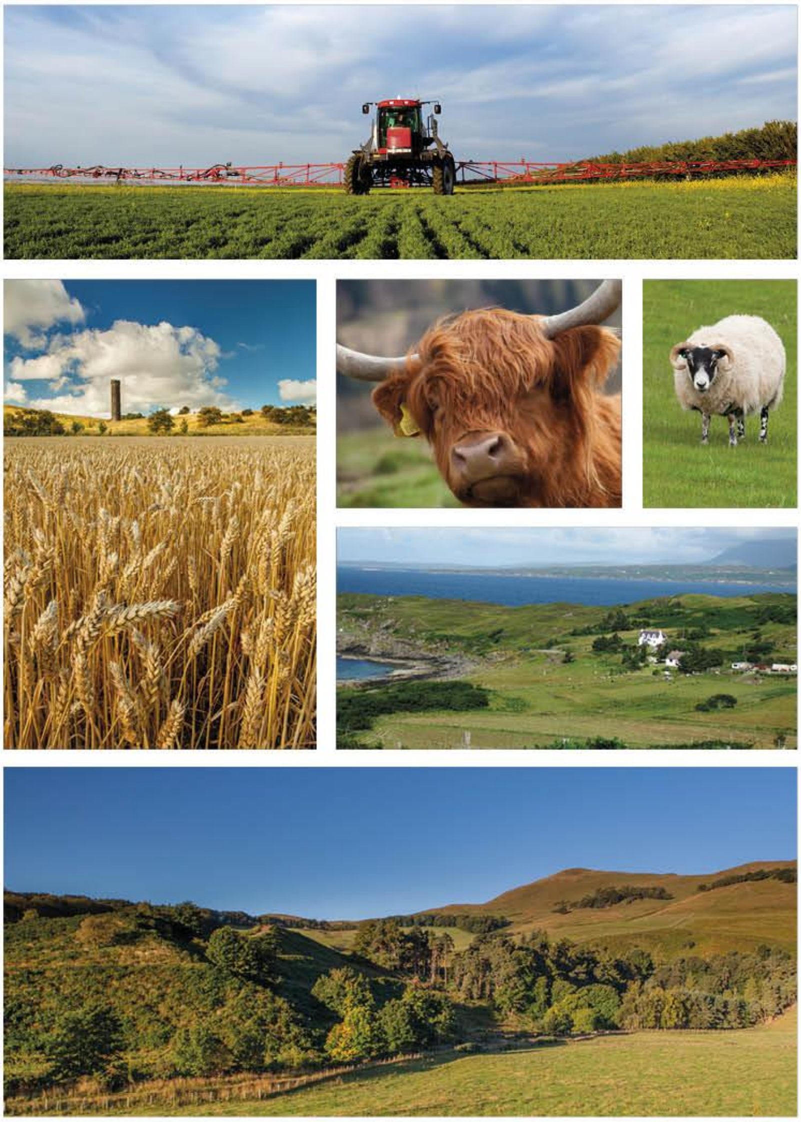
New Entrants to Farming

Succession and Business Structures

Farm Advisory Service

National Advice Hub
T: 0300 323 0161
E: advice@fas.scot
W: www.fas.scot



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Business Structures

Your very first business decision could be to consider the most suitable structure to operate your business. This decision may depend on a number of factors such as whether you are a new entrant or joining an existing family business, your personal circumstances or future plans. This is an important decision to get right as it will determine how profits are taxed moving forward and your potential liability for any debts of the business. You may therefore wish to seek the professional input of an accountant at this early stage in your business.

The potential business structures available include sole trade, partnership, private limited company or limited liability partnership. Each of which are discussed below.

Sole Trader

From an administrative and cost point of view, operating your business as a sole trade is the simplest way to run your business.

In terms of administration, a sole trader must register with HM Revenue and Customs (HMRC) for a Self Assessment Tax Return and Class 2 National Insurance Contributions (NIC). This can be done online at https://www.gov.uk/log-in-file-self-assessment-tax-return/register-if-youre-self-employed or by completing HMRC form CWF1.

A sole trader must register with HMRC by 5 October in the businesses second tax year. For example, if you starting trading on 1 May 2017, you should register with HMRC by 5 October 2018. Failure to register on time could result in a penalty. You should therefore consider registering with HMRC as soon as you can after starting your business.

A sole trader will pay income tax and NIC on all profits arising in the accounting period ending in the current tax year of assessment. For example, a sole trader with an accounting period ending 30 April would be assessed to income tax and NIC during the year ended 5 April 2018 on the profits arising during the year ended 30 April 2017.

You can choose what period you make your accounts. Special rules outline how the profits of a business are taxed in the first 3 years and this could result in profits being subject to income tax and NIC twice. You may therefore wish to discuss what period you should make your accounts to with an accountant.

Partnership

Where two or more individuals come together in business, they might operate a partnership. A partnership agreement would set the rules of how the partners would work together, what happens if there is a disagreement or death of a partner etc.

In terms of profits, the partners may agree to allocate the profits and losses of the business either in pre-determined proportions as set out in the partnership agreement or the partnership agreement may provide flexibility in how the profits/losses are shared from year to year.

In terms of taxation, a partner's share of profit from the partnership is subject to tax and NIC in the same way as sole traders. Similar to that of sole traders, partners are liable for all debts of the partnership. However, each partner is jointly and severally liable for any partnership debts.

Therefore, if any partner is unable to pay their share of the partnership debts, their debt can fall on the other partners.

A partnership must register with HMRC for a Partnership Tax Return. The nominated partner, that is the partner responsible for sending the Partnership Return to HMRC, should do this. The registration can be done online at https://www.gov.uk/set-up-business-partnership/register-partnership-with-hmrc or by completing HMRC form SA400.

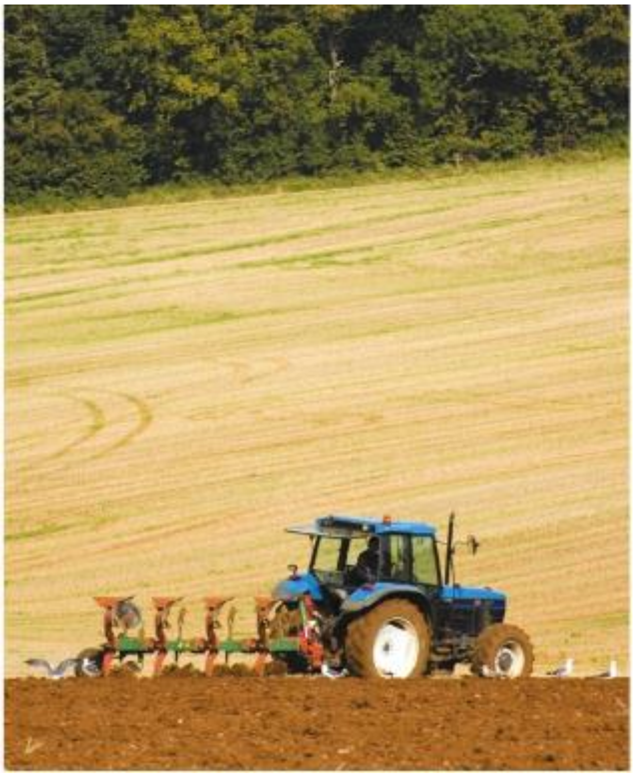
Each new partner must also register with HMRC for a Self Assessment Tax Return and Class 2 NIC. The deadline fo registering the new partnership and partners is the same as that of sole traders.

Limited Company

You can run your business as a private limited company. Ownership of a company is recognised by owning shares in the company. Where an individual works for the company, they are both an owner (shareholder) and an employee.

A private limited company would need to be created. This can be done online or through an agent. The company would then need to be registered with Companies House.

Once setup, the company must register with HMRC for a Company Tax Return and corporation tax. This must be done within three months of starting to do business.



One of the advantages of operating as a private limited company is that the company is legally separate from the people who run it and also has separate finances from the owners. This means that owners of the company are limited in their liability to the nominal share capital invested in the company.

Operating as a private limited company does however come with additional administrative requirements.

A limited company is required to prepare statutory accounts which must be sent to Companies House. A company is also required to provide details of the shareholders of the company each year to Companies House. Furthermore, there may be obligations to register with HMRC as an employer and operate a payroll, even where the director is the only employee.

Any profits generated by the company belong to the company. When a company generates profits, the profits are subject to corporation tax.

Owners of the company can extract profits by way of a salary or dividend. It is possible to structure an owner's remuneration package in a tax efficient manner to minimize income tax and NIC.

Limited Liability Partnership

A limited liability partnership (LLP) is a group of individuals, referred to as "members" in business together.

An LLP is created in the same way as a private limited company and administered in every aspect like a private limited company other than for taxation. An LLP is taxed the same as a partnership.

An LLP offers members the protection of limited liability if the business fails with the added administrative and statutory reporting obligations of a company and none of the potential tax and NIC advantages.

This structure is particularly suitable for medium and large-sized partnerships. Whatever business structure is used, it is important to retain all records in connection with your business as these will be used to prepare your accounts and will form the basis of any income tax and NIC or corporation tax that may be due to pay to HMRC.

Other Tax Issues

VAT

VAT registration will be required if your farming businesses turnover exceeds £85,000. You can register voluntarily if your turnover is below £85,000, unless all your income is exempted from VAT. The main sources of farming income i.e crops and livestock sales are zero rated which means there is no VAT payable on the monies received. VAT on expenditure can be reclaimed for purchases which are related to zero rated sales or standard rated income.

However where the farm rents out cottages or land (other than for grazing), these sources of income are exempt from VAT and therefore any costs relating to these are potentially not fully reclaimable. A business with both taxable and exempt sources of income is partially exempt and special rules apply to determine how much VAT can be reclaimed on expenses.

Capital Gains Tax (CGT)

Disposing of any assets including partnership assets either by way of a gift or sale could give rise to CGT implications. The lowest rate of CGT is 10% increasing to 28%. There are however steps that individuals can take to either mitigate or defer a potential CGT charge. Specialist tax advice should be sought as early as possible.

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With thanks to Karen Wilson, Business Advisory Manager, Johnston Carmichael chartered accountants who prepared this guidance note – http://johnstoncarmichael.com/