animals will usually exhibit a range of conditions and values.

The decision on whether to adopt the herd basis should therefore be driven by the farmer's view on whether animal values will increase over the years they will be farming.

Replacements

HMRC accept that animals are replacements where they join the herd within 12 months of outgoing animals.

The replacement period is extended to 5 years following a tax-free profit or loss on the disposal of 20% or more of the herd. In this case, there is a clawback of the previous tax free profit or loss on replacement.

Joiners not qualifying as replacements are treated as additional animals and enter the herd at the actual cost of those animals.

Anti-avoidance

Animals must be accounted for at market value in a connected business, if a tax advantage would otherwise be achieved by coming off the herd basis. This stops businesses from engineering an advantage by coming off the herd basis on a change of partner (unless sufficient herd animals are sold to third parties first).

The herd basis is restricted to production animals; ie livestock kept by a farmer wholly or mainly for their produce (eg milk or youngstock). HMRC's view is that a herd basis election cannot cover animals in a 'flying herd' (ie where animals are continually being bought or sold and do not remain in the herd for a normal productive life).

Please contact us if you would like to discuss herd basis planning.

MAKING TAX DIGITAL FOR INCOME TAX – POSTPONED AGAIN!

Most farmers are VAT registered and therefore obliged to comply with the Making Tax Digital requirement to keep accounting records electronically.

Readers who are not VAT registered, or who perhaps have personal property income, may be interested to learn that Making Tax Digital for Income Tax (originally scheduled for April 2018) has been postponed again.

On 19 December 2022, Government announced that the system will now begin in April 2026 for individuals with turnover and/or gross rents exceeding £50,000 per annum; with that entry threshold set to be reduced to £30,000 the following year.

No date was given for partnerships, trusts or other entities.

Following Government's announcement, some commentators have questioned whether the MTD Income Tax regime will ever actually happen. In May 2023, the Institute of Chartered Accountants in England and Wales wrote to HMRC, requesting that the proposed requirement for quarterly income tax returns be dropped. The VAT regime already means that most businesses must now keep electronic accounting records, which was believed to be the original objective of Government and HMRC.

Government's announcement means that, for non-VAT registered entities, Making Tax Digital is no longer (for the time being) a driver to switch to accounting software and the smallest businesses may now decide to shelve its introduction.

Modern cloud-based software still has important advantages for other businesses, including:

- Streamlining your bookkeeping
- Improved standard of recordkeeping; especially reconciliations
- Secure information storage managed by the software company
- Facility for different users (including the accountant!) to access up to date information from any secure location, without needing a new download or backup
- Provision of instant, up-to date management information
- Facility to store invoices electronically (attached to each transaction) and dispense with paper

Where a decision is made not to use software for the time being, please consider having a separate bank account for all income and expenses of the trading or property letting activity. Using a separate business bank account will be a useful preparatory step if it proves necessary to adopt software later and, in the meantime, the separate account will help extract information more easily for the annual tax returns.

Please ask us if you would like advice on your record-keeping.

BUDGET UPDATE

Since last Autumn's edition went to press, there have been three Budgets – September and November 2022, and March 2023.

While these have not brought major changes in income or capital tax rules affecting farmers, detailed changes to bands and allowances are set to increase costs:

Employment costs

The National Living Wage for workers aged 23 and over increased from £9.50/hour to £10.42/hour from April 2023. This is a 9.7% increase.

Income tax

The personal allowance (£12,570) and higher rate (40%) tax threshold (£50,270) are now frozen until 2028, but the income level above which the additional rate (45%) becomes payable is reduced from £150,000 to £125,140 for 2023/24. There continues to be an effective 60% income tax rate on income between £100,000 and £125,140. The minority of farmers in the fortunate position of having those high income levels should consider the tax efficiency of pension payments when profits are high. From 6 April 2023, the pension annual allowance is increased to £60,000 for most taxpayers (or £10,000 for those who have previously withdrawn money from a pension fund) and, from 6 April 2024, the pension lifetime allowance is to become unlimited.

Income tax rates on dividend income have increased by 1.25% for 2022/23 onward and are now 8.75% for basic rate taxpayers and 33.75% for higher rate taxpayers. Moreover, the tax-free dividend allowance was reduced from £2,000 to £1,000 on 6 April 2023 (and will be further reduced to £500 in April 2024).

Van and van fuel benefit in kind charges for employees are now index-linked and have increased to £3,960 and £757 respectively for 2023/24.

National insurance

For 2022/23, individuals with self-employment earnings between £6,725 and £11,908 are automatically treated as having paid class 2 national insurance. Only individuals with earnings under £6,725 will need to consider paying voluntary contributions for future state pension purposes. Contributions remain compulsory for individuals under pension age with earnings exceeding £11,908.

Similar principles apply for 2023/24 and future years, but with updated threshold amounts.

Corporation tax

From 6 April 2023, the 19% corporation tax rate applies only to the first £50,000 of annual profit. Profits between £50,000 and £250,000 are taxed at 26½%, and profits over £250,000 are taxed at 25%.

Relief for small companies' research and development tax credits has been reduced.

Coupled with the increases in dividend tax, and a proposal to require all companies to provide profit and loss account information to Companies House, these changes reduce the attraction of company structure for profitable farms.

Other taxes

The capital gains tax annual exemption (£12,300 for 2022/23) has been reduced to £6,000 for 2023/24 (and will be further reduced to £3,000 for 2024/25).

The inheritance tax nil rate band (£325,000) and residence nil rate band (£175,000) are now frozen until 2028. By then, the nil rate band will have been unchanged for 19 years.

From 6 April 2024, inheritance tax agricultural property relief will be restricted to property in the UK.

The VAT registration threshold of £85,000 is frozen until 2026.

The silver lining

To end on a positive note for farmers (many of whom are in receipt of state pension), the state pension has increased by 10.1% for 2023/24, meaning that a full pension for the year is worth £10,600 for those on the new rules.

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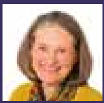

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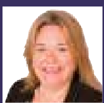

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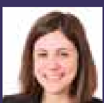

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AGRICULTURAL SHOWS

We will be attending the following agricultural shows. Please come along and see us there.

NORTH DEVON
2 August

HONITON
3 August

OKEHAMPTON
10 August

CHAGFORD
17 August

HOLSWORTHY
24 August

For further details visit our website www.simpkinsedwards.co.uk