

Farmers and market gardeners

This Help Sheet gives you information about special rules which can apply to farmers and market gardeners:

- farmers' averaging relief
- herd basis
- losses
- the treatment of compensation for compulsory slaughter
- some aspects of information from accounts in addition to those covered in Help Sheet 229 *Information from your accounts*
- agricultural buildings allowance.

Farmers' averaging 2007-08 and 2006-07

Provided certain conditions are met, a special relief 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 and be taxable on half the total for each of the two years. This helps to even out fluctuating results. (Farming includes the intensive rearing of livestock or fish on a commercial basis for the production of food for human consumption.)

Averaging does not affect the amount of tax and NICs you pay for 2006-07. The adjustments for both years are taken into account in your 2007-08 tax and NICs. You should pay your 2006-07 tax and NICs in full, even if averaging reduces your profit for that year. Otherwise you may have to pay interest on unpaid tax and NICs.

Who can claim?

Claims can be made by:

- sole traders
- partners, except people who joined or left the partnership in 2006-07 or 2007-08.

You cannot claim if your business commenced or ceased in 2006-07 or 2007-08.

How to claim

- Sole traders

Claim in box 70 in the *Self-employment (full)* pages.

- Partners

Claim in box 10 in your *Partnership* pages. If you wish to claim averaging, you are entitled to do so even if your partners decide not to claim.

What are the conditions?

The difference between the profits for the two years must be at least 30% of the profits of the year with the better result. To help people where the results are not quite so different, relief is also available on a special tapering scale where the difference is between 30% (full relief available) and 25% (no relief). Below 25% claims may not be made.

If you claim averaging and calculate your tax, you must also calculate the increase or decrease in your Income Tax and Class 4 NICs for 2006-07. Make the alteration for 2006-07 by adjusting your 2007-08 tax. If the adjustment is an increase, enter the amount in box 13 on page TCS 2 of your *Tax Calculation Summary* pages. If it is a decrease enter the amount in box 14.

What is meant by profit?

These notes cannot give detailed guidance on every situation. If you read these notes but cannot then calculate your profits for 2007-08 or 2006-07, ask us or your tax adviser for further help.

- Sole traders

Profit means profits after capital allowances and balancing charges. Losses count as zero. For 2007-08 your profit is the figure in box 62 on the *Self-employment (full)* pages (see below), adjusted by any amounts in boxes 66 and 67.

For 2006-07 it is the figure in box 3.76 of your *Self-employment* pages, adjusted by any amounts in boxes 3.77 and 3.79.

- Partners

Your profit for 2007-08 is the figure in box 7 of your *Partnership* pages, adjusted by the figures (if any) in boxes 8 and 12. For 2006-07 your profit is the figure in box 4.7 of your *Partnership* pages adjusted by the figures in boxes 4.8 and 4.10.

Examples of averaging where profits differ by more than 30%

Example 1

John's results are as follows:

2007-08 profit £10,000

2006-07 profit £40,000

If averaging is claimed the profit for each year becomes:

$$\frac{(\pounds 10,000 + \pounds 40,000)}{2} = \pounds 25,000$$

This applies even if the £40,000 for 2006-07 was the result of an averaging claim for 2006-07 and 2005-06.

John's 2007-08 profit is increased by £15,000 and this increase must be entered in box 70 (sole traders) or box 10 (partners).

Example 2

Ian's results are as follows:

2007-08 loss £20,000

2006-07 profit £32,000

The loss counts as zero when averaging is computed so the average result for each year is:

$$\frac{(\pounds 32,000 + 0)}{2} = \pounds 16,000$$

Ian's 2007-08 profit is increased from £0 to £16,000 and this increase of £16,000 must be entered in box 70 on page SEF 4 of the *Self-employment (full)* pages (or box 10 of the *Partnership* pages if Ian is a partner). The loss of £20,000 should be entered in box 75 (box 19 for partners). Unless there are any adjustments in boxes 66 and 67 (boxes 8 and 12 for partners), this figure will be the same as the figure in box 62 (box 7 for partners).

What about the change in the profits for 2006-07?

A claim to averaging for 2007-08 and 2006-07 deems there to be a change to your income for 2006-07. If, as a result, you wish to change other claims to relief for 2006-07, you can do so when making the averaging claim. But averaging does not change your actual income or your tax bill for 2006-07. Depending on whether your 2006-07 profit goes down or up as a result of averaging, relief is given or the extra tax is charged by way of an adjustment to your tax liability for 2007-08.

If you claim averaging and you calculate your tax and Class 4 NICs, you must also:

- calculate the increase or decrease in your tax and Class 4 NICs for 2006-07 which would have happened if you had amended your 2007 Tax Return because of the changed profit including any consequential changes (for example, because changing the profit changes the limits for Retirement Annuity Relief), and
- enter the adjustment on your *Tax Calculation Summary* pages for 2007-08 in box 13 (increases) or box 14 (decreases).

What if the profits differ by between 30% and 25% of the profit for the year with the better result?

In that situation you can claim to have a special sum deducted from the profit for the higher year and added to the profit for the lower year. This sum is computed by multiplying the difference by 3 and subtracting 75% of the profit for the higher year.

Example where profits differ by between 30% and 25%

Example 3

Liz's results are as follows:

2007-08 profit	£50,000
2006-07 profit	£36,000

The difference is £14,000 which is between £15,000 (30% of the higher figure) and £12,500 (25% of the higher figure) so Liz can reduce the higher figure and increase the lower figure by:

$$(3 \times £14,000) \text{ minus } (75\% \times £50,000) = £4,500$$

The reduction of £4,500 to Liz's 2007-08 profit must be entered, in brackets, in box 70 (sole traders) or box 10 (partners).

What if your profits change?

Any averaging claim you have made in your Tax Return will lapse if your profits for either 2007-08 or 2006-07 change. Provided the time limit for amending your Tax Return has not expired, you can make a claim to average the changed profits by amending your Tax Return, whether or not you originally made a claim.

Even if the time limit for amending your Tax Return has expired, you can still make a claim if you used averaging to compute your taxable profit before the profits changed. You cannot amend the Tax Return yourself but you should write to us to ask for any necessary adjustments to be made. Do not delay writing because there is a time limit.

Stock Valuation

Partners can ignore this section when completing the *Partnership* pages. Help Sheet 232 *Farm stock valuation* explains the methods of farm stock valuation which are acceptable to us. Ask the Orderline for a copy if you need one.

There is only space to enter a single figure for stock in box 83 of your personal or Partnership Tax Return.

You may provide a breakdown of that figure in the 'Any other information' box, box 101. Providing this information with your Tax Return may help avoid enquiries.

The Herd Basis

Partners can ignore this section when completing the *Partnership* pages.

What is the herd basis?

The herd basis is a special method of calculating profits or losses which may be used by people who keep production livestock. If you use the herd basis you will need to keep records so that you can identify the figures to be used when applying the special rules.

As a normal rule, farm animals are dealt with as trading stock. However some farm animals - those which are kept by farmers not primarily for resale but for the sake of the products (for example, milk or eggs) or offspring (for example, lambs or piglets) which they produce - are in many ways more like capital assets of the farmer's business. Tax law recognises this by giving farmers the option of dealing with such 'production animals' under the herd basis. It provides a set of rules whereby a herd or flock of production animals is excluded from trading stock and treated, in most but not all circumstances, like a capital asset.

A farmer must elect for the herd basis; otherwise the animals are treated as trading stock. The election must specify the class of animals concerned and, once it has been made, the herd basis must be used for as long as the farmer continues to keep animals of that class. The election has to be made soon after the farmer first starts keeping animals of that class, and then the herd basis applies to those animals from the outset. There is a further opportunity to elect to use the herd basis if a herd or a substantial part of it (20% or more) is compulsorily slaughtered.

What is the effect of electing for the herd basis?

Where a herd basis election is in force, the treatment for the purpose of computing farming profits of the herd or herds covered by the election is governed by the special rules. Very briefly they are:

- the initial cost of the herd is not an allowable deduction, nor is the cost of any subsequent increase in herd size
- the net cost of replacing animals in the herd (but not any element of improvement) is an allowable deduction
- where the odd animal, or just a few animals (amounting to less than 20% of the herd), are sold from the herd and not replaced, the resulting profit or loss is taken into account in arriving at the farming profits
- where the whole herd, or a substantial part (20% or more) of the herd, is sold and not replaced, the resulting profit or loss is not taken into account.

The herd basis can also apply where animals are jointly owned, for example, in some share farming arrangements.

There are further special rules for particular situations.

Adjustments to be made in the Self-employment (full) pages of your personal Tax Return or the Partnership Tax Return

If you have made a herd basis election then you should include the herd in box 82 in your Balance Sheet Summary.

It may be helpful if you provide in the 'Any other information' box, box 101 a breakdown of the figures showing the number and cost of the animals. Similarly, box 101 may be used to show how any herd basis adjustments in your accounts or in the 'Calculating your taxable profit and loss' section on page SEF 3 (or page 2 of the Partnership Tax Return) are calculated. Providing this information with your Tax Return may help avoid enquiries.

To get to the taxable profit, special adjustments may be needed to the profits shown by the accounts. This will depend upon the way the herd is accounted for. You should deal with these adjustments by making entries in boxes 31 to 45 on page SEF 2 to remove profits or losses which have been included but which are not taxable, and/or expenses which have been included but which are not allowable. If a sum which is not taxable has been included in your business turnover in box 14, then the adjustment should be made in box 60.

For example:

- an animal dies and is replaced by a better animal costing £200 more than a replacement of the same quality as the one that died. Because of the way the accounts are prepared, the cost of the replacement is included in box 16. The £200 which is not allowable should be included in box 31
- a substantial part of a herd is sold and the profit of £10,000 is included in box 28. It is not taxable so it should be adjusted by a negative entry in box 43. If the profit had been included in business turnover at box 14 then the adjustment would be in box 60
- the following year the herd in the previous example is replaced. The cost of the replacements is included in box 16. The proceeds of sale of the herd sold the previous year now become taxable and must be added to the profit. Make the adjustment in box 58 and put a note in the 'Any other information' box, box 101 to explain the adjustment
- a home bred dairy cow is added to a herd. The cost of breeding it is included in the various expenses in the accounts. The farmer's records are not adequate to calculate the cost accurately. The cost is estimated at 60% of market value (see Help Sheet 232 *Farm stock valuation*). If the sum to be disallowed has been included in sales, then no further adjustment is required. Otherwise the sum to be disallowed should be included in box 31.

If an adjustment is needed but you are not sure where to put it, please include it where you think best and use the 'Any other information' box, box 101 to say what you have done.

If you would like further information about the herd basis, ask us or your tax adviser.

Losses

Most losses can be claimed against other income. But there are special rules which restrict your ability to claim if your farm is uncommercial or if you had a run of losses (calculated before capital allowances) of more than five years. Please refer to Help Sheet 227 *Losses* before making a claim. For further information, ask us or your tax adviser.

Compulsory slaughter

Compensation for compulsory slaughter is normally treated as sale proceeds whether or not the animal concerned is part of a production herd accounted for on the herd basis. Where the animals slaughtered are not on the herd basis and could not be (even with the fresh opportunity to elect for herd basis following compulsory slaughter of more than 20% of a herd) you can use Extra Statutory Concession B11 to remove the profit arising from the year of slaughter and bring it in in equal instalments over the next three years. Use box 60 to show profits removed and box 58 to show profits brought back in and put an explanation in the 'Any other information' box, box 101.

Standard Accounts Information

General guidance on the completion of pages SEF 2 and SEF 5 of the *Self-employment (full)* pages (or pages 3 and 5 of the Partnership Tax Return) is contained in the *notes* to those pages. Help Sheet 229 *Information from your accounts*, gives further advice on transferring figures from accounts to the Tax Return and includes two examples of a general nature.

The accounts produced for farming businesses have traditionally included more detail than those for other businesses of a comparable size. Examples on pages 7 to 12 show how the figures from one such set of accounts could be used to complete the standard accounts information sections of the *Self-employment (full)* pages or Partnership Tax Return.

The accounts are intended to be broadly realistic, but figures are illustrative only. They do not necessarily reflect our views on what may or may not be acceptable in any particular case.

For most businesses the information on the *Self-employment (full)* pages or Partnership Tax Return, together with any entries in the 'Any other information' box considered necessary, will enable a full and fair picture of your business to be presented.

In some larger or more complex businesses, this may not, on its own, provide an adequate means of disclosure. The submission of further information including, where necessary, accounts and supporting calculations should be considered where:

- a large farming business has a substantial turnover
- the farming business is complex (perhaps because it is highly specialised or diversified)
- accounts and/or a note of the calculations are required for a proper understanding of the figures.

The standard accounts information sections of the Tax Return must also be completed as usual.

Agricultural buildings

The 2007 budget announced the withdrawal of agricultural buildings allowances. You can still claim agricultural buildings allowance for the cost of constructing farm buildings, barns, cottages, farmhouses and similar works (you cannot claim for the cost of the land on which the building stands) but the allowance is being

phased out so the effective rate of 4% in 2007-08 reducing to 3% the following year and so on until by 2011-12 no allowance will be due. The rate you are actually able to claim is determined by how much of your chargeable period, normally the period for which you draw up accounts, (but if you have recently started, ceased or made changes to this you should consult your tax adviser) falls within each of these tax years.

Example 4

A barn costs £50,000 to construct during the year ended 5 April 2008. The amount of the agricultural buildings allowance available to set off against your profits is £2,000 for the year ended 5 April 2008, £1,500 for the year ended 5 April 2009, £1,000 for the year ended 5 April 2010, £500 for the year ended 5 April 2011 and nil thereafter.

Example 5

You spent £10,000 on a cowshed in 1990. The allowances are due at £400 a year. You draw up accounts for nine months from 1 April 2007 to 31 December 2007. You can claim agricultural buildings allowance in this account of £300 ($£400 \times \frac{9}{12}$). In 2008-09 assuming the chargeable period is 12 months the amount of the claim will reduce to £325 available to set off against your profits [$(\frac{3}{12} \times 400) + (\frac{9}{12} \times 400 \times 75\%)$].

Some buildings do not qualify in full for agricultural buildings allowance. If a building is a farmhouse, the maximum expenditure qualifying for agricultural buildings allowance is one-third of the construction expenditure. If the accommodation and the amenities of the farmhouse are out of due proportion to the nature and extent of the farm, the expenditure which qualifies is less than one-third.

Example 6

You construct a farmhouse at a cost of £150,000. The maximum expenditure qualifying for agricultural buildings allowance is £50,000 ($\frac{1}{3} \times £150,000$).

If a building which is not a farmhouse is used partly for non-agricultural purposes, only part of the expenditure qualifies for agricultural buildings allowance.

Example 7

You construct a barn for £60,000. This has three sections of which you use two for your farm and one for private storage. The expenditure qualifying for agricultural buildings allowance is £40,000 ($\frac{2}{3} \times £60,000$) and the allowances due are £1,600 (4% of £40,000) for 2007-08, £1,200 for 2008-09, £800 for 2009-10 and £400 for 2010-11. There are no allowances after this date.

The allowance for each agricultural building is calculated separately.

There are special rules if you sell an agricultural building or if you buy an agricultural building on which somebody else has been claiming allowances. Your tax adviser will be able to give you advice about these.

Example 8

Trading and Profit & Loss Account for the year ended 31 March 2008

Sales of livestock	£14,800		
Transfers to herd (Note 1)	<u>1200</u>	16,000	Box 14
Sales of produce:			
• crops and subsidies	42,163		
• milk	68,337		
• straw	<u>50</u>	110,550	Box 14
Miscellaneous receipts	650		Note 2
Sheep grazing	<u>950</u>	<u>1,600</u>	Box 15
		128,150	
Opening valuation	42,500		
Feeds, seeds & fertilisers	<u>42,800</u>		
		85,300	
Closing valuation	44,200	41,100	Box 16
GROSS PROFIT		87,050	
Rent (Note 3)	2,350		Box 20
Rates and water (Note 3)	1,700		Box 20
Wages	14,125		Box 18
Insurance	1,205		Note 4
Equipment and vehicle expenditure	15,923		Note 5
Light & Heat (Note 6)	3,779		Box 20
Telephone (Note 6)	759		Box 22
Contracting and plant hire	1,991		Note 7
Lease of milk quota	4,620		Box 16
Haulage	365		Box 16
Veterinary expenses (Note 8)	1,215		Box 27
Bank charges	2,273		Note 9
Hire purchase interest	1,274		Box 25
Silage wrapping	1,592		Box 16
Accountancy	923		Box 27
Valuation charges	175		Box 27
Miscellaneous expenses	1,297		Box 29
Depreciation	<u>6,292</u>		Box 28 & Box 43
		<u>61,858</u>	
NET PROFIT		<u>£25,192</u>	

Balance Sheet at 31 March 2008

Fixed assets			
Land	200,269		Box 82
Buildings	125,694		Box 82
Machinery	32,578		Box 81
Milk quota	9,520		Box 82
Dairy herd (herd basis)	<u>17,700</u>		Box 82
		385,761	
Current assets			
Valuation			Note 10
Growing crops	12,200		
Livestock	14,750		
Produce	14,050		
Deadstock	<u>3,200</u>		
	44,200		Box 83
Debtors and prepayments	<u>14,770</u>		Box 84
	58,970		
Current liabilities			
Creditors	16,021		Box 89
Overdraft	11,565		Box 90
HP account	<u>25,641</u>		Box 91
		<u>53,227</u>	
Net current assets		<u>5,743</u>	
Net assets		<u>391,504</u>	Box 92
Represented by:			
Capital Account			
• Balance at 1/4/07	384,623		Box 93
• Net profit	<u>25,192</u>		Box 94
	409,815		
• Less drawings	<u>18,311</u>		Box 96
		391,504	Box 97

Note 1

Herd basis adjustment to exclude the cost of home-bred additions to the herd. Following the suggestions in this Help Sheet, the herd basis reconciliation is included in the 'Any other information' box, box 101.

Note 2

Miscellaneous receipts comprise haulage (£401) and wayleaves (£249). Haulage has been included as an item of business income in box 14. The wayleaves are included in box 15. Wayleaves received after 5 April 1997 are no longer subject to deduction of tax and are no longer required to be excluded from the farming profits.

Note 3

The private proportions of rent and of rates and water are respectively £475 and £200. These amounts need to be disallowed in arriving at the profit for tax purposes and are included in box 35.

Note 4

There are several figures making up the overall insurance expense. £210 relates to motor vehicles partly used for private purposes. This amount is included in the entry in box 19 (see Note 5 below). There is a choice as far as the balance is concerned. That part relating to the premises and property could be included in the entry in box 20; but it would also be reasonable to enter the full amount of the balance in box 22 on a consistent basis from year to year. The latter approach is adopted here.

Note 5

The equipment and vehicle expenditure comprises the following: tractor/combine repairs, £6,351, tractor/combine diesel, £5,102 and motor car expenses, £4,470. This latter figure, together with the motor insurance costs, is entered in box 19. Of the total motoring costs of £4,680 (£4,470 + £210) 30% are for private use and are disallowed by entering the private proportion, £1,404, in box 34. The tractor/combine expenditure has been treated as a direct cost of production and included in the entry in box 16, although it would be equally acceptable to separate the repairs expenditure and enter it in box 21.

Note 6

The private proportions of light and heat and of telephone are respectively £650 and £150. To arrive at the profit for tax purposes, these amounts have to be disallowed and are included in the entries for boxes 35 and 37 respectively.

Note 7

Contracting and plant hire comprises costs of a ditching contractor £1,767 and plant hire, £224. The expenditure all relates to maintenance of the farm and has been entered in box 21. Had the contracting been in respect of contract milkers or contract harvesters, for example, it would have been entered in box 16 as a direct cost of production.

Note 8

Veterinary expenses includes £177 for treatment to a privately owned pony. This has been disallowed by including the amount in the entry in box 42. All associated expenses of upkeep of the pony have been met privately or charged to drawings.

Note 9

Bank charges includes £701 interest charges which is entered separately in box 24.

Note 10

Details of the valuation at the year end are included in the 'Any other information' box, box 101 to help clarify the figure shown in box 83. It is not necessary for a professional valuation to be obtained but the likely reliability of the valuation will be one of the factors we will consider in deciding whether to open an enquiry.

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.