

Farming & Estates

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UPDATE

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Claire Shepherd, Kevin Burree and Claire Woodthorpe bring you up to date with current issues and recent developments in the farming and estates sector

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CAP HEALTH CHECK REFORMS

In 2008, EU agriculture ministers reached agreement on the Health Check of the Common Agricultural Policy.

The idea was to modernise and streamline the CAP, making it more market-oriented, removing a number of restrictions on farmers and simplifying the Single Payment Scheme. The result is the new EU Regulation 73/2009. Claire Shepherd gives a summary of the principal changes:

UNUSED ENTITLEMENTS.

From the 2010 scheme year, 'use it or lose it' becomes every two years, not three – if you have more entitlements than land then to avoid forfeiting any, you will need to be careful to claim against all your entitlements at least once within the two year period.

SET-ASIDE. Set-aside is abolished and entitlements now become ordinary entitlements, but note that new cross-compliance requirements have been introduced which mitigate the effect of this abolition and

further proposals are expected in 2009.

SALE OF ENTITLEMENTS.

There is now no requirement that 80% of entitlements transferred without land need to have been activated prior to the transfer.



MILK QUOTAS. By 2015, milk quotas will no longer be a production restraint. To ease the transition, quotas will continue to be increased across the EU until they expire in April 2015. In Italy, the full 5% increase will be introduced immediately. Farmers who exceed their quota by more than 6% in 2009/10 and 2010/11 will face a levy 50% higher than normal.

MODULATION. Compulsory modulation rates will increase to 10% by 2012. They are currently 5% for farmers receiving more than €5,000 in direct payments. As a result more funding will be available for programmes to address environmental issues, such as climate change, renewable energies, biodiversity and water shortage. For every 1% increase in compulsory modulation, voluntary modulation will be reduced by 1%. The UK already voluntarily modulates significantly, so the net effect for UK farmers is neutral, but modulation levels across the EU will become more even. In the UK, the total level of modulation in 2009 is 19% rising to 22% in 2010. For farms claiming over €300,000 in direct support a further modulation of 4% will be required from 2009 onwards. This will affect larger farms.

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Farmhouses. Where are we now?

A number of recent tax cases have had an impact on HMRC's view of agricultural property relief on farmhouses and business property relief on agricultural land.

Claire Woodthorpe gives an update on those cases and guidance on some steps to take to potentially mitigate any liabilities.

The much publicised 'farmhouse cases' of recent years have led to confusion as to what exactly qualifies as a farmhouse and what steps can be taken to preserve and maximise the inheritance tax reliefs on property.

Probably the most damaging thing to come out of the farmhouse cases was the introduction of the 'what is a farmer' question. There are occupants of farmhouses that HMRC argue enjoy a country

residence with a farm attached and are not actively involved in the farming operations. The suggestion is that this lack of involvement means that the farmhouse is not occupied for the purposes of agriculture and therefore relief should not be allowed.

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“Those involved in contract farming arrangements and elderly partners who have semi retired from the business may not qualify as farmers”

Farmhouses. Where are we now? (Continued from front page)

The tax profession argues that the ‘purpose of occupation’ test in the legislation applies to the land NOT the house, and the reason for this is that duality of purpose has always been a factor of farmhouse occupation as it is, after all, a house.

Happily ignoring the legislative issues HMRC have gone on to examine what ‘active involvement’ actually means and it is here that we see the introduction of the ‘dirty fingernail test’. The farmer under this test is the person ‘who farms the land on a day to day basis’. Lifestyle farmers will certainly find it difficult to obtain relief. However, this also implies that those involved in contract farming arrangements and elderly partners who have semi retired from the business may not qualify as farmers and therefore could be denied the relief on their houses.

This is at odds with previous guidance which states that the

farmhouse is the place from which management operations are conducted, which would mean that APR can be given on the house occupied by the landowner where they have entered into a contract farming arrangement.

Cases reported as being challenged by HMRC typically involve an elderly partner who they will argue is not in a position to make decisions, or situations where the contract arrangement involves little or no input from the landowner.

However, if real decisions are being made by the landowner/occupier then it is possible to argue that they are actively involved and relief should still be given.

It should be noted that no changes have yet been made to the legislation, and that HMRC’s opinion and guidance have been based purely on fairly recent (and low level)

case law. As each case must be judged on its own merits this means there is still an argument to be had, even for farmhouses that fall outside the guidelines.

Some good news for farmers has just come from a 2009 case HMRC v Trustees of the Nelson Dance family, in relation to Business Property Relief (BPR). Although APR is only available on the agricultural value of the land, BPR is available on the full value, and the Court decided BPR is available where individual assets are transferred but the business itself is not.

However, it is expected that the government will legislate in response to this, possibly in this year’s budget, so tax planning based on this decision should be postponed.



Mason v Boscawen

A 2008 decision will potentially have a serious impact on rent reviews under an Agricultural Holdings Act 1986 (AHA) tenancy where the landlord has elected to charge VAT. Kevin Burree explores the issues:

As a result of a recent decision in the High Court, for the purposes of the AHA, the word ‘rent’ includes any element of VAT where a

landlord has ‘opted to tax’.

It seems to follow that the effect of decreasing VAT to 15% has meant that the rent has decreased with effect from 1 December 2008, restarting the three year period for the purposes of rent review. The resulting consequence is that the next date on which either party may obtain a rent review is 1 December 2011.

If this is true, then since the Chancellor has stated an intention to increase the rate of VAT on 1 January 2010, this would have the further effect of freezing agricultural rents for an additional three year period. Although the

High Court did not decide these questions directly, the judge commented that the effect would be an “inadvertent and possibly prolonged agricultural rent freeze”. The High Court has called for legislation to be rapidly passed to amend the AHA to resolve this. The ruling has the potential to cause great hardship to landlords or tenants, or both. If you are involved in a AHA tenancy rent review where this could be an issue, then funding may be available for bringing a ‘test case’.



Renewable energy - waste not want not!

Farm waste products can often be used to produce heat and power. Although the capital outlay involved in setting up these projects is often prohibitive, this does not have to be the case, as **Claire Woodthorpe** explains.

Significant tax reliefs are available for investment into renewable energy when a company is established that will own the energy producing equipment and supply any energy produced. Reliefs for both the company and its investors will be available as follows:

1. 100% capital allowances should be available for the costs of equipment within the company
2. These allowances will likely create a loss in the company which can be surrendered to the government in exchange for a cash

payment

3. Loans taken by an individual to start the company will be 'qualifying' meaning interest paid on them can be set against income to create a reduction in income tax liabilities

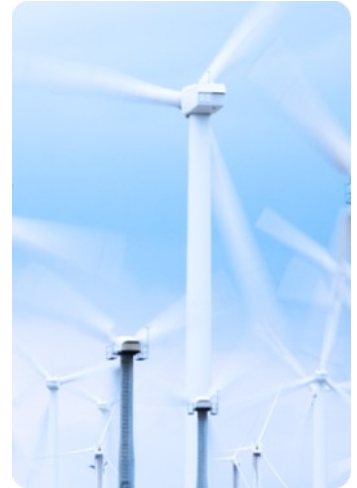
4. Capital gains arising on the sale of private assets can be deferred when investing into the company, meaning no tax is due until the shares are either sold or cease to qualify

The company cannot sell the energy back to the farm at a less than commercial rate, but remember that the buyers of the energy are also the investors/ owners of the company. Although they pay the going rate, when the company makes a profit they have the potential to get some money back by way of a distribution of

dividend or salary.

There is no need for this to be a self contained project. If neighbouring farms or estates wish to become involved, then structuring the project as a company will enable this to happen fairly simply and will limit the liability of each party.

None of the reliefs above are available should an individual or unincorporated business undertake a renewable energy project outside of this structure. However, the tax reliefs available when the project is structured correctly may encourage you to give further consideration to 'going green'!



Nitrate vulnerable zones

The Nitrate Pollution Prevention Regulations 2008 came into force on 1 January 2009 under the Nitrates

Directive, whose aim is to reduce nitrogen losses from agriculture to water to protect human health and aquatic ecosystems. **Kevin Burree** reviews the changes.

Areas where nitrate pollution is a problem are designated as Nitrate Vulnerable Zones (NVZs) and rules for certain agricultural practices must be followed.

55% of land in England was designated as an NVZ in 1996 and 2002. With the addition of areas designated within the latest legislation the overall area has increased to 68%. Maps to determine whether land is in the NVZ can be found on the

following websites:

DEFRA www.defra.gov.uk

MAGIC www.magic.gov.uk

The closed periods for application of slurry and poultry manure have been revised according to soil type, and restrictions on muck-spreading immediately following a closed period apply. There will be a complete ban on artificial fertiliser between 1 September and 15 January except on specified crops.

Within a three year period, farmers will need to increase their storage capacity to 26 weeks for pig slurry and poultry manure and 22 weeks for other slurry. Grants are expected to be available early in 2009 but it is unclear whether HMRC will treat storage tanks as

eligible for capital allowances - guidance is expected.

The Regulations require certain records to be drawn up and put in place. For land within a pre-existing NVZ (designated in 1996 or 2002 and again in 2008), the rules must generally be complied with from 1 January 2009. For land within the new NVZs, the rules do not fully come into effect until 1 January 2010.

The Environment Agency is responsible for assessing compliance with the Regulations by visiting farms. Compliance is also a Statutory Management Requirement for cross compliance under the SPS. Failure to comply could lead to a deduction of single payment.

"There will be a complete ban on artificial fertiliser between 1 September and 15 January except on specified crops"

For further information on any subjects covered in this update or if any of the issues affect you.

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SINGLE PAYMENT SCHEME CHANGES



Claire Shepherd reviews the impact of a number of other recent changes to the SPS not arising from the Health Check:

From 1 April 2008, the ten-month rule was abolished. Instead, to receive payments, a farmer must be able to match his payment entitlements to eligible land at his disposal on 15 May in the year of claim.

In order to claim against the entitlements, they must be registered to the farmer when the claim is lodged. The latest date for lodging a claim without penalty is 15 May (therefore for the 2009 SPS the deadline is 15 May 2009).

If you are taking a transfer of entitlements in order to match entitlements against land at your disposal and make a claim, you must notify the

transfer to the Rural Payments Agency by 2 April to be able to claim in that scheme year.

The payment window is 1 December to 30 June and we are already seeing the RPA dealing with payments promptly. However, as there is a delay between the claim and the payment, it is possible to be liable for tax on the entitlements before the payment is received.

The RPA has recently published a list of the most common cross compliance breaches and some useful checklists to help claimants prepare for inspections.

RPA www.rpa.gov.uk

The standard reduction for a first time breach of cross compliance standards will now be 3% for 2009. This can be increased or reduced depending on the severity of the breach.

The RPA has traditionally been lenient for first time breaches, but as a result of a recent EU audit it has been advised that the rules must be more strictly applied and we can expect tougher penalties from the RPA as a result.