The Scottish Government's New Entrants to Farming Programme

SRUC

Guidance Note:
Business Structures & Taxation of Agricultural Businesses

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Business Structures – Which Should I Use?

Having made the decision to be your own boss, it is important to decide the best legal and taxation structure for your enterprise. The most suitable structure for you will depend on your personal situation and your future plans. The decision you make will have repercussions on the way you are taxed, your exposure to creditors and other matters.

The possible options you have are as follows.

Sole Trader

This is the simplest way of trading. There are only a few formalities to trading this way, the most important of which is informing HMRC. You are required to keep business records in order to calculate profits each year and they will form the basis of how you pay your tax and national insurance. Any profits generated in this medium are automatically yours. The business of a sole trader is not distinguished from the proprietor's personal affairs so that if there are any debts, you are legally liable to pay those debts down to your last worldly possession.

Partnership

A partnership is an extension of being a sole trader. Here, a group of two or more people will come together, pool their talents, clients and business contacts so that, collectively, they can build a more successful business than they would individually. The partners will agree to share the joint profits in pre-determined percentages. It is advisable to draw up a Partnership Agreement, which sets the rules of how the partners will work together. Partners are taxed in the same way as sole traders, but only on their share of the partnership profits. As with sole traders, the partners are legally liable to pay the debts of the business. Each partner is 'jointly and severally' liable for the partnership debts, so that if certain partners are unable to pay their share of the partnership debts then those debts can fall on the other partners.

Limited Company

A limited company is a separate legal entity from its owners. It can trade, own assets and incur liabilities in its own right. Your ownership of the company is recognized by owning share in that company. If you also work for the company, you are both the owner (shareholder) and an employee of that company. When a company generates profits, they are the company's property. Should you wish to extract money from the company, you must either pay a dividend to the shareholders, or a salary as an employee. The advantage to you is that you can have a balance of these two to minimize your overall tax and national insurance liability. Companies themselves pay corporation tax on their profits after paying your salary but before your dividend distribution. Effective tax planning requires profits, salary and dividends to be considered together.

There are many advantages as well as disadvantages to operating through a limited company.

There are additional administrative factors in running a company, such as statutory accounts preparation, company secretarial obligations and PAYE (Pay As You Earn) procedures. A big advantage of owning a limited company is that your personal liability is limited to the nominal share capital you have invested.

Limited Liability Partnership

A limited liability partnership is legally similar to a company. It is administered like a company in all aspect except its taxation. In this, it is treated like a partnership. Therefore you have the limited liability, administrative and statutory obligations of a company but not the taxation and national insurance flexibility. They are particularly suitable for medium and large-sized partnerships.

Taxation of Agricultural Businesses

HM Revenue & Customs gives advice on starting your own agricultural business at www.hmrc.gov.uk/courses/syob/farm/index.htm and this gives guidance on how to register yourself and business for tax, national insurance, PAYE, VAT, etc as required.

The main taxes that you will have to deal with are:

Income Tax

Income tax is charged on the profits for a sole trader, partnership and on monies drawn from a company as salary or dividends.

The income tax rates are currently 20%, 40% and 45% and individuals under the age of 65 have an annual tax free allowance of £9,440 in tax year 2013/14.

Corporation Tax

Companies pay corporation tax on their profits. The tax rate is currently 20% on profits up to £300,000.

National Insurance (NIC)

Partners and self-employed people pay both Class 2 and Class 4 NIC. Class 2 is paid at a rate of £2.70/week and class 4 for 2013/14 is charged at 9% on profits between £7,755 and £41,450 and at 2% above that. Employees and directors of companies pay Class 1 NIC on salary at 12% and the employer pays Class 1 NIC at 13.8% on the same salary. Class 1 NIC is calculated on weekly and monthly pay and there are separate rules for directors.

VAT

VAT does not apply to all sales and for agricultural businesses many sales are zero rated. It can often be beneficial to register for VAT before you reach the statutory sales threshold of £79,000 so that VAT can be reclaimed on purchases.

Registration for most of the above taxes can be done online by visiting HMRC website www.hmrc.gov.uk.

All the taxes have specific rules and reliefs which apply to specific trades such as agriculture and it is advisable to seek the advice of accountants who specialise in this area. It is also advisable to take advice on the financial records you need to maintain or employ the services of an experienced book-keeper.

From the above summary of the tax treatment of various business structures, it would seem reasonable to suggest that operating as accompany and paying tax at 20% is more tax efficient than operating as a sole trader or partnership if earnings take the tax rate into 40%. However, the decision to incorporate a business needs to consider many more aspects than just income tax savings.

In order to benefit from lower income tax rates in a company there needs to be a clear understanding of the future of the business in order to make plans to avoid additional costs and taxes and to protect assets for future generations. As noted above, there are points to take into account that involve more than just accounting and taxation considerations and it is advisable to seek advise from accountants with particular knowledge in this area.

This guidance note was prepared by Robin Dandie, Head of Agriculture at Johnston Carmichael chartered accountants www.jcca.co.uk .

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