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Wind farms – tax considerations

Following the recent introduction of Feed-in-Tariffs (FiTs) by the government many renewable technologies have been enjoying significant interest. In particular the number of planned installations of wind turbines has increased considerably. But what are the tax implications of such an installation?

Income Tax

Where the wind turbine is not part of a domestic installation, then the income from the turbine will be taxable. HM Revenue & Customs have confirmed that where a turbine is installed to offset a farm's electricity costs the income can simply reduce the electricity expense in the accounts.

Capital allowances

The installation of wind turbines in a business will attract capital allowances including a proportion of the associated professional costs and site preliminaries.

The government intends to provide more certainty about the rate of these capital allowances following a recent consultation.

Inheritance Tax

Where a wind turbine is installed by a farmer as part of the business then it should be possible to obtain Business Property Relief (BPR) on the turbine and the site. Depending on how the asset is owned this effectively means that some or all of the value of the turbine and site would be excluded from the deceased's estate.

However, the position is less clear where a farmer leases land to a third party operator, and the third party installs the wind turbine. In this situation the site would effectively be an investment in the hands of the farmer (or landlord) and would therefore be unlikely to qualify for BPR. This would result in the site being included in the deceased's estate at its full market value. Any market valuation is likely to be reflect both the rental payable under the lease agreement and the remaining term of such an agreement.

This said, following recent developments in case law, there may be an opportunity for active farmers who have let land under a lease agreement for the installation of wind turbines to still qualify for BPR on the site. Such case law suggests that the farmer needs to be able to demonstrate that the turbine investment site is an integral part of the farm business.

Care must also be taken where the capital value, revenue and profit from such a leased site could outweigh those of the farm business itself. In this situation an estate could face losing BPR on all of its farming assets.

For these reasons proper tax planning is required before committing to leasing land for this purpose. It may be that such assets are better owned in a separate entity to prevent the loss of BPR on the existing trading assets. The capital gains tax consequences of making any transfers of assets, including their timing, would also need to be considered.

VAT

In addition it is very important to consider the VAT implications of any taxable supplies made from the wind turbines in the form of both the generation and export FiTs.

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VAT and farm property

Dreaming up future expansion plans?

HM Revenue & Customs (HMRC) take a special interest in farm property – particularly the farmhouse and the conversion and/or redevelopment of outbuildings.

Different rates of VAT apply to construction works carried out and many different rules relate to claiming back the VAT.

In this article we can only summarise the works that attract the zero per cent or five per cent VAT rates and typical pitfalls on VAT reclaims. As always, timely professional advice based on individual circumstances should be sought in all cases.

Zero per cent VAT

The zero per cent VAT rate applies to construction of new dwellings and to listed buildings that are (or will be converted into) dwellings, provided the works are "approved alterations" which require listed building consent.

Big savings can be made by making small changes, for example, to the pitch or height of a roof so that ordinary repair works, which would normally be billed at 20 per cent can be billed as zero per cent. Again the works must be "approved alterations" which require listed building consent. Care is needed to ensure that the cost of special building materials required for listed building consent is not greater than the VAT saving.

5 per cent VAT

This rate should apply to conversion and repair works to the fabric of the building for dwellings that have either been empty for over two years, or for the conversion of outbuildings into dwellings, or for the conversion of houses into flats (or vice versa).

Caution is advised with the precise wording of planning consents (and council tax records in the case of empty dwellings) as HMRC will almost certainly review these in detail in the event of any query.

Reclaiming VAT

Claiming VAT back on VAT returns is not possible for dwellings to be rented out as residential accommodation. However, it is possible to reclaim VAT for dwellings to be rented out as holiday accommodation provided that VAT will be accounted for on holiday accommodation receipts. "DIY" house builder or converter claims must only relate to residential non business use as HMRC must disallow any clams that relate to intended business use (such as bed and breakfast).

Farmhouse repairs

It is almost fifteen years since the NFU and HMRC reached an agreement that up to 70 per cent of VAT on farmhouse repairs and maintenance (but not utilities like gas and electricity) can be reclaimed by sole proprietors or partnerships as business use. This does not apply for domestic accommodation used by company directors or where the works clearly relate to non business use, for example a bedroom extension unless you can persuade HMRC it is for business use. Sadly, one tongue in cheek claim by one farmer that the bedroom extension was used to "dream up future expansion plans" did not succeed!

Please do get in touch if you wish to discuss any points in further detail at any time.

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Is now a good time to purchase that new kit?

The Annual Investment Allowance (AIA) is currently £100,000. This means that up to £100,000 can be spent on plant and machinery in an accounting year ending before April 6, 2012 (March 31, 2012 for companies) and the full cost of this can be deducted from the taxable profits of the business.

From April 2012 the AIA is to be reduced to £25,000. This means that tax relief for any capital expenditure in excess of £25,000 can only be realised over a number of years. For most plant and machinery the main writing down allowance is to be reduced to 18 per cent (from 20 per cent) per annum but for certain cars and property fixtures, it is to be reduced to 8 per cent (from 10 per cent) per annum.

Where significant capital expenditure is planned within the next few years then it may be sensible to bring this forward to realise the tax discount now in year one rather than having to wait several years.

Workings Tax Credits – changes ahead

Over the last few years Working Tax Credits (WTCs) have been a lifeline to many farmers and rural businesses. However, the amount of tax credits available to them is set to change.

How do I qualify?

Currently to qualify for WTCs you need to be at least 16 years of age, work at least 16 hours per week and be either a couple with children, a lone parent, or live with a disability. Furthermore, a single person is also eligible if they are at least 25 years of age and work for at least 30 hours per week. Both self employed and employed individuals are eligible to claim.

How much am I currently entitled to?

If you qualify for WTCs you are entitled to receive the basic element of £1,920. Couples and lone parents may receive a further £1,950 on top of this and there is an extra £790 if you work at least 30 hours per week. However, these amounts are reduced if your income exceeds £6,420. Specifically for every £100 your income is above this limit then your tax credit payments are reduced by £41.

For example, a single person working 30 hours a week with an income of £7,420 and no children would be entitled to:

Basic element	£1,920
30 hours element	£790
Less income excess	(£410)
Working Tax Credit available	£2,300

By working the calculation backwards, this individual would cease to be eligible for any WTCs when his taxable income reached £13,030.

How is my income calculated?

When calculating income for tax credits purposes it is not the net profit per the accounts that is taken into account. Rather it is the tax adjusted profit which includes any capital allowances claimed in the year. Any personal pension payments and gift aid contributions also reduce an individual's income for tax credit purposes.

For many farmers in the last couple of years' capital allowance claims have been high due to the increase in the Annual Investment Allowance limit to £100,000. This in turn has reduced the taxable profits for both income tax purposes and tax credit purposes. However, from April 2012 the Annual Investment Allowance will be reduced to £25,000 per year. Furthermore Agricultural Buildings Allowances are no longer available. These reductions in capital allowances are likely to increase taxable profits and therefore reduce any tax credit claims available.

When a claimant's entitlement is assessed, initially it is the previous year's income that is taken into account. Once the claimant has their actual income figures for that year the claim is revised based on these figures. If the revised income is less then further tax credits will be due. If the revised income is greater then it depends on how significant the increase is. If the increase is less than £10,000 then any tax credits received for that year may be kept in full. However, where the increase is more than this limit then HMRC will ask for some or all of the tax credits received for that year to be repaid.

This limit of £10,000 replaced (from April 2011) a previous limit of £25,000, and it is set to be reduced further in future years. This, coupled with the varying amount of capital allowances available to a business, means that it is more likely that WTC payments will fall.

What is the future of Working Tax Credits?

It is the government's intention to replace WTCs with a Universal Tax Credit system from around 2014. This new system aims to reduce the overall amounts of tax credit paid and will be aimed at employees rather than the self employed. The new system will assume that all self employed individuals earn at least the National Minimum Wage. This means that a married couple working 40 hours per week would have an assumed combined income of £24,670 and are therefore likely to be ineligible for any tax credit payments.

Another planned change under the Universal Tax Credit system is the introduction of capital tests. Such tests mean that anyone with capital of more than £16,000 should receive no universal tax credits. These planned changes will apply to new entrants from 2014 and all existing claimants will be moved to the new scheme sometime between 2014 and 2017. Therefore where individuals are currently eligible for WTCs then claims should be made now so that they are able to continue to benefit for longer.

If you would like any further information about WTCs or Child Tax Credits, which this article has not covered, please do not hesitate to contact myself or your usual contact at Moore and Smalley.

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Furnished holiday lettings

Followers of the proposed tax changes to furnished holiday lettings relief could be forgiven for thinking that successive governments were dancing an elaborate version of the hokey cokey. Over the last two years, it has been hard to tell whether it would be 'in' or 'out' but Chancellor George Osborne has certainly shaken it all about!

What qualifies as a furnished holiday let?

The first change is that the conditions to qualify as a furnished holiday let have been tightened up. From 2011/12 onwards, it must be actually let for 105 days in a tax year, instead of 70 days, and it must be available for let for 210 days, instead of 140. The overriding rule remains, that the property must be let on a commercial basis with a view to profit.

If a property falls short of the required 105 days, there are provisions for averaging the number of days with other properties in the same year. If the average exceeds 105 days, all the properties will qualify. Alternatively, if a property has met the letting condition for one year, it may be treated as qualifying for the following two years if the owner so elects.

Income Tax Losses

Until 2010/11, a loss on a furnished holiday let could be offset against the taxpayer's other income such as employment income or partnership profits. From 2011/12, this facility has been withdrawn and the rules are now far less generous. Losses from UK holiday lets may only be offset against profits from UK holiday lets in the same or future years, while losses from holiday lets in other EEA member states may be offset against profits from other EEA holiday lets in the same or future years.

Tip: make sure loss claims for 2009/10 and 2010/11 have been maximised

Capital Allowances

The plant and equipment in a furnished holiday let qualifies for capital allowances, including the 100% annual investment allowance for expenditure up to £100,000. This includes items such as heating / air conditioning systems. For expenditure incurred after 5 April 2008, it also includes the general plumbing and electrical systems. If you have purchased a property and have not claimed capital allowances for the 'plant' element of the purchase price, now is the time to make a claim!

Tip: check that capital allowances have been claimed on all eligible plant and equipment.

Capital Gains Tax

Furnished holiday lets continue to attract the highly beneficial Entrepreneur's Relief, which means that capital gains tax should be payable at 10%, instead of the 18% and 28% rates that normally apply. To be eligible for relief, the property must have met the furnished holiday let conditions for twelve months immediately before the sale. The use of the property before that period does not need to be considered: it is only the use in the final 12 months that counts for this purpose.

Gift relief also applies to furnished holiday lets, which means that properties may be transferred by way of gift without incurring a capital gains tax charge. This can make them a possible subject of a lifetime gift to reduce inheritance tax.

Inheritance Tax

There have been no changes to the IHT rules regarding furnished holiday lets. Actually, it is an exaggeration to say that there are any particular IHT rules for these properties. In general, it is fair to say that properties are likely to be fully chargeable to IHT unless additional services are provided beyond the normal cleaning and linen changing in between lets. For example, owners may arrange excursions.

Tip: consider making lifetime gifts of furnished holiday lets to mitigate inheritance tax exposure.

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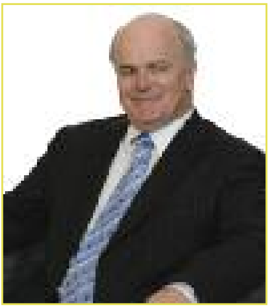

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