



2009/10

LANDED ESTATES GROUP
2009/10 REVIEW



Introduction

As Head of the firm's Landed Estates Group it gives me great pleasure to introduce our 2009/10 Annual Review. Earlier this year, I succeeded Martin Webster as Head of Group. Martin headed up the group from its inception in 2005 and I would like to record our thanks to him for his hard work over the last four years.

I hope you enjoy reading the Review. As always, we have sought to compile a snapshot of the challenges and opportunities currently facing our sector and, in particular, flag up key areas that may require attention in the coming year.

The impact of legislative change is one of the constants of the landed estates world and change continues apace. Good news came in Finance Act 2009 with the extension of Agricultural Property Relief to agricultural holdings in the wider European Economic Area, but bad news arrived at the same time with the announcement that the attractive Furnished Holiday Lettings tax reliefs will be removed next April.

For those seeking to maximise Business Property Relief from inheritance tax the decision in the "Balfour" case was reassuring, albeit that it is being appealed by HM Revenue & Customs. These developments and others feature in the articles that follow. We will continue to monitor the progress of these developments and keep you updated through our regular newsletter, 'Rural Business'.

Whilst opportunities to benefit from development land sales have for the time being largely fallen away, the current economic environment opens other doors; for example the emergence of the "stay-cation" for those who cannot afford a foreign holiday and this should benefit estate owners with holiday cottages and visitor related businesses.

These are exceptionally challenging times for "UK plc" and the rural economy has not escaped the impact of the recession. We all realise that estates make a very significant contribution to local life, not least as employment providers, and in many ways they are direct drivers of the health of their local economy.

We are therefore working hard to assist our clients not only to survive the economic downturn, but also look at ways to capitalise on further opportunities that exist to ensure that they continue to flourish.

We remain closely involved with the organisations that play a key role in representing rural interests. Significant support is provided in a variety of forms to a number of organisations including the Historic Houses Association, the Country Land and Business Association and the Game and Wildlife Conservation Trust. In addition we are continuing our series of Land Agents Tax Updates at various locations across the country and once again these are endorsed by the Royal Institution of Chartered Surveyors.

In conclusion, I hope that you, our clients and contacts, find the enclosed articles thought provoking and of practical use. Please do not hesitate to get in touch with us if we can help in any way and a full list of contacts can be found on the back page. As ever we are grateful for your continued support and we look forward to working with you in the year ahead.



A handwritten signature in black ink that reads "Matthew Burton". The signature is fluid and cursive, with a long horizontal flourish underneath.

Matthew Burton
Head of Landed Estates



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How to mitigate the 50% (or 60%) income tax charge

The new additional rate of income tax, confirmed in Finance Act 2009, for those with incomes in excess of £150,000 has been well headlined, but there are other changes which have not received as much attention which, for some, will introduce ever higher rates of marginal tax.

For example, the withdrawal of personal allowances, in full or part, for those earning over £100,000 from 6 April 2010 will mean the taxpayers income between £100,000 and £112,950 can be taxed at a marginal rate of 60% in 2010/11.

In the past, many have utilised pension contributions, especially substantial single premium payments as a means of reducing their exposure to top rate tax and an effective method of funding their retirement plans.

However, this method of mitigating higher rate tax can no longer be used to any great extent following complex rules already introduced to limit the availability of tax relief (see our separate article on page 9) to higher rate tax payers.

The new 50% rate will also apply to the majority of trustees who will pay tax at 50% (rather than the current 40%) on any trust income over the 'basic rate band' of £1,000.

For family trusts that exist because there is a desire to accumulate wealth for future generations the introduction of a 50% income tax rate has the potential to seriously erode the value of accumulated undistributed income within such trust funds.

Against the backdrop of higher income tax rates, the rate of tax on capital gains at 18% looks increasingly attractive, especially for those on higher incomes who may have the ability to amend their investment policy to generate capital gains rather than income. How long this tax rate differential will exist is anybody's guess.

This, of course, is not available to everybody due to the nature of the investment held and it would be wise to look at other strategies which might be considered by individuals, and trustees, to minimise the extra bite of income tax the Treasury is looking to take.

Points for individuals:

Accelerate cash extraction

A tax saving can be captured by extracting cash from a farming, or other rural business, which is conducted through a limited company by payment of a dividend or possibly bonus, before 6 April 2010. Cash management plans may need to be put in place now to ensure that the cash will be there when you need to pay it out.

Advance planned income receipts

Consider closing interest bearing savings accounts pre 6 April 2010 to accelerate the receipt of interest.

Deferring expenditure

A simple strategy for property owners is to defer tax deductible expenditure (for example, property repairs) until after 5 April 2010.

Investing for capital growth

With a tax rate of 18% and an annual allowance of £10,100 (2009/10 rate) for capital gains, £20,200 for a married couple, investors may be attracted by capital growth rather than income returns. However investing for capital returns may come with greater risk and longer return periods. Care also must be taken to ensure that shifting investments does not generate any unanticipated tax burdens.

Investing for capital growth in your own rural trading company can bring even greater scope for tax savings as the availability of entrepreneurs capital gains tax (CGT) relief may mean that you pay tax at only 10% on disposal, subject to certain conditions and the lifetime limit of £1 million for each taxpayer.

Again, it is worth remembering that for spouses or civil partners there is the potential to double the limit provided both are appropriately involved in the business.

Use of company

With the small company tax rate at 21% for profits up to £300,000, moving activities into a limited company to save tax and 'warehouse' profits prior to a further liquidation, or sale, may be an attractive option for some as the gains which then arise should be subject to CGT, rather than income tax (also see above).

Where there is a need to extract cash in the short to medium term, share buy back arrangements offer interesting possibilities. This might be especially useful where perhaps different generations of the family are involved and cash generated can be used to buy back shares of the more cash hungry or senior shareholders. However, careful planning is needed to ensure the appropriate capital treatment of such transactions.

Partnerships

For an existing partnership consider bringing in a limited company to share in these surpluses. They will be taxed at the much lower corporate tax rates, as just outlined.

Balancing income between family members

Consider gifts of income producing assets between spouses or civil partners to ensure that allowances and lower tax rates are used. Also think about bringing spouses or children into the family business to spread profits and income in a tax efficient manner, but ensure that this is done in an appropriate way having regard to all the tax, financial and legal ramifications first.

Tax efficient investments

Maximising annual tax free investments always makes good tax sense and the annual allowance for Individual Saving Account (ISA)s will increase to £10,200 for tax year beginning 6 April 2010.

Enterprise Investment Schemes (EIS)s and Venture Capital Trusts (VCT)s are also available providing CGT deferrals and in some cases also income tax relief.

Tax deductible outgoings

Interest on eligible loans, for example money borrowed to invest in or lend to your business or to invest in rental property, attracts income tax relief. The new rules and 'super' tax rate for 2010\11 means that taxpayers, subject to the additional rates can obtain 50%, or in some cases more, tax relief on such borrowings.

It is also worth bearing in mind that it is the purpose of the loan that determines whether tax relief is available on the interest. So raising a mortgage on your home and using the funds to invest in your company should allow you income tax relief on your mortgage interest and also provide an interesting improvement in your potential exposure to inheritance tax.

Points for Trustees:

A balancing act?

Trustees of discretionary and accumulation and maintenance trust are particularly hard hit by the rise in income tax rates to 50%, which will apply to almost their entire income. This may lead them to consider their investment policies so that they invest in assets which give rise to capital gains rather than income returns.

There may also be increasing interest in investment company bonds to provide a tax efficient wrapper around the underlying investment. But they will need to take care to balance any need to provide income to beneficiaries against investing for capital growth.

Making income distributions to pass on the 50% tax charged to beneficiaries may be a wise strategy; however, considerable care is needed where dividend income is involved.

In such cases, it should be noted that it will not be possible to distribute all of the trust income due to the way the trustees' income is taxed.

However, trustees receiving rental income will usually experience fewer difficulties, as the trustees will actually pay tax on their entire surplus rental income rather than have part of the liability covered by the so-called 'notional' tax credit.

Change the income tax status of the trust

Trustees might consider giving their beneficiaries revocable interests in possession. As this is a revocable interest the trustees can retain control and the beneficiaries will be taxed on their trust income at their own tax rates without the need for the trustees to account for tax at the 50% rate. There should be no CGT or IHT drawbacks to the creation of a revocable life interest.

And finally...

Two notes of warning to sound. The Revenue are aware of the advantage offered to tax payers by converting income into gains and they will seek to prevent tax avoidance. Exactly how they will do that is not yet clear and so we must proceed with caution.

Secondly, it would seem very likely that a future government, of whatever colour, will be tempted to close the gap that has opened between the rates of tax on income and gains in an attempt to replenish the Treasury's coffers. We must remember that it is not very many years ago that we had a 40% CGT rate for higher rate tax payers.

All that said there is, even more than ever, the need to plan ahead in order to mitigate the tax burden as the majority of last minute "fixes" to reduce the tax charged are no longer available.

VAT: highlights of the year

It is not too much of an exaggeration to say that VAT is currently a system in upheaval. The rate of change continues to accelerate across all areas of the tax, and as each area falls due for review it seems, inevitably, to be replaced by a much inflated and more intricate version.

Several things have been at work recently to fuel this accelerating change – the continuing fall-out from the merger between the two old Revenue Departments; changes in European law to further integrate the VAT system of the common market; the overhaul of the judicial system; consequences of class litigation actions; the ‘war’ on avoidance, and political initiatives in the recession.

Not all of these bear in full on the landed estates sector. For example, one of the biggest changes to the VAT system for many years (known for some obscure reason as the “VAT Package”) will start to take effect from 1 January 2010. This will revolutionise the VAT treatment of transactions between Member States. If you are one of the few estates affected, you need to understand what these changes will mean.

However, other changes will affect, and are already affecting, this sector more than might be expected, because most of them apply to all registered persons. Examples include the new option to tax regime; new partial exemption rules and “Lennartz” accounting rules; the new Tribunal system; new VAT Return error correction rules; a new penalty regime; compliance issues arising from VAT rate changes, and new requirements with regard to on-line filing. And more is on the way.

Option to Tax

The law underpinning the option to tax was completely re-written with effect from 1 June 2008. The reasons why you might want to opt an estate or a particular property may remain the same, but the processes and procedures are now very different. They are on the one hand more complex and more prescriptive, but on the other hand offer businesses more flexibility.

A new type of option (a “Real Estate Election”) was created, though it would appear that very few have yet been made. Options to tax made when the facility was introduced in 1989 may now, subject to various conditions, be revoked. This is not the place to go into all of the details, but those responsible for these matters within estate offices, or for advising generally in relation to land transactions, must be sure they are fully familiar with them.

Partial exemption

Changes were made to the partial exemption Standard Method with effect from 1 April 2009. Again, these provide some flexibility but at a cost of increased complexity. In themselves these are relatively minor changes, all but one of which (in relation to overseas supplies) are optional, but need to be seen in the context of the accumulation of changes to the partial exemption regime (such as the statutory over-rides) that have taken place in recent years. A review of the partial exemption rules is ongoing, and further changes (for example with regard to the de minimis limits) are expected soon.

"Lennartz"

On the subject of input tax deduction generally, there are proposals to limit the benefit of "Lennartz" accounting by removing buildings and land from its scope. Also, there is a review of the workings of the capital goods scheme underway.

Penalties, surcharges and Tribunals

There seems to be an underlying philosophy among those responsible for making a success of the "merger" of the two Revenue Departments that integration can only be achieved through homogenisation. Everything must be the same across all of the taxes. From 1 April 2009 a new civil penalty regime has been applied across all taxes, replacing all of the carefully targeted misdeclaration penalties which had been developed specifically in the context of VAT in the twenty five years since the Keith Committee reported in the early 1980s. From 1 April 2010 the present late registration penalty will similarly be replaced. It appears that the "default surcharge" system (penalties for late returns) will continue for the time being, however.

So too with the Tribunal system. Successful appellants in VAT Tribunals (unlike appellants before the Special Commissioners) could obtain an award of costs. Not any more. Indeed the VAT Tribunals themselves have gone, merged into a new Tax Tribunal with two Tiers (one, it might be said, for each cheek).

Perhaps more worryingly, somewhere in the homogenisation process we appear to have lost a 15% penalty (which applied in most VAT cases) and gained a 30% one. In fact, 30% is likely to be a minimum since penalties will be on a sliding scale up to 100% depending on the degree of carelessness

or concealment. Few people are aware that the risks they run by making errors on their VAT returns have now doubled. Moreover, the period in which HMRC can raise assessments, or in which taxpayers can make adjustments, is in transition from three years to four. A systemic error is therefore potentially likely in future to cost a third more in demands for arrears.

VAT returns errors

A new error correction regime came in from 1 April 2009. Most errors of up to £10,000 can now be corrected on a current VAT return (the previous limit was £2,000). While that sounds like a welcome increase there is a sliding scale which taxpayers need to be aware of. Also, the changes made to the civil penalty regime mean that correcting an error on a return does not necessarily protect from a penalty so taxpayers may need to disclose errors even if they are corrected in that way. Most people will take some time to adjust to the new rules, and some will be caught out.

Standard rate changes

Everyone by now is no doubt aware that the standard rate of VAT will return to 17.5% from 1 January 2010. There is related anti-avoidance legislation, so in the run up to the change back you will need to think carefully about how these rules affect you. Despite the anti-avoidance law, there will be considerable scope to apply the lower standard rate across the date of the change (see our separate article on page 15).

On-line filing

Finally, taxpayers are gradually being coerced into submitting their tax returns, including VAT returns, electronically. From 1 April 2010, on-line filing will be compulsory for newly-registered businesses, and for registered businesses with a turnover of more than £100,000. The writing is on the wall for the paper return.

Conclusion

For further details on any of the aspects mentioned in this article, or any other VAT related topics, please contact Douglas Gordon, the VAT partner within the Landed Estates Group on 0207 841 4059 or email him at douglas.gordon@saffery.com

Inheritance tax: tenanted farms – increasing relief to 100%

Owners of tenanted farmland will be familiar with the inheritance tax reliefs that are available to them. Broadly, 100% Agricultural Property Relief (APR) is available on land subject to a tenancy granted on or after 1 September 1995, and 50% APR is available on land subject to a tenancy granted before 1 September 1995.

Under the Regulatory Reform (Agricultural Tenancies)(England and Wales) Order 2006, more commonly known as the TRIG reform, it is now possible to have a post 1 September 1995 tenancy that still gives the tenant the same rights enjoyed under an Agricultural Holdings Act 1986 tenancy.

However, HM Revenue & Customs (HMRC) have confirmed that 100% APR would be available on the land subject to such a tenancy, because the tenancy is granted after 1 September 1995.

The opportunity therefore exists for landlords to negotiate with their tenants regarding the creation of new tenancies and thereby increase the rate of APR on their tenanted land from 50% to 100%. In practice tenants may be nervous of any such changes or need convincing there is benefit for them in a new tenancy.

One also needs to consider the other tax implications of creating a new tenancy, namely capital gains tax (CGT) and stamp duty land tax (SDLT). If these taxes apply (and there are differing views as to whether this is the case amongst the legal and accountancy professions) they will fall upon the tenant rather than the landlord.

When a tenant surrenders his tenancy HMRC may take the view that a disposal has taken place for CGT purposes, and if the lease has a value a capital gain will arise. If there is a gain it should be possible for the tenant to claim rollover relief against the acquisition value of the new tenancy.

With regard to SDLT, there are specific provisions in the SDLT legislation that “where a lease is granted in consideration of the surrender of an existing lease between the same parties – (a) the grant of the new lease does not count as chargeable consideration for the surrender, and (b) the surrender does not count as chargeable consideration for the grant of the new lease.”

The grant of a new tenancy would seem to be covered by this legislation. There is also the SDLT that may arise on the rent payable under a new lease. Again the SDLT legislation may provide some relief but this will depend on the particular circumstances of the old tenancy.

From the above comments it can be seen that the creation of new tenancies needs to be handled carefully, especially as the tenant will need to be convinced that he will not be liable to CGT or SDLT as a result.

However, the benefits to the landlord can be considerable and hence perseverance can pay off.

Not such a relief *to have a pension?*

One of the most publicised measures introduced in Finance Act 2009 was the restriction on tax relief on pension contributions made by wealthier individuals.

Whilst the policy behind the change seems to be to concentrate the UK's resources on the less affluent, those who are affected by the change will need to revisit long-term planning because the longstanding and accepted pension principle that tax relief is granted on contributions in exchange for accepting taxation on annuity payments in retirement has simply been abandoned.

The complexity of various aspects of the new rules is such that it will be very difficult for a taxpayer to know if they are caught by additional tax charges or restrictions to relief unless they take professional advice.

Worse still there is considerable unfairness in the new system – it is possible with only a little thought to construct a situation where the marginal tax rate that an individual will suffer on their income is well in excess of 100% (see example 1).

For many high earners, it will now simply be uneconomic to make further pension contributions, since the post-tax return will be less than if they had invested directly. Such individuals would be advised to cease making pension contributions altogether (see example 2).

What follows is a general commentary on the new rules, although we believe that the post-April 2011 rules may well be amended prior to implementation.

The measures

From 6 April 2011 where a person earns £180,000 or more in a tax year, then they will receive only 20% tax relief on their pension contributions.

Where the individual earns £150,000 or less then they will still receive full tax relief on their pension contributions. This is currently 40%, and there is some uncertainty as to whether this will increase to 50% on 6 April 2010 when the additional rate of income tax is introduced – with the pension tax relief rules as currently drafted a 50% taxpayer would only receive 40% tax relief for his or her contributions but HMRC have indicated that this may not have been their intention.

Where the individual earns between £150,000 and £180,000 tax relief will be tapered so that some amount between basic and higher rate relief is given.

The legislation will not only have to deal with the “tapering” provisions in a fair manner, but will also have to address the complex issue of whether and if so how superannuation and defined benefit schemes should also be subject to restrictions (likely to be an emotive issue with civil service pensions being a superannuation scheme), as well as to consider the impact of employer contributions.

“Anti forestalling measures”

Since the introduction of the new rules is delayed until April 2011, taxpayers might seek to make large pension contributions in 2009/10 and 2010/11 and gain what the Government clearly considers to be an unfair advantage.

(continued overleaf)

Example 1

Mr A earns £150,000 and pays £80,000 of those earnings into a pension scheme, receiving tax relief of £32,000.

In the same tax year, Mr A later receives a bonus of £30,000, taking his earnings to £180,000. This bonus is taxed at 51.5% (the new higher rates of income tax and NIC), meaning tax of £15,450. But the tax relief on his pension contribution is now restricted to 20%, meaning that his tax relief falls by £16,000.

The total tax cost to the individual of receiving the bonus is £31,450, a marginal tax rate of 105%.





Example 2

Mrs B is aged 60, intends to retire at 65 and will take her pension at that date. She earns in excess of £180,000 per year, and it is anticipated that she will remain a higher rate taxpayer after retirement.

If she makes a pension contribution of £100,000 this will be worth £125,000 once the 20% tax relief has been given. This will roll up tax free at say 5% per year for five years, becoming around £160,000 on retirement.

£40,000 will be withdrawn as a tax free lump sum, and the remainder will be taxed at 40% when paid as an annuity – tax of £48,000 will be payable on the total fund, and so the after-tax value of her pension will be £112,000.

If she instead keeps the funds in bonds or another liquid investment paying the same 5% per year, this will be taxed at 50%, leaving an after-tax return of 2.5%. After the same five years, if she reinvests her net income, her investment will be worth £113,000.

Mrs B would therefore be better off keeping her money outside of a pension in this case.

To combat this, temporary “anti forestalling” legislation was introduced in Finance Act 2009.

Very broadly, the new rules apply where an individual:

- has income in excess of £150,000 in the tax year in question, or had done so in the last three years; and
- contributes more than £20,000 (£30,000 in some limited circumstances) to a pension scheme in that period.

If both of these criteria are met then a tax charge of 20% will be levied on the excess over £20,000 (or £30,000) via self assessment.

The definition of “income” for these purposes is not straightforward, and includes certain salary sacrifice arrangements as well as unearned income, although some deductions such as charitable gifts are allowed.

Where regular contributions have been made at least quarterly under an arrangement that was in place prior to the Budget, and these continue to be made, these will be exempt from the anti forestalling tax charge, as “protected pension inputs.” Less regular contributions above £20,000 (or £30,000) will suffer the charge. This is one of the more unfortunate aspects of the new legislation and will disproportionately affect entrepreneurs rather than employees, since a business owner would tend to make pension contributions only once or maybe twice a year, after a year’s profits have been determined, and not at all when the business’s performance is less strong.

Such contributions could now give rise to tax charges if made in 2009/10 or 2010/11.

There are also complex rules for defined benefit pension schemes, which require an actuarial valuation to be performed of the value of the benefits available to the taxpayer each year, and tax is in some cases applied to any increase in this value.

Conclusion

Now, more than ever, careful thought is necessary prior to any material pension contribution or alteration of existing pension arrangements.

It may even be necessary to wait until the last possible day before committing to pension contributions, in case earnings or other income that cannot be determined until very close to 5 April, send you over the limits. We can advise on this, along with any other annual tax planning.

Back to basics: *inheritance tax business and agricultural property reliefs*

In recent years, large areas of agricultural land have changed ownership, not only through inheritance of agricultural property from previous generations, but noticeably there are many holdings that have been bought by individuals who derive their wealth and main income from outside of agriculture.

One driver for this has often been to shelter wealth from inheritance tax (IHT) by virtue of Agricultural Property Relief (APR) and Business Property Relief (BPR), and at the same time derive significant lifestyle benefits that go with owning farmland and living in the countryside. These individuals have two key reliefs available to them, APR and BPR.

Agricultural Property Relief

APR is given without claim on the agricultural value of land and buildings used in connection with the agricultural activity, and also includes such cottages, farm buildings and farmhouses, together with land occupied with them, as are of a character appropriate to the property.

APR is not available on livestock, deadstock, farm plant and machinery, milk quota, Single Farm Payment entitlements, bank balances, and the value of land in excess of its agricultural value. The agricultural property must have been owned for at least seven years if tenanted and only two years if farmed in-hand.

Business Property Relief

BPR is only given if claimed, and is available on the full value of all the assets used in a qualifying trading activity, including land and property, livestock, deadstock, plant and machinery, milk quota, Single Farm Payment entitlements, and bank balances (bank balances that are excessive in relation to the trading activity will not qualify for relief). The business property must have been owned for a minimum period of two years.

In the context of a farming business BPR is a more generous relief as it is available on all the assets used in the business, and is particularly beneficial if the land and property has any development value over and above the agricultural value. Generally one would expect a farming business to be relieved from IHT by BPR rather than APR, with APR more likely to be utilised by owners of land used for farming who do not participate in the farming business itself.

Let us now look at three common ownership structures used for holding country estates, namely sole trader, partnership or limited company and how each works in the context of obtaining, or not, BPR.

In the case of a sole trader the farmland and property will be owned by the proprietor who will also own the farming business. In the case of a partnership or limited company, a decision will need to be made whether the farmland and property are to be assets of the partnership/limited company or to remain in the personal ownership of the taxpayer, who then makes the farmland and property available to the partnership/limited company, either informally or by way of a lease.

As partnerships are effectively “looked through” for tax purposes then partnership assets, such as the farmland and property, will form part of the business assets and would qualify for 100% BPR. If the farmland and property were held outside the partnership but made available to it then BPR would only be available at 50%.

Limited companies are not “look through” for tax purposes and the farmland and property would be a company asset. From a BPR perspective this is not a problem, but many clients are reluctant for land and buildings to be owned by a company, firstly because the company tax rate (maximum

28%) on capital gains in the event of a sale of land can be higher than the client's own rate (18%), and secondly there will be additional tax liabilities if the client wishes to extract land sale proceeds from the company by way of dividend or remuneration.

There are often also income tax issues where assets are made available for the use of the director / shareholder.

Rental Property

A question that could usefully be posed might be "Do you have any property located on your estate that forms all or part of a rental business?" If the answer is in the affirmative you might be able to arrange matters such that some of this property (on which no IHT reliefs are available) qualifies for 100% BPR.

'Farmer' Case

Following the Farmer case (1999) BPR is given on the whole of the assets in a business that is 'wholly or mainly' carrying on a trading activity. This means that a primarily farming business could include some rental income properties and still qualify for 100% BPR on all the assets in the business.

There are numerous tests which were applied in the Farmer case, capital employed, time spent by the employees and consultants, levels of turnover (although not levels of profit or loss) and in constructing such a business it would be important to ensure that all these tests were satisfied, not just on commencement but at regular intervals throughout the life of the business.

If the business were to fail the 'mainly' test then it is likely to be treated as a business mainly of the making and holding of investments, which would not qualify for BPR at all, and one would effectively lose BPR on the farming business assets which would have qualified on a stand alone basis.

If there are a substantial number of rented properties it may be necessary to establish the farming business as a partnership and add the appropriate value of rented properties such that the partnership can be viewed as a business that consists mainly of farming, and is distinct and separate from the client's rental business.

It must be said that the facts in the Farmer case were that of a farming business that over time derived a rental income from properties originally occupied for farming purposes but which became surplus to requirements. One would not necessarily envisage HM Revenue & Customs (HMRC) accepting a constructed business qualifying for BPR after two years, but the longer the period is over which the business operates must increase the chances of a successful BPR claim.

Taking a pragmatic view, as long as the business passes the 'wholly or mainly' test, then even if HMRC deny BPR relief on the rental properties, the farming business would still qualify for BPR, and the client would be no worse off than if nothing had been done at the outset, apart perhaps from the professional fees incurred in creating the structure.

'Balfour' Case

More interest in this area has arisen since the "Balfour" case was reported. The case involved a life tenant of a Scottish estate extending to about 1900 acres and which included two in-hand farms, three let farms, a number of let business premises and some 26 let residential dwellings.

In the judgement the tribunal judge commented that he considered the taxpayer to be conducting a single business notwithstanding the trust ownership and taking matters in the "round" the lettings were ancillary to the trading activities.

Accordingly, BPR was available. This is an important decision for landed estate owners, however it remains to be seen if the taxpayer is still successful after the case has been appealed by HMRC.

'Nelson Dance' Case

In the meantime, following the Nelson Dance case (2008) it is now possible to contemplate the gift of business assets even if those assets themselves do not constitute a business capable of being operated as a separate activity.

It was widely expected that this decision would be overruled by legislation included in the Finance Act 2009, but fortunately for taxpayers no such legislation was introduced and accordingly, it would be wise in appropriate circumstances, to take advantage of this ruling especially while there are depressed land and property values.

VAT: return of standard rate to 17.5%

As has been widely publicised, the standard rate of VAT will return to 17.5% with effect from 1 January 2010.

The relatively recent experience of managing the change from 17.5% to 15% will be fresh in most people's minds, and for most the return to the 17.5% rate will simply mean the operation of the special tax point rules in reverse. However, an important difference this time is that there is special anti-forestalling legislation to prevent abuse of those rules.

Tax points - a reminder

The VAT tax point rules are set out in summary in the panels opposite. In cases where a supply can be treated as taking place either before or after the date of the rate change, suppliers will have a choice as to what to do. Where the customer can reclaim the VAT there is probably no benefit in adopting the special rules that apply on a change of rate.

In most other cases people will wish to take advantage of the lower rate to the fullest extent they can and apply that rate to the whole of the supply (whereas, when the rate went down, people were anxious to split supplies to take advantage of the part to which the lower rate applied).

Typically, therefore, the question will be: "What happens if I receive payment or issue an invoice before 1 January 2010, but deliver goods or perform a service afterwards?" In most cases, the supplier will be able to opt for the lower rate.

Anti-forestalling

This special legislation works by applying a supplementary charge of 2.5% in specific circumstances, to transactions entered into on or after 25 November 2008.

The supplementary charge is designed to operate (a) when a customer is not entitled to reclaim in full VAT charged to him, and (b) where the basic tax point occurs after the rate change but there is an actual tax point before that date. In addition, one of the following conditions must be met:

- the supplier and customer are connected, directly or indirectly,
- payment is not due until more than 6 months after the supplier's invoice date,
- the payment is financed by the supplier (or someone connected with him), or
- where the ATP is after 31 March 2009 and the value of the relevant supplies (which can include schemes) exceeds £100,000 (unless it can be shown this is normal commercial practice).

Similar provisions apply to grants of rights as an avoidance mechanism. The supplementary charge will also apply to some services that do not have a BTP, or where the BTP is preceded by periodic billing or payment.

These "Listed supplies" include construction services, water, fuel and power, and rentals under a long lease (but not premiums).

Types of Tax Point

	Basic	Actual
Goods	Delivery	Invoice
		Payment
		14 day rule
Services	Performance	Invoice
		Payment
		14 day rule

A **Basic Tax Point (BTP)** occurs when goods are delivered or made available to the customer or, in the case of services, when the work is actually performed (which generally means all the work being completed apart from invoicing).

There are some supplies that do not have a BTP - rent is a common example. In the absence of any other tax point, the BTP determines when the tax should be accounted for and therefore the prevailing rate of VAT.

However, there are frequently situations where an invoice is issued before the sale takes place, or a payment such as a deposit is made in advance. These are **Actual Tax Points (ATPs)** which supersede the BTP.

Also, if an invoice is issued within 14 days of the BTP (which can be extended up to 30 days by agreement with HMRC) that date becomes the ATP. HMRC can also agree other types of ATP.

Entity		Tax points on an upward change of rate	
15% (before 1 Jan)	1 January 2010	17.5% (1 Jan & after)	Result
BTP + ATP			Charge at new rate
		BTP + ATP	Charge at new rate
BTP		ATP	New rate is default position, but seller can opt for old rate
ATP		BTP	Old rate is default position, but seller can opt for new rate (but check anti-forestalling rules)

Transaction examples

Rent

There is no BTP for standard rate rent. If you would normally invoice rent before 1 January for later periods you can charge 15%, or apportion payments received after 31 December for periods spanning the change.

The anti-forestalling provisions will not apply in the case of rent if the invoice is for not more than one year in advance, provided that is in accordance with your normal commercial practice when no VAT rate increase is expected.

Construction services

Work completed before 1 January but paid for or invoiced afterwards can be supplied at 15%.

Work in progress on 1 January can be apportioned, based on measurable work or normal costings. Work paid for or invoiced before 1 January but done afterwards can be charged at 15% subject to anti forestalling.

Continuous supplies of services

Where there is an ATP prior to 1 January for services provided afterwards the seller should account for VAT at 15% (subject to anti-forestalling). Where the ATP arises on or after 1 January the rate will be 17.5%. However, if some of the work was performed before, the charge may be apportioned.

Other services

Where there is a single supply of a service which is nonetheless provided over a period spanning the date of the change, there will be a basic tax point falling after 31 December. If all tax points fall on or after 1 January but some work was performed before then the seller may still treat that part of the work as liable to 15%.

Example

An individual customer asks a landowner to invoice him before January 2010 for a day's shooting that will take place during October 2010, so that the whole amount can be charged at 15%.

Assuming the other conditions are met, anti-forestalling will not apply in this case provided that full payment is due to be made within 6 months of the invoice date.

VAT Accounting

If you have provided goods or services before 1 January but do not raise an invoice until later you may be able to apply the old or the new rate. If you invoice later at 17.5% you can still subsequently re-invoice at 15%, provided this is done within 45 days of the rate change (i.e. by 14 February 2010). Buyers should take care to ask for credit notes within that time limit, as it will be too late to correct it afterwards.

Goods

Generally the same rules apply to goods as to services. However, it is important to ensure that any pre-payment for goods is for specific rather than generic items.

Special situations

The rate change generally will have a consequence for fuel scale charges and possibly the Payments on Account Scheme.

Also, if your business operates a flat rate scheme, or a retail scheme, or a second hand scheme or any other scheme or approval such as self-billing affecting the time at which transactions are recognised, you will need more detailed guidance.

Further Advice

Please contact Douglas Gordon our VAT partner in the Landed Estates Group on 0207 841 4059.

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