

Contents

01
Introduction
Don't Shoot the Tax Man!

02
Contract Farm Or FBT?

03
Mineral Extraction: Tax Planning
Opportunities

04
Agriculture in 1930's America
Who to Contact

Agriculture & Estates Briefing

Summer 06

Introduction

Welcome to the Summer 2006 edition of Chantrey Vellacott DFK's Agriculture & Estates Briefing. In this issue our attention is turned to the taxation treatment of game-shooting, taxation and commercial considerations of contract farming versus letting land on a Farm Business Tenancy (FBT), tax planning opportunities with land subject to mineral extraction and the personal commentary of John Harris

(head of our Agriculture & Estates department) on agriculture in America in the 1930's.

The overall aim of this briefing is to make you aware of our specialist knowledge of businesses operating in the rural economy and to inform you of potential issues that may affect you, your business, family, customers or your clients.

We are a firm of Chartered Accountants keen to continue our long established reputation of providing business services and advice to individuals and businesses within the rural sector of the economy throughout the Midlands and Southeast. John Harris also farms in rural Northamptonshire. This gives him and his team a close association with the issues affecting the rural economy.

Don't Shoot The Tax Man!



HM Revenue & Customs (HMRC) recently announced that it is targeting the shooting industry following evidence that 'non-compliance and misunderstanding' in the administration of VAT and income tax accounting in respect of shooting activity was occurring throughout the country.

HMRC listed the areas of tax irregularities as:

- Commercial shooting being inappropriately described either as private shooting, non-profit making club activity or the supply of zero-rated birds;
- Exchanging, in non-recorded barter transactions, supplies of standard-rated shooting for zero-rated or other supplies;
- Failure of shoots, having exceeded registration thresholds, to register for VAT accounting (the 2006/07 VAT registration threshold is £61,000);
- Artificial separation of business activities to stay below VAT registration thresholds;
- Under-recording of sales values;
- VAT and income tax irregularities on claims for private expenditure.

So what does this mean for landowners and farmers? Should a landowner involved in shooting activity be charging VAT or not? What expenditure, if any, can be offset against income? This article offers some basic guidance to help clarify the position:

Where a landowner shoots in hand (i.e. they manage and control the shooting on their land) it is only in limited circumstances, when the landowner is not considered to be undertaking a business

activity, that no VAT is chargeable on the contributions that others may make to join the landowner in the shooting activity.

HMRC has indicated that, for a landowner to be considered not to be undertaking a business activity, they must be able to demonstrate that:

- Only close friends and relatives are permitted to shoot on their land;
- No advertising is made to the general public;
- The shooting accounts show a loss at least equivalent to the usual contribution made by one of the participants (to demonstrate that the other participants are not paying for the landowner's share of the costs);
- Any loss on the shooting activity is shouldered personally by the landowner and not by their business.

From the above it is apparent that exactly who participates in the shoot, how they are called upon to contribute to the costs of the shoot and exactly how much they contribute relative to the costs are important factors to consider. If the shooting is considered to be a business activity then standard-rated VAT should be charged on contributions if the landowner is, or as a consequence of the shooting should be, VAT registered.

Where a shooting syndicate is set up so that a group of defined individuals share the expenses of a shoot then the arrangement will not, under normal circumstances, be regarded as a business activity. As such the syndicate will not be regarded as making taxable supplies to individual members of the syndicate.

However, if the syndicate regularly allows non-members to participate, or regularly makes supplies of other goods or services, the syndicate will be regarded as conducting business activity and VAT will be chargeable on supplies made to both members and non-members.

Note that where a grant of shooting rights is made by a landowner to a syndicate the value of the grant will normally be subject to standard-rated VAT. If the landowner granting the shooting rights is a member of the syndicate then care must be taken to ensure that the value of any agreement, whereby the landowner pays less than their full share of syndicate expenses, is taken into account and subject to standard rated VAT.

Furthermore, if a landowner supplies goods or services to the syndicate (e.g. gamekeeper services) and the landowner is VAT registered then the supplies will be subject to VAT which the syndicate, or its members, will not be able to recover as input VAT.

Finally, where a landowner makes payments towards shooting activity (be it in hand, as a syndicate member or as a fee-paying individual) for his own private enjoyment then any input VAT paid should not be recovered nor should the expenditure be offset against their taxable income.

Please contact us if you would like to receive further taxation advice concerning your existing or proposed shooting activities.

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Contract Farm Or FBT?



With the debacle over establishing entitlements for the single farm payment subsidy now almost over, it appears that many landowners are finally being able to put in place new strategies that had previously been put on hold while the reform of the agricultural subsidy regime was ironed out. Strategies being implemented are wide-ranging – for some expansion is top of the agenda whilst for others diversification, retraction or retirement is the sensible approach to take. The purpose of this article is to briefly examine the choice facing a landowner who has up until now farmed their land as an owner-occupier but, having endured some hard graft for little financial reward over recent years, is now

considering employing contractors to farm their land or letting it to another farmer under a Farm Business Tenancy (FBT).

First of all there are a multitude of commercial factors to consider and I have listed what I believe to be the key considerations in the table below. The most important factor to consider is the level of control that the landowner has. Under a contract farming arrangement the landowner will retain full control – they will continue to ‘be the boss’ and have the final say in the farming operations undertaken on their land (although often this is subject to twelve rounds of arguments with the rest of the family first!). Under an FBT arrangement, however, the

landowner will become a landlord and, as such, a degree of control will be lost to the benefit of the tenant.

Whilst commercial factors should be the principle driver behind a change in farming strategy it is important to always consider the taxation implications as some significant differences and potential tax liabilities can arise. In the circumstances set out in this article differences stem from the fact that, whilst a switch to contract farming will be considered to be the continuation of a farming trade, letting land out on an FBT will not. As a result, tax advantages associated with trading activity will be lost under the FBT route (see table below).

Key Considerations		Contract Farming	Farm Business Tenancy
Commercial	Control over land	Retained in full	Lost in part
	Hands-on involvement	At your discretion	At the discretion of the tenant
	Cash flows	Less certain	More certain
	Risk exposure	Continued exposure to trading risk	Reduced exposure to risk
	Restructure costs	Redundancy of existing employees, commission costs of plant sale, seeking and coming to an agreement with a contract farmer	Not too dissimilar in level to that of contract farming, especially if ‘off the shelf’ FBT agreement adopted
Business succession – the ability of family offspring to take over the farm	Available at any time	Restricted windows of opportunity (on renewal or default of tenancy)	
Income Tax	Ability to offset losses against other income (including gains) in the current or preceding tax year	Available	Not available
	Ability to offset proportion of farmhouse expenses against taxable income	Available	Not available
Capital Gains Tax	Business asset taper relief	Available	Not available
	Rollover relief	Available	Not available
Inheritance Tax	Availability of agricultural property relief	Available on agricultural value of farmland and farmhouse	Available only on agricultural value of farmland
	Availability of business property relief	Available on non-agricultural value of farmland	Not available
Value Added Tax	Recoverability of input VAT (assuming no option to tax in place)	Recoverable	Not recoverable



Taking the commercial and taxation considerations together, it is unlikely that there will be a clear winner in terms of the best strategy that the landowner should elect for. Much will depend on pertinent individual circumstances. The fact of the matter is that in order to retain more favourable tax advantages a landowner must retain trading status and, in turn,

exposure to greater levels of risk. However, whether the retention of more favourable tax advantages is of direct benefit to the landowner will depend on their individual circumstances. As such it is my duty to conclude that, if you are considering altering your farming strategy, it would be wise to consult with your professional advisors.

If you would like further clarity on any of the points listed in this article please do not hesitate to contact me.

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Mineral Extraction: Tax Planning Opportunities



Mineral deposits offer the farmer or landowner a valuable opportunity to raise significant sums of money for reinvestment, diversification or simply debt repayment. However, the manner in which the minerals are disposed of can have a material effect in taxation terms, which, in extreme cases, could prove to be a deterrent to the sale. Careful consideration of the manner in which the sale is to be made should therefore be undertaken prior to entering into contract. Looking at some various possibilities in turn:

1) Outright sale of land to an extraction company

This situation triggers a partial disposal for capital gains tax purposes and rollover relief and business asset taper relief should be available as long as owner occupied before the disposal.

If the land was let out previously then non-business asset taper relief will be claimable.

2) Sale of land to an extraction company, with option to buy back at end of extraction

Here the difference between the sale price of the land and the repurchase price will be taxed as income, as profits of a property business. A deduction of 2% of the profit for each year between the sale and repurchase will be available.

No rollover relief or taper relief is applicable as the transaction is not capital in nature.

3) Royalties received for the minerals extracted

In this circumstance the landowner does not lose title to the land containing the minerals. Instead the value of his land is depleted by the extraction of the minerals concerned. As such when a royalty contract is entered into 50% of the sums received are taxed as income and 50% taxed as capital.

This arrangement is quite common as it provides certainty as to quantities before payments are made. However, no rollover relief is available. This can have severe consequences if new land is to be purchased with the proceeds.

Any expenses incurred should be halved and that part pertaining to the income stream relieved. No such offset is permissible against the capital portion.

4) If land owned by a company, is the sale of the company more beneficial?

Again this decision revolves around the eligibility or otherwise of business asset taper relief. The sale of the shares in the company may attract full business asset taper relief, whereas other potential deals may not be as taxation efficient.

Further to the taxation consequences of mineral extraction there are other commercial factors that need to be considered should a mineral extraction company target your land – these include:

- The need for and expected timing of cash flows
- Timing and method of extraction works
- Expected quantities of mineral extraction
- Impact on existing business operations

To conclude, the taxation of mineral extraction is complex and different approaches to the extraction of minerals can lead to significant differences in overall tax liabilities. As such, the taxation consequences of mineral extraction must be borne in mind in tandem with the commercial decision making process. If you are approached by a mineral extraction company then please do consult with a professional advisor with adequate levels of experience. At Chantrey Vellacott DFK we do indeed have the experience to give you advice that should keep the taxation liabilities associated with mineral extraction to a minimum.

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Blakesley Show – 5th August 2006

Once again, Chantrey Vellacott DFK will be taking a trade stand at the 2006 Blakesley Show. Fingers crossed the weather will be as good as last year. Whether you are a client of ours or not please do come and join us for a drink and a 'farming yarn' on our stand.

We look forward to seeing you there.



Agriculture In 1930's America



I happened to pick up my son's history textbook the other day and began to read about agriculture in the United States of America in the 1930's. I learned that US Farmers had enjoyed good prices during the First World War, with much of European farming disrupted for obvious reasons.

However, as Europe recovered, US prices began to fall and supply exceeded demand. By 1933 average farm incomes had fallen to \$7,107 from \$13,938 in 1929 and 5% of farmers had been evicted from the land for failing to keep up with mortgage payments. In April 1933 angry farmers in Iowa attempted to hang a judge who was signing eviction orders. The Farmers Union leader Mr Ed O'Neal stated "we will have a revolution in the countryside within less than 12 months".

The US government reacted by creating the Agricultural Adjustment Administration (AAA), headed by Henry Wallace (1888 - 1965) who came from a farming background.

The aims of the AAA were to raise prices by 'adjusting' the size of farm crops. In this respect 'adjusting' effectively meant reducing. In order to take fields out of production compensation would be paid. The compensation payment would be raised by a tax paid by food processors who in turn would pass the cost on to the consumer in the form of higher prices.

Interestingly enough the same ethical issues as today began to appear; "How can we destroy crops when there are so many poor in the world?" "Should we be killing pigs just to boost the price of pork?" "Is it not just the big farmers that are getting the big compensation payments?" "If we are not producing as much we do not need as much labour."

Farm incomes did however rise in the remaining inter-war years.

Does this have any relevance to today? I think so. It is only human nature that the same ethical issues should arise when food production is discussed. That is not

date-sensitive, although the animal rights lobby has become more powerful as time has progressed.

What I do believe is of relevance is the fact that in the US in the 1930's it was the food processors who paid for the compensation by way of a form of direct taxation. Imagine the uproar today if the likes of Sainsburys and Tesco were taxed so as to subsidise the farmer. How politically likely is it that such an action would ever be contemplated today? We perhaps should not lose sight of the fact that it can at times be politically expedient for the farming community to be seen as 'subsidy junkies', but who is really being subsidised?

Perhaps Mr Wallace got it right?

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Who To Contact

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This newsletter has been written for the general interest of our clients and contacts. It is essential to take advice on specific issues. We believe that the facts are correct as at July 2006 but there may be certain errors or omissions for which we cannot be held responsible.

The opinions expressed in guest articles are those of the respective contributors and their firms. We believe that these should be of interest to our clients and contacts but the articles do not necessarily represent the views of Chantrey Vellacott DFK LLP.

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