The tax downside of diversification

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BUSINESS GUIDE

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There may be many opportunities you are considering to diversify away from farming activity. Your diversification idea will hopefully generate an additional income, but it's important to understand the potential tax implications of each diversification project.

For example, a new venture may be set up as a separate business to the farm business but be aware of conflicts between different taxes. It's important to consider Income Tax, Capital Gains Tax, Inheritance Tax and VAT when looking at diversifying.

Equally, the type of business structure you're considering, whether that's a sole trader, partnership or limited company, can also have different tax requirements, so make sure you explore the different options which will be most suited to your new business.

Farming has favourable and generous tax treatment compared to other UK businesses including Income Tax Relief and Agricultural Property Relief (Inheritance Tax). But, diversification risks losing these hugely valuable reliefs which is why very careful planning is needed.

This guide is a very brief summary of the points you may wish to consider when it comes to tax and your diversification project.

VAT

With farming most of the sales are zero rated for VAT so farmers often find themselves in a refund position when submitting VAT Returns. It's important to consider VAT and to see whether the sales are zero rated, standard rated, exempt, outside the scope or at a reduced rate, as there may also be partial exemption rules for VAT if any of the sales are exempt.

As the farm is usually VAT registered any new business operated through the farm will also need to be VAT registered.

It's not uncommon for new ventures (e.g. furnished holiday lets) to be set up as a separately owned business for VAT purposes, but this may not be the best structure when it comes to Inheritance Tax planning.

Income Tax

There are some favourable Income Tax reliefs that are available to farmers so it's important to be aware of these when looking at diversification.

For example, Farmers Averaging is a special relief that is available to farmers and market gardeners under which they can claim to add together their profits from farming or market gardening for two years or five years and be taxable on the average of those profits. Profits from diversified activities will need to be excluded from Farmers Averaging calculations.

"The type of business structure you're considering can have different tax requirements. Make sure you explore the different options and identify which will be most suited to your business."

What types of buildings can we get Tax Relief on?

All commercial buildings including:

- Offices
- Warehouses
- Factories
- Hotels
- B&Bs
- Care homes
- Restaurants

Farm Buildings:

- Barns
- Silos
- Dairies
- Farm cottages
- Holiday lets
- Dips for sheep and cattle
- Glass houses
- Incinerators
- Water towers

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As a point to consider, there are rules to treat farming as one trade, even if the farms are in different areas. But, there are specific rules with offsetting losses against other income. If your farm is uncommercial and you have had a run of losses of more than five tax years please do not assume the losses from the farm can be offset against diversified activities.

Capital Gains Tax

This type of tax relates to the profit when you sell/ dispose of something, such as an asset, that has increased in value. It's the gain you make that's taxed, rather than the amount of money received.

There are several reliefs such as Rollover Relief, Holdover Relief and Entrepreneurs Relief available which may be important to investigate when making the decision to diversify.

Inheritance Tax

Inheritance Tax is a tax on the estate (the property, money and possessions) of someone who has died.

Each individual has a threshold (nil rate band) of £325,000 (or £650,000 joint), and there is also an additional threshold for passing on the family home that applies to an Estate under £2 million which is worth being aware of.

It is also important to note that Agricultural Relief (APR) is available on the agricultural value of agricultural property. Diversifying into other uses could impact whether or not the building qualifies for APR.

If farm buildings have a hope/development value, APR will not apply but Business Property Relief (BPR) may be possible.

Capital Allowances

One area of taxation we look at quite regularly is Capital Allowances that can be claimed for with these diversifying projects.

Capital Allowances are the sums of money a UK business can deduct from the overall corporate or income tax on its profits.

A Capital Allowance is given instead of depreciation for certain types of asset. Depreciation is not allowed as a deduction for tax purposes, and must be added back to net profit for tax purposes. If capital expenditure does not qualify for a Capital Allowance, it means that the business gets no Tax Relief for such expenditure.

The Annual Investment Allowance is currently £200,000.

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What fixtures within a building can we get Tax Relief on?

- Alarm systems
- Electrical systems
- Emergency lighting
- Heating systems
- Cold water systems or tanks
- Air conditioning systems
- Carpets/flooring
- Hoists
- Signage
- Kitchens
- Sanitaryware
- Insulation
- Installations costs e.g. levelling land
- A proportion of professional/ planning costs

A detailed Capital Allowance review is often needed for diversifying projects.

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Furnished holiday lets (FHL)

One form of diversification might be into furnished holiday lets, but when it comes to taxation benefits that can come from this type of business there are some key criteria to ensure they qualify as FHL. The units must be:

1. Available for letting to the public for at least 210 days (previously 140 days)
2. Let for at least 105 days (previously 70 days)
3. Must not be let for periods of longer term occupation (31 days) for more than 155 days during the year

This type of business can be treated as a trade for tax purposes and so it can benefit from tax advantages over other lettings including:

- Capital Allowances entitlement
- Profits count as earnings for pension purposes
- Capital Gains Tax reliefs for traders including Business Asset Rollover Relief and Entrepreneurs Relief
- However, Business Property Relief for Inheritance Tax is now difficult to achieve. A whole range of other services must exist as well as several FHL properties to make a strong case

Residential properties

The tax treatment for residential properties, such as barn conversions is very different to furnished holiday lets. For other residential rental properties, Capital Allowances cannot be claimed.

There are several recent changes with rental properties, which should be noted, including:

- Restriction of Tax Relief of interest
- Increased Stamp Duty on additional properties
- Capital Gains Tax window payment from 6th April 2009

Watch out for the partial exemption rules when rental properties exist in the farm business for VAT purposes.

Please note every farm is different and will have different problems and solutions. Crowthers Accountants Limited accept no responsibility for any actions you take as a result of reading this guide and disclaim all liability.

Author information

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Crowthers Accountants

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