

THE SINGLE FARM PAYMENT – ACCOUNTING AND TAXATION

Clarification has recently been issued by both HM Revenue & Customs (HMRC) and the accounting bodies setting out the way in which the single farm payment (SFP) should be accounted for and taxed. The scheme commenced on 1 January 2005 and will affect accounting periods ending after 31 July 2005.

OUTLINE

There has been a fundamental change in farming subsidies which has impacted on all aspects of farming operations, including taxation and the preparation of farm accounts.

Recognition of income, and the timing of tax payments, is no longer based on the sale of the farm produce.

This note is a condensed summary of the rules and should allow farmers and landowners to determine the approach they need to take, and identify areas where further advice is required.

A distinction needs to be drawn between the income which is received under the scheme (SFP), and the asset from which that income is derived. This new asset has been referred to as 'Payment Entitlement' (PE).

INCOME RECOGNITION

SFP is paid with reference to each calendar year (claim year). Farmers have been required to select a ten month basis period, commencing between 1 October prior to the claim year and 30 April in the claim year.

Entitlement to receive SFP is dependent, among other qualifying conditions, on 'occupying' the eligible farm land for the whole of the ten month basis period.

Income will be recognised in the accounts in accordance with the basis period selected by each farmer.

No SFP income will be recognised until the farm land has been occupied for the full ten month basis period.

Once this occupation test has been satisfied, SFP income will accrue evenly up to 31 December, for each claim year.

The accounts for farmers who retain the same basis period each year, and draw their accounts up to the same date each year, will include a full year's SFP income.

A change to the basis period or a change to the date to which annual accounts are drawn up should be carefully considered as the recognition of income may accelerate future tax payments.

Example

A farmer has a 31 October 2005 year end, and has elected for the basis period to run from 1 October 2004 to 31 July 2005.

At 31 October 2005, the ten month occupation test has been satisfied, and the farmer recognises 100% of the SFP in the balance sheet at that date. However, the claim year is not complete, and he therefore treats 2/12ths as deferred income and releases 10/12ths to the profit and loss account.

In contrast, if a basis period commencing after 1 January 2005 were selected, no income would be recognised as the ten month basis period would not be complete at the year end. This choice could defer the payment of tax.

INCOME TAX

For the continuing farmer, the SFP will be treated as a trading receipt and will be subject to income tax in the normal way.

Where there has been a partial, or complete cessation of farming activities, the SFP may be assessed to income tax in a less favourable way.

Many farmers are choosing to reduce the cropped acreage, leaving a larger area fallow. In these circumstances, it is likely that a farming activity is continuing on all of the land, and the SFP will be treated as a trading receipt.

Where there is a complete cessation of farming, the SFP will be treated as a non-trading receipt. Importantly, any brought forward farming losses will not be available to offset against the SFP. It will also be difficult to claim expenditure, such as farm consultant's fees, as a deduction.

In limited circumstances, it may be possible to argue that a new trade (i.e. that of land management) has commenced. Whilst this would not preserve brought forward



farming losses, it would allow expenses to be claimed, and future losses to be offset against other income.

INTANGIBLE ASSETS

In some situations, principally for incorporated farmers, consideration will need to be given to the accounting treatment of the Payment Entitlement (PE), which will be accounted for as an intangible asset.

CAPITAL GAINS TAX (CGT)

For CGT purposes PE is treated as a separate asset from the land. Consequently, PE obtained at the start of the scheme will have a nil base cost, and for taper relief purposes, ownership commenced on 1 January 2005.

For continuing farmers the PE will be used in their business and will qualify for business asset taper relief. For PE disposals after 1 January 2006, the effective rate of CGT will reduce to 20%, and will reduce to 10% for disposals after 1 January 2007.

For taxpayers who have ceased farming, only non-business asset taper relief will be available. The effective rate of CGT on a disposal will be 40% until the PE has been owned for a minimum of three years.

CGT reliefs

For non-corporate traders, roll-over relief and holdover relief will be available.

Connected parties

It will not be uncommon for PE to be surrendered between landlord and tenant for consideration which is less than market value. This is most likely to arise when the parties are connected.

In these circumstances, the transaction will be deemed to take place at market value which could place an unexpected CGT bill on the tenant.

Land transactions

There will have been a number of land transactions completed prior to 1 January 2005, where the sale contract specified how the PE should be dealt with.

These disposals will be treated as the grant of an option to acquire the PE at a future date, and the computations will need to be prepared on this basis.

Capital loss claims

With the exception of milk quota, most other agricultural quota ceased to exist on 31 December 2004. Claims should therefore be made for any available capital loss.

CORPORATE INTANGIBLE ASSETS

Where PE is owned by a taxpayer subject to corporation tax, disposals will be subject to the corporate intangible assets regime.

It will only be possible to rollover surpluses on the disposal of PE into other intangible assets.

Further advice should be sought before making any disposals.

INHERITANCE TAX (IHT)

Agricultural property relief (APR)

APR will continue to be available for farmland, so long as it is either used for the purposes of agriculture on the date of transfer or if there is a realistic expectation that it will be returned to agricultural use in the future.

The PE itself will not qualify for APR.

Business property relief (BPR)

For continuing farmers, the PE will qualify for 100% BPR.

Where farming has ceased, BPR may still be available on the land if a new trading activity has commenced on the land. In addition, if the PE is used in that new business, relief will be extended to the PE.

If the PE is not used in a business, no BPR will be available and the full value will be subject to IHT.

It is important to remember that BPR will only be available when PE is transferred as part of the transfer of a business rather than as the transfer of a single asset.

Wills

As the PE is a separate asset from the land it may be necessary to review farmers' wills.

VAT

Where PE is transferred at the same time as the land, the nature of the supply will follow that of the land. For example, where opted land is transferred, the transfer of the PE will be standard rated. Specific advice should be sought, as the treatment will be dependent on the facts.

Where PE is transferred without land, the supply will be standard rated and subject to the usual registration requirements.

Transfers of businesses including PE will usually be treated as the transfer of a going concern and will be outside the scope of VAT.

If you would like further information or advice, please contact any of our partners with whom you are already in contact or one of the writers:

James Kidgell

jameskidgell@dixonwilson.co.uk

David Nelson

davidnelson@dixonwilson.co.uk

David Mellor

davidmellor@dixonwilson.co.uk

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► Dixon Wilson
Rotherwick House
3 Thomas More Street
London E1W 1YX

Telephone 020 7680 8100
Fax 020 7680 8101
E-mail dw@dixonwilson.co.uk

► Dixon Wilson
19 avenue de l'Opéra
75001 Paris
France

Telephone +33 1 47 03 12 90
Fax +33 1 47 03 12 85
E-mail dw@dixonwilson.fr

► www.dixonwilson.com