



IN THIS ISSUE... Pages 1, 2 & 3 **VAT Partial Exemption Method** Pages 3, 4 & 5 **Renewable Energy**
Pages 5 & 6 **Will Pension Annuitisation – A Thing of the Past?** Page 6 **Shorthold Tenancy Agreements**

Note from the editor



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Welcome to the latest edition of the landtax newsletter. I would like to warmly welcome our two new consultants, Galit Goldshmid and Graham Boddington who have both just joined us. Further details about them and the rest of the landtax team can be found in the enclosed flyer and on our website, along with previous editions of this newsletter.

This issue covers the ever topical subject of VAT partial exemption

including some recent changes and ways of enhancing VAT recovery. We also have a guest article discussing the new feed in tariffs available on renewable energy generation through the use of wind turbines, solar panels and similar, together with updates on pension changes and changes to Assured Shorthold Tenancy Agreements. I would like to thank all the contributors to this issue.

VAT partial exemption method – can you recover more?

Caroline Lovibond

Not everyone's favourite subject I know but an area where savings can often be made with a bit of care and thought.

You may have spotted the changes introduced in 2010 building on the changes in 2009. Whilst for very small businesses and in marginal cases these may help and are set out below, I thought it would also be useful to remind you of some relevant factors to bear in mind when considering partial exemption.

The trick is to balance simplicity with getting a sensible result. If your affairs are quite straightforward and the amounts involved are modest, you can often reduce partial exemption to a

reasonably routine process. But for a large estate with varied activities it is a good idea to understand the general principles and to actively manage your affairs.

You don't necessarily have to be a tax professional to do any of this, there is an art as well as a science.

The basics

The basic principle of partial exemption is that a business that has income from both exempt and taxable supplies cannot reclaim all of its input tax. It can only reclaim input tax "attributable" to taxable supplies.

Bits and pieces...

133 late filing penalties

In the recent case of *Lewis v CRC*, HMRC issued 133 penalty notices over the failure to correctly report one subcontractor over an 11 month period and the Tribunal upheld them all. A salutary reminder of what happens when reporting rules are ignored.

In practice, such partly exempt businesses need to attribute VAT on purchase invoices into one of three categories:

1. VAT wholly attributable to taxable supplies – claim 100% input tax, subject to normal rules.

...Continued on page 2

2. VAT wholly attributable to exempt supplies – potentially irrecoverable, as input tax cannot be reclaimed in relation to exempt activities, unless the amounts are “de minimis” - see below.
3. VAT attributable to both taxable and exempt supplies, e.g. general overheads (the VAT is known as ‘residual input tax’) – claimable according to an agreed formula but also a part of the de minimis calculation.

Bits and pieces...

Furnished Holiday Lettings: Consultation

The new proposals are now out for consultation until 22 October and will potentially be effective from 2011/12 for individuals and 1 April 2011 for companies. Longer availability and actual letting periods of 210 (formerly 140) and 105 (formerly 70) days a year are proposed which may be hard to achieve in practice. The final legislation will be announced in due course.

Standard Method of Calculation

HMRC have said that 120,000 of the UK’s 140,000 partly exempt taxpayers use the following, standard method to apportion their residual input tax. The standard method must be used by all taxpayers unless they have agreed a ‘special method’ with HMRC.

$$\begin{array}{l} \text{Input tax to claim} = \\ \frac{\text{taxable supplies (excl. VAT)}}{\text{total supplies (excl. VAT)}} \\ \times \text{residual input tax} \end{array}$$

Certain income is excluded - for example sales of capital assets, and “incidental” investment or property income. If there is a significant rent roll, rent is probably not incidental.

Traditionally, the calculation is undertaken each (monthly or quarterly) VAT period, followed by an “Annual Adjustment” using annualised figures. Without an Annual Adjustment, an arable farmer with non-incidental rents, for example, might experience a low VAT recovery rate for most of the year, except when crops are sold. The Annual Adjustment “averages” the recovery rate across the year. From 1 April 2009, taxpayers can choose to use the “averaged” recovery percentage from the previous year’s Annual Adjustment as a provisional figure for their VAT returns.

De minimis tests

The de minimis rules can be very important for small partly exempt businesses as they provide an opportunity to reclaim up to £7,500 of input tax each year in relation to exempt activities. Apparently the UK has one of the highest thresholds in the EU – a generous concession indeed by HMRC! HMRC say that the majority of taxpayers using the standard method meet the de minimis tests and can thus reclaim their exempt input tax.

Up to 31 March 2010 a business was classed as de minimis if the following two conditions were met:

- the exempt input tax is less than £625 per month; AND
- the exempt input tax is less than 50% of the total input tax.

A business can be de minimis on a quarterly basis but note that this is superseded by the annual adjustment which takes priority.

Since 1 April 2010 we now have not one test but three! Two new simplified tests have been introduced aimed at simplifying accounting issues for a small business and hopefully avoiding

the need to split all those invoices into the three different categories where some of the totals are already known.

Simplified Test 1:

- total input tax is less than £625 per month on average; AND
- value of exempt supplies is less than 50% of all supplies.

Simplified Test 2:

- total input tax less taxable input tax is less than £625 per month on average; AND
- value of exempt supplies is less than 50% of all supplies.

Businesses that are currently partly exempt with the ‘old’ test may be de minimis under the ‘new’ tests and may be able to claim all their input tax up to £7,500 a year. If you think this might apply to you then it may be worth while doing some sums.

A business that is de minimis in one year can assume it will also be for the four quarters of the next tax year although an annual adjustment calculation at the end of that year may bring it back within partial exemption with corresponding tax payments due. Beware - a large increase in exempt income could result in a substantial payment due.

Improving recovery of input tax

With a little thought tax recovery can often be improved. It is vital to look at the reason WHY the expenditure has been incurred – this can often change the analysis of the input tax.

Consider a business which has a dairy farm (zero rated) adjacent to a property it rents out as (non-incidental) residential accommodation (exempt).

A fence is built between a dairy field and the rental property. Consider why the fence has been built. If it was only built for the tenant's benefit for privacy for example then the VAT would be attributed to the rental income and be exempt input tax.

But, suppose the fence was built to separate the cows from the tenant's children. Is the purpose to keep the cows out of the garden or the children out of the field? Depending on the answer the cost of the fence could potentially fall into any of the three categories and effect the partial exemption calculations accordingly.

So, the quality of the information going into the calculation is important. As far as the calculations themselves are concerned, in many instances, the standard method is a decent compromise between simplicity and a fair result. But it isn't always ideal.

Imagine now that the fence above is between a crop of timber and the garden of the residential property. In this case it may be that the fence is both to keep the children out of the woodland and also to keep any woodland animals out of the garden and it may be accepted that the fence has been put up for both purposes.

Forestry income is standard rated but the income might not arise for 20 years. In this case in the standard method calculation set out above, there could, therefore, be no taxable income to include in the formula and the VAT recovery on the fence would be 0%.

In this case it is clearly unfair to the business owner to use a turnover based method of calculating VAT recovery and is an example of a situation where it could be beneficial to agree a 'special method' with HMRC. Under a special method apportionment can be based on

turnover, headcount, number of transactions, floor area, or inputs – anything that reflects the reality of the situation and gives a fair result. The taxpayer must certify that the method proposed will give a "fair and reasonable" result.

So if partial exemption affects you, don't forget to consider the new de minimis rules to see if they apply to you. In addition, always consider carefully WHY each expense is being incurred before you allocate the input tax – it just might make a difference!

You might also like to consider spreading expenditure across two VAT years, for example by paying for or incurring expenditure in both March and April.

As a final thought – don't forget the standard rate of VAT increases to 20% on 4 January 2011.

Renewable energy – how FIT is your risk appetite?



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Feed in tariffs (FITs), introduced in April 2010 by the government aim to emulate similar schemes in the rest of Europe, to grow dramatically the adoption of small scale and medium scale renewable energy generation in the UK (micro-generation). The new micro-generators will benefit from three sources of income.

1. The most important is the feed in tariff which is set by the government. The rate of tariff is dependent of the scale and type of technology. The tariffs are guaranteed for 20 to 25 years dependent on the technology and are index linked.
2. Secondly, an export tariff for the sale of the electricity exported to the grid.
3. Thirdly savings on energy bills for electricity currently used on the site. The technologies to which the FITs apply are wind power, solar photo voltaic (PV) panels, hydropower and anaerobic digestion (AD).

The scheme administrator is Ofgem and micro-generators require a power purchase agreement (PPA) with an Ofgem licensed electricity supplier to receive the FITs.

There are many rates of return that are being claimed within the renewable energy industry at present, which realistically need to be assessed on a case by case basis, but do look very favourable.

Content with the principles - what next?

Since the announcement of the scheme there have been many companies offering their products and services with regard to renewable energy projects. The majority of these companies are concentrating on small scale wind turbines and solar PV panels. Many of these companies are relatively new and more often than not have yet to install any of the technology solutions they are offering in the UK.

The main elements of moving a project forward can be summarised as follows:

- site assessment
- consultation
- planning
- finance

Site assessment

This stage ensures the site is physically viable for the relevant renewable technology project. One of the major factors in the site assessment is the grid connection. The road network and access issues for the delivery of the relevant technology are also a major consideration.

Consultation

This is required to include consultation with all the relevant statutory bodies, including Natural England, Telecoms, Aviation, MOD etc and the local planning authority which will determine the scope of the planning requirements for the project which are dependent again on location, scale etc.

Planning

Planning represents possibly the main issue and headache to micro generators and/or their developer partners. The



government targets for renewable energy require a significant uptake of the technology over the next 10 years. Remarkably the UK produces the least renewable energy electricity in the whole of Europe with the exception of Malta. The relevant planning policy documents, of which PPS 22 provides the greatest detail for renewable energy, are all worthy documents, but when gold plated by local planning authorities who are mindful of local opposition may be a significant impediment to projects moving forward. Local opposition, ‘NIMBYs’ are well organised, well funded, in my opinion biased and not interested in the success and development of the rural economy.

The planning requirements, dependent on the scale of the project, may require an environmental impact assessment (EIA), traffic assessments and the usual accompanying access and design statements etc common to all planning applications.

Finance

Firstly, any micro generator requiring finance for a scheme will have to determine whether they are looking to fund their renewable energy project

using the existing farm business assets or wish to obtain project finance based on the viability of their chosen scheme and secured on those renewable energy assets. In my experience there have been many differing views from high street lenders who are positive about the scheme in principle but when pressed for lending decisions cannot deliver project finance – yet! However, there are lenders prepared to offer funding on a case by case basis.

Risks and returns

Returns from the projects can be very good depending on the site suitability and the technology chosen.

The risks can also be high. The risks for the renewable energy project are essentially the upfront costs for feasibility studies, planning application costs, EIA, specialist consultants and last but by no means least legal fees. Until planning permission is granted, these costs will have to be met by the farmer/landowner or their developer.

Other risks in the medium term include the new coalition government plans to introduce the ‘Big Society’ with the localisation of planning laws. This is likely to be a watering down of the planning inspectorate and devolving

more of the powers to a local level.

Risk appetite

If you have the risk appetite and the conviction to push through a renewable energy project and the capital to fund the upfront costs then retention of the ownership of the project assets and income will be the correct strategy to follow. If your risk appetite is low, but

you wish to benefit in part from the return from the FIT scheme then a royalty payment and/or rent for leasing the site to a Micro generator developer who will deal with the upfront costs and hassle may be the best strategy.

If either approach fits your risk appetite then, hopefully, your farming and landowning business will benefit from

a useful diversified income source which is index linked for the future and will help sustain the business for the longer term. You will also be doing your bit for the environment!

Ellam, Oxtoby & Peck are carrying out independent feasibility studies for clients or alternatively can set-up the low risk approach with a Micro-generator developer.

Will pension annuitisation become a thing of the past?



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As promised by George Osborne following the Emergency Budget, the Government has now issued their consultation document in relation to pension annuitisation and it makes “sensible” reading. At last, someone in Government appears to be trying to make the system fairer (and less complex?) and provide individuals with more control over when and how they take their benefits.

The key proposals are:

- There will not be a formal requirement to take benefits from a pension scheme at ANY age, although lump sum death benefits paid from any funds where benefits have not been taken by age 75 will be subject to tax charges.

- ASP (drawdown post age 75) will be abolished and individuals currently in ASP will fall into the new regime, but only from 6 April 2011. Unsecured Pension (USP – drawdown pre age 75) will be split into:
 - “capped drawdown” – this will be broadly similar to USP as it stands but will not necessarily have the same maximum income limit, and
 - “flexible drawdown” – individuals will be able to draw unlimited amounts from their pension scheme subject to being able to demonstrate that they have satisfied the Minimum Income Requirement (MIR). Lump sums taken under flexible drawdown will be taxable at the individual’s marginal rate of income tax.
- A uniform tax charge of 55% will be applied to lump sum death benefits paid from pensions in drawdown, and also to benefits that have not been put into drawdown where an individual is over the age of 75. This will replace the 35% tax charge currently applied to USP lump sum death benefits, and the (up to) 82% tax charge applied to ASP.

There are no plans to make any further changes, that will apply before 6 April 2011, for those currently in USP or

Bits and pieces...

HMRC Reminder

A timely reminder that HMRC have now withdrawn agents' copies of PAYE coding notices and other self assessment forms so it is now more important than ever to send copies of all notices to your tax adviser.

ASP. This means lump sum death benefits will be taxed at 35% in respect of a client who dies in USP before 6 April 2011, but if they die after 5 April 2011 the tax charge will be 55%. In ASP the same principle applies, except that the tax charge can currently be up to 82%, whereas lump sum death benefits would only face a tax charge of 55% on death after 5 April 2011.

Both the capped and flexible drawdown options will be available

before and after age 75 and you will be able to take tax free cash after age 75.

The MIR will involve an individual demonstrating a sufficient level of “secure” income.

This secure income must:

- be in payment – i.e. it is not an entitlement to future benefits,
- be guaranteed for life,
- take into consideration expectations of future cost of living.

It is anticipated that an individual’s state pension and state second pension will count towards the MIR. There is no suggestion that income from sources other than pension schemes will count towards the MIR.

The exact level of MIR is not set out in the consultation although will be set at a level to protect the Government from the risk of an individual falling back on the state. This will no doubt be one of the main points of debate.

Changes to Assured Shorthold Tenancy Agreements

Caroline Lovibond

From 1st October 2010 the maximum rent threshold for an Assured Shorthold Tenancy (AST) is to be raised from £25,000 per annum to £100,000 per annum.

At present, any residential tenancy where the annual rent exceeds £25,000 is a common law tenancy. With effect from 1st October 2010 these agreements will automatically convert to being an AST, provided the rent is less than £100,000 per annum.

Existing common law residential tenancies will be affected as follows from 1st October 2010:

- Deposits - any residential tenancy with rent below £100,000 will need to be registered with a government approved tenant’s deposit protection scheme. Currently deposit protection relates to AST’s but not to common law tenancy agreements.

- The contractual termination provisions of existing common law tenancies will be determined by the Housing Act.
- At the end of the contractual term, unless a section 21 notice has been served, the agreement will automatically become a periodic tenancy.

Landlords should review their rental levels and register any deposits without delay.

your feedback...

We would like to know if there are any particular issues which are important to you and that you feel we should cover. Please do get in touch...

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