Sheep Stock Clubs

Possible Business Structures

Campbell Stewart MacLennan & Co

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Introduction

Common grazings are areas of land used by a number of crofters and others who hold a right to graze stock on that land. Those individuals may choose to communally manage their stock on that land through a Sheep Stock Club. These notes focus on the possible business structures for such clubs.

Unincorporated Association

Members agree to come together to collectively manage their sheep stocks – it is advisable to document the purpose and rules for the Club and its members in a 'Constitution' and 'Rules'. A management committee will govern the Club and be responsible for matters such as keeping books and records, preparing accounts and, where appropriate, filing corporation tax returns.

UK agricultural co-operatives, including unincorporated clubs, are treated as a co-operative association if they are:

- established in the UK and UK resident, and
- carrying on agricultural or horticultural business on land occupied by them in the UK

For this purpose, a co-operative association means a body with a written constitution from which the Secretary of State is satisfied that it is in substance a co-operative association.

Such associations receive similar treatment to registered societies as regards interest and share dividends.

HMRC generally accept an unincorporated club is 'dormant' for tax purposes if it owes less than £100 of corporation tax per year – the Club should identify its existence to HMRC but it is unlikely to be required to file a tax return or pay any corporation tax. This may be the case for small clubs, or those that that are treated as a co-operative association and routinely distribute annual profits to their members.

Advantages	**Disadvantages**
Minimal regulation - nothing to file with Companies House / FCA etc.	Unlimited personal liability for the Club's debts, contractual obligations and any claims against it in the event of the Club having insufficient funds or insurance coverage.
Accounts may be prepared under FRS105, which are simpler and shorter than those prepared under FRS102. They should be attached to corporation tax returns submitted to HMRC but iXBRL tagging is not yet mandatory.	Limitations on raising finance and often restrictions on bank accounts – e.g. no overdraft facility.
Where the club is treated as a co-operative and profits are distributed to members (sometimes referred to as a 'dividend') this is an allowable deduction for corporation tax purposes.	The Club may be liable to pay corporation tax on surpluses.
	Distributions are linked to members 'shares' and may not reflect the level of active participation carried out by those members.

Partnership

A group of people agree to come together to collectively manage their sheep stocks and share the joint profits in pre-determined proportions – it is advisable to draw up a Partnership Agreement which sets out partners' responsibilities and applicable share. Each partner is treated as self-employed and responsible for filing their own self-assessment tax returns and are collectively responsible for filing a partnership tax return.

Advantages	Disadvantages
Minimal regulation - nothing to file with Companies House / FCA etc.	Unlimited personal liability for the Club's debts, contractual obligations and any claims against it in the event of the Club having insufficient funds or insurance coverage.
Accounts should be prepared in accordance with UK GAAP (which includes FRS105) but the format is more flexible. The partnership tax return will include figures from the accounts, but the accounts are not filed with HMRC.	Each partner is 'jointly and severally' liable for the club's debts - if certain partners are unable to pay their share of the partnership debts then those debts can fall on the other partners.
Subject to the terms of the Partnership Agreement, partner shares can be varied between the partners from time to time so all partners receive a fair share for their level of participation.	Partners pay tax on their share of profits, regardless of amounts drawn in the period – they may need to leave cash in the Partnership to fund working capital needs or future capital projects.

Limited company

A separate legal entity is formed with members collectively managing their sheep stocks and receiving payments for their work or in relation to their share – the Memorandum and Articles of Association set out the rules of the company and directors (members elected to govern the Club) must also comply with the provisions of the Companies Act 2006.

Accounts and annual returns (confirmation statements) must be filed with Companies House.

A company may be limited by shares or by guarantee – the latter meaning that members agree to contribute a certain sum in the event of liquidation.

Advantages	Disadvantages
Limited liability – members are generally not personally liable for the Club's debts, contractual obligations or any claims against it. In the event of liquidation, they are only required to contribute the unpaid element of their shares or, in case of companies limited by guarantee, the amount set out in the Articles.	Administration and Regulation – all directors are responsible for ensuring the Club complies with the Companies Act 2006. There are strict filing deadlines and penalties for non-compliance.

As a separate legal entity, the Club can own property	Accounts must be prepared in the prescribed format, 'iXBRL' tagged and submitted to HMRC with the tax computations.
Additional borrowing options and banking facilities – banks can take security over the company's assets and may offer business accounts with overdraft facilities.	Documents filed with Companies House and directors' details are filed on the public register.

Limited liability partnership (LLP)

A separate legal entity is formed with members collectively managing their sheep stocks – the Limited Liability Partnership Agreements sets out the rules and responsibilities of the partners but doesn't require to be filed with Companies House. 'Designated members' have responsibilities similar to those of a director of a limited company.

Accounts and annual returns (confirmation statements) must be filed with Companies House but members are treated as self-employed for tax purposes so file their own tax returns in respect of their share of the profits.

Advantages	Disadvantages
Limited liability – members are generally not personally liable for the Club's debts, contractual obligations or any claims against it.	Administration and Regulation – all designated members are responsible for ensuring the Club complies with the provisions of Companies Act 2006 relevant to LLPs. There are strict filing deadlines and penalties for non-compliance.
As a separate legal entity, the Club can own property	Accounts must be prepared in accordance with the Statement of Recommended Practice: Accounting by Limited Liability Partnerships
	Documents filed with Companies House and designated members' details are filed on the public register.
	Partners pay tax on their share of profits, regardless of amounts drawn in the period – they may need to leave cash in the Partnership to fund working capital needs or future capital projects.

Registered societies

These are registered with, and regulated by, the Financial Conduct Authority (FCA) and include:

- co-operative societies – businesses that are run for the benefit of their members, distributing profits between their members
- community benefit societies – businesses that are run for the benefit of the wider community, re-investing profits in the community
- 'pre-commencement societies' (industrial and provident societies, registered before 1 August 2014)

Bona fide co-operative society

There is no statutory definition of this. Criteria of the registering authority requires:

1) Community of interest – common economic, social or cultural need or interest amongst all members
2) Business must be for the mutual benefit of members with the benefits they receive deriving mainly from their participation in the business
3) Control of the society must be vested in members equally – one member one vote
4) Interest on share or loan capital shouldn't exceed a rate needed to obtain and retain capital sufficient to carry out the society's business
5) Profits (if distributable to members) should be distributed in relation to the extent that members have traded with the society or taken part in the society's business
6) Membership should be open and should not be artificially restricted to increase value of proprietary rights or interests.

A society can't be a co-operative if it carries on or intends to carry on, a business with the object of making profits mainly for the payment of interest, dividends or bonuses on money invested in or lent to it.

A ***Community Benefit Society*** is like a co-operative, only if it is wound up its assets don't go to members but to the community it is intended to benefit.

Agricultural co- operatives

Agricultural co-operatives meet the criteria for mutual concerns if their constitution provides that:

- only members can use the facilities and services they provide, and
- if it is a marketing agency
  - it sells on behalf of the growers and never owns the produce,
  - members agree to market a certain amount of produce through the co-operative or provide a certain amount for processing,
- any surplus is shared out among members according to the amount of business they have done with the co-operative recently.

If a co-operative buys produce from members who grow it, then sells it to a third party, the trade is not mutual. However, if a co-operative sells the produce as an agent for the members and makes a surplus from the service, the trade is mutual as long as it passes the other tests for mutuality.

Advantages	Disadvantages
Limited liability – members are not personally liable for the Club's debts, contractual obligations or any claims against it.	Accounts must be prepared under FRS102, and contain additional disclosures, so accountancy fees may be higher.
Although accounts and annual returns must be filed with the FCA, to date they have tended to be more lenient than Companies House	Accounts must be audited unless the members elect to dispense with this requirement. This election must be made each year.
Profits distributed to members (sometimes referred to as a 'dividend') are an allowable deduction for corporation tax purposes.	Clubs with more than £90k turnover will find their accounts subject to an Independent Accountant's report. Although less onerous than a full audit, this must be provided by a registered auditor which can mean an additional fee.

Groups

Clubs which have been in existence for many years may find they have inactive members, perhaps though age or ill health or due to shares having been passed down to people living out with the township or with other commitments. If surpluses have been distributed per share, this may seem unfair to members who have actively participated in the management of day to day activities. Such members may charge the club for such work, bring in contractors or employ a shepherd, leaving a smaller surplus to distribute.

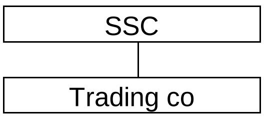
The Club may consider having different categories of shares but should bear in mind that control of a registered society must be vested in members equally – one member one vote.

Alternatively, clubs may wish to create a group structure or a standalone entity may be formed to manage the livestock with the Sheep Stock Club essentially an investment company. Some options are outlined below.

Where Clubs are diversifying with projects such as renewables and forestry, they should give some thought to how those projects are managed and where they fit within the overall structure.

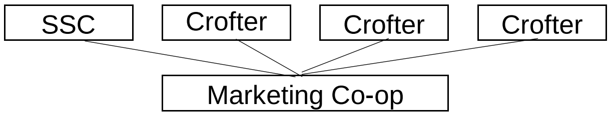
Advice should be sought before setting up another entity, with existing rules, agreements and regulations checked for any restrictions.

Option 1:



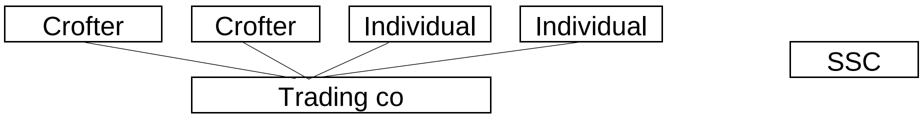
The Sheep Stock Club creates a wholly owned trading subsidiary, managed by active members and potentially others, such as young agricultural contractors that don't have a croft and are unable to acquire a share in the Sheep Stock Club. Such members are paid in relation to work done and any surpluses are passed up to the Sheep Stock Club for distribution to its members so the overall financial position is not dissimilar to that of the Sheep Stock Club. Non-Sheep Stock Club members would have a say in the management of the new entity however. The Sheep Stock Club would continue to own the livestock and receive subsidies and would pay the trading company a management fee.

Option 2:



A new entity is owned and managed by the Sheep Stock Club and other producers, with surpluses being distributed between members in relation to their throughput. The Sheep Stock Club continues to own the livestock and receive subsidies, which are used to pay the marketing agency’s levies and fees. Depending on the rules and agreements in place, it may qualify for mutual tax status.

Option 3:



A new entity is owned by active crofters, who need not be members of the Sheep Stock Club, and potentially other individuals such as young agricultural contractors that don’t have a croft. The Sheep Stock Club is a stand-alone entity which contracts with the new entity to manage the livestock and potentially sell it as agent on behalf of the Sheep Stock Club. As the Sheep Stock Club is not a member, and members of the new entity need not be producers, mutual tax status is unlikely.