JOHNSTON CARMICHAEL

in association with

SCOTLAND OF FOOD & DRINK

Summer Budget Briefing – A Food & Drink Focus

An analysis of the Summer Budget and how Scotland's Food & Drink industry can maximise tax reliefs and incentives

Meet the Johnston Carmichael Food & Drink Team

Johnston Carmichael are Scotland's leading firm of independent chartered accountants and business advisers in the food and drink industry with over 350 clients, both large and small, including some of Scotland's most successful privately owned food and drink companies.

Our Food & Drink team is very well connected and understands the industry's opportunities and challenges; the growth of export, controlling raw material costs, supply chain management, availability of funding, the power of branding and the increased demand for local produce.

As your business grows and you face new challenges, you may like the help and support of a firm who really understands your industry, and has the fresh perspective to bring new ideas to help you. Our team are on hand to listen, learn and advise, so please feel free to contact us.

Adam Hardie
Partner, Business Development
and Head of Food & Drink
Edinburgh
0131 220 2203
adam.hardie@jcca.co.uk

Sandy Manson
Chief Executive
Aberdeen
01224 212222
sandy.manson@jcca.co.uk

Graeme Fraser
Partner, Audit
Aberdeen
01224 212222
graeme.fraser@jcca.co.uk

Jamie Waugh
Partner, Audit
Inverness
01463 796200
jamie.waugh@jcca.co.uk

Caroline Muir
Director, Corporate Tax and
Deputy Head of Tax
Edinburgh
0131 220 2203
caroline.muir@jcca.co.uk

Stewart Pennington
Director, General Practice and
Deputy Head of Food & Drink
Edinburgh
0131 220 2203
stewart.pennington@jcca.co.uk

Jillian Sharp
Director, General Practice
Inverness
01463 796 200
jillian.sharp@jcca.co.uk

Fiona Kenneth
Senior Manager, Audit
Aberdeen
01224 212222
fiona.kenneth@jcca.co.uk

Paul Cochrane
Senior Manager, Tax
Glasgow
0141 222 5800
paul.cochrane@jcca.co.uk

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The Budget proposals may be subject to amendment in a Finance Act. You should contact us before taking any action as a result of the contents of this summary.

Foreword

Welcome to the Summer Budget Briefing 2015 – Food & Drink Focus, in conjunction with Scotland Food & Drink.

Scotland's food and drink (F&D) industry is in good health. In the last four years our industry has grown at three times that of the UK, a phenomenal statistic. As the leading accountancy and business advisory firm in F&D, we continue to work hard to understand the industry, bringing our specialist knowledge and insight to the fore, helping our client's businesses to prosper.

Strong brands continue to engage consumers and retailers alike and drive growth of F&D companies. Recommendations by the Smith Commission, soon to be legislated, will ensure that the 'Made in Scotland' brand is recognised by EU law. The government is keen to encourage economic growth and innovation in the F&D industry, through the continuation of generious R&D tax reliefs and enterprise investment schemes, allowing businesses and investors to to optimise their tax position and be rewarded for their innovation.

Our F&D budget briefing provides full analysis of the measures announced by Chancellor Osborne, and we also share some useful guidance on how businesses within the F&D sector can maximise the tax reliefs and incentive schemes available. As always, should you wish to find out more about how Johnston Carmichael can help you or your business, please feel free to contact one of our F&D team, who'd be happy to help.

Adam Hardie
Partner and Head of Food & Drink at Johnston Carmichael

The Scottish F&D industry has been enjoying phenomenal sales growth in recent years and there is good reason for us to be recognised as a Land of Food and Drink for the quality products with a strong identity that we produce.

Scotland Food & Drink have a longstanding relationship with Johnston Carmichael, working in partnership to support the growth of the industry. The announcement of the budget brings with it complexities and results in lots of questions- to have expert guidance in the aftermath is crucial for companies.

It is important that Scottish F&D businesses have access to professional advice, one such example is insight into the relief available on R&D investment. Innovation is a key element of the industry strategy and for our continued success while the level of R&D investment in the sector has more than doubled since 2009, one of the reasons that we've seen manufacturing in Scotland grow at two and half times the rate of the UK average over the last few years.

James Withers
Chief Executive at Scotland Food & Drink

Key Summer Budget Highlights
Personal Taxes

Income tax rates and tax bands

The basic rate of income tax is currently 20%. The band of income taxable at this rate is currently £31,785 (£42,385 after accounting for this year's tax-free personal allowance). In his Budget announcement, the Chancellor revealed plans to increase the personal allowance to £12,500 by the end of this parliament (i.e. five years time) and took the first step towards that commitment by increasing the personal allowance by £400 to £11,000 for 2016/17. This results in a basic rate taxpayer being £80 better off in the 2016/17 tax year.

The personal allowance for 2017/18 will then increase to £11,200.

The Chancellor also committed to increase the level of income at which people start to pay 40% tax to £50,000, over the next five years, starting with an increase in the higher rate threshold from £42,385 to £43,000 for 2016/17 and £43,600 for 2017/18.

Going forward, the government plans to ensure that the personal allowance will always be set at a level so that those on the national minimum wage, working 30 hours a week, do not pay tax.

For higher earners, the personal allowance is reduced by £1 for every £2 of taxable income over £100,000. Therefore, from April 2016, those with a taxable income over £122,000 will lose their full entitlement to the personal allowance.

The additional 45% tax rate will remain payable on taxable income above £150,000 in 2016/17.

Reform of dividend income

Dividends are one of the areas pinpointed by the Chancellor as creating an imbalance within the tax system. The government announced that from April 2016 they will remove the dividend tax credit (which is currently a notional 10% tax credit) and replace it with a new, tax-free Dividend Allowance of £5,000 per year for all taxpayers. Previously, an individual was entitled to receive dividend income up to the higher rate threshold (currently £42,385) before being charged income tax on the dividend income, as the notional 10% tax credit covered any tax due. The intention of the £5,000 Dividend Allowance is to safeguard those individuals with modest investments, so they will still not suffer tax on this income, but means that individuals with either significant share portfolios and/or shareholdings in their own business will now be exposed to greater levels of income tax on their dividend income.

The dividend tax rates will be set at:

- 7.5% for basic rate taxpayers,
- 32.5% for higher rate taxpayers and
- 38.1% for additional rate taxpayers

So for example, an individual who is currently a higher rate taxpayer earning £50,000 in dividend income will be worse off by almost £2,000 next year. However, an additional rate taxpayer with £5,000 or under of dividend income, will be £1,528 better off after this change.

Personal savings allowance

As announced in March 2015, the government is also introducing a savings allowance from 6 April 2016 (in addition to the dividend free allowance). This allowance will remove tax on up to £1,000 of savings income for basic rate taxpayers and up to £500 for higher rate taxpayers. The automatic deduction of 20% income tax by banks and building societies will cease from this date.

Capital Gains Tax

No significant changes on capital gains tax (CGT) were announced.

Capital Gains Tax rates

Current rates of CGT remain at 18% to the extent an individual has available basic rate band, 28% thereafter. The rate for disposals qualifying for Entrepreneurs' Relief continues to be 10% with a lifetime limit of £10m for each individual.

CGT annual exemption

The CGT annual exemption is currently £11,100.

For most Trustees the annual exemption is currently £5,550.

Whilst key changes were announced in the March budget to Entrepreneurs' Relief, the only further change announced relates to investment managers and the capital gains tax treatment of 'carried interest'. Previously these individuals may have received a sum chargeable to capital gains tax which was linked to the successful performance of a fund ("carried interest") and they paid tax at CGT rates (i.e. up to 28%) instead of income tax rates (up to 45%). Going forward such payments for carried interest will effectively be taxed as income.

Private landlords

Major changes to the taxation of private rented property were announced. These will affect many individual landlords:

- Interest relief on mortgages will be reduced for higher rate taxpayers, the reduction being phased in over four years from 6 April 2017. From April 2020, mortgage interest relief will only be given at 20% for all taxpayers, whether they are liable to basic or higher rate income tax.
- From 6 April 2016 landlords will no longer be able to claim the 10% wear and tear allowance, but instead will only be able to claim the actual costs incurred in replacing furnishings. A consultation document will be issued shortly and this measure is expected to raise over £700m for the Exchequer.

Other property tax changes:

- The tax-free income threshold for the rent-a-room relief is to increase from £4,250 to £7,500 with effect from 6 April 2016. This applies where individuals let out a room in their only or main home, and can cover charges for food as well as accommodation.
- Landlords of furnished holiday lets will still be able to claim capital allowances.

Inheritance Tax

As had been widely reported, the Budget put forward proposals to bring into play an additional Inheritance Tax (IHT) nil rate band.

Main Residence Nil Rate Band

The nil rate band has been £325,000 since 2009/10 and it was announced that it will continue at this level until the end of 2020/21. However, there will be a new additional nil rate band when an estate includes a residential property that is passed on death to a direct descendant. This additional nil rate band will be £100,000 in 2017/18 and will increase by £25,000 annually so that by the end of 2020/21 it will be £175,000.

This new additional nil rate band will only be available in full where the net value of an estate (after deducting liabilities but before reliefs and exemptions) is below £2m. If the net value of an estate is above £2m the band will be tapered away by £1 for every £2 that the net value exceeds this amount.

In order to qualify, the property must have been the deceased's residence at some point. In the event that an estate contains more than one residential property, the personal representatives will be able to nominate which property should qualify.

The measure is expected to cost the government over £2.6bn.

Inheritance Tax Changes: Trusts

There have been a number of recent consultations on changes to the rules concerning the calculation of IHT trust charges. Proposals were previously put forward

to simplify trust IHT calculations and put an end to tax planning involving 'pilot trusts'. However the resulting draft legislation was omitted from the Finance Act earlier this year. Supplementary notices contained within the Budget material advise that these proposals will now be taken forward and legislated for in the next Finance Act.

Non-Domiciled Persons

Significant reforms were announced relating to non-domiciled individuals, following on from recent consultations. A further consultation process is to start later in the summer and the intention is that legislation will form part of the Finance Bill 2016.

Currently, long term non-domiciled persons can claim the 'remittance basis' and pay up to the £90,000 remittance basis charge rather than suffer UK tax on their worldwide income and gains. In addition they will only pay inheritance tax on their worldwide estate if they are deemed domiciled in the UK. However, from April 2017 non-domiciled persons who have been resident in the UK for more than 15 out of the past 20 years will be treated as UK domiciled for all tax purposes.

Further proposals will impact non-domiciled persons who hold UK residential property through an indirect structure such as an offshore company or partnership. It is intended that, from April 2017, all such residential property will be within the charge to IHT. Again this is subject to consultation.

Farming

Extension of profit averaging period for farmers

As announced in the March budget, the ability for farmers to average profits is to be extended. Limited detail was provided at that time and the government announced a consultation. From tax year 2016/17, farmers will be able to average profits for the year of claim and the previous four years. HMRC are asking a number of questions on the precise form the new relief should take.

The proposal is that the new relief should retain many features of the old provisions, but the mechanism is yet to be decided. Views are sought on the following points:

- Should the new relief be more like the old one?
- Should marginal relief be abolished?
- Should claims be made annually or for all five years at once with an irrevocable opt-in?
- What form should transitional reliefs take?

It is important for individuals in the sector to feedback on this consultation prior to 7 September if they want to influence the form this new extended averaging will take.

Welfare Reform

Significant changes were announced in relation to the welfare state, in particular a shake-up of the 'Tax Credits' system and its successor the 'Universal Tax Credit'. Over the course of Parliament, these changes, together with housing benefit and other welfare reforms, are expected to significantly reduce government spending, with the objective being to make it fairer for taxpayers who pay for it, while continuing to support the most vulnerable.

Some more positive announcements were made, such as the commitment to introducing tax-free childcare to support working parents with the costs of childcare from early 2017.

Tax Credits

Key changes announced include:

- A reduction to the income threshold for tax credits from April 2016 from £6,420 to £3,850 per year.
- An increase to the taper rate applied to tax credits when you earn above the income threshold. Going forward, any tax credits awarded will be withdrawn at a rate of 48 pence for every extra pound earned above the income threshold (previously tapered at 41 pence in the pound).
- The child element of tax credits will no longer be awarded for third and subsequent children born after 6 April 2017. Those already in receipt of tax credits with an interruption of less than 6 months, will be protected. Also, children with disabilities will continue to receive the Disabled Child Element under tax credits and multiple births will be protected.
- From April 2016 the income rise disregard (this is the amount by which a claimant's income can increase in the year, compared to prior year, before the award is adjusted) will be halved to £2,500.
- The family element of tax credits from April 2017 will no longer be awarded when a first child is born.

Pensions

For an industry already hit with radical changes, further tax changes were announced by the Chancellor.

To pay for the additional inheritance tax nil rate band and to control the cost of pensions tax relief at this time, a 'pensions tax' was announced by the government.

From April 2016 the government will apply a taper to the annual allowance for those with incomes in excess of £150,000 including pension contributions. For every £2 of income in excess of £150,000 the annual allowance for pension purposes (currently £40,000) will be reduced by £1 down to a minimum of £10,000 gross.

The impact of this is that if someone with income in excess of £150,000 contributes more than £10,000 gross (the net contribution required being £8,000) there may be a clawback of pensions tax relief.

The government have advised that in order to ensure this 'pensions tax' is targeted at the higher and additional rate tax payers, individuals with income (excluding pension contributions) below a threshold of £110,000 will not be subject to a Tapered Annual Allowance.

Reforming pensions tax relief

The reform to pensions does not stop here though, as the government has announced that in order to ensure the right incentives are in place to encourage people to save into pensions for the longer term, they will be consulting on whether pensions tax relief should be more fully reformed by, for example, offering greater simplicity and flexibility. Indeed the changes announced in March have gone some way to start to introduce such flexibility.

Taxation of lump sum death benefits

The government has confirmed that from April 2016 taxable lump sum death benefits paid from a registered pension scheme or non-UK pension will be taxed at a recipient's marginal rate of income tax.

Apprenticeships

The government will introduce a levy on large UK employers to fund new apprenticeships. The levy will support all post 2016 apprenticeships in England. It will provide funding that each employer can use to meet their individual needs. The funding will be directly controlled by employers via the digital apprenticeship voucher, and firms that are committed to training will be able to get back more than they put in. Further details will be given at the Spending Review.

Tax Lock

As mentioned in the Queen's speech, the government will set a ceiling for the main rates of income tax, the standard and reduced rates of VAT, and employer and employee (Class 1) NIC rates, keeping them at current levels.

The tax lock will also ensure that the NIC Upper Earnings Limit cannot rise above the income tax higher rate threshold. The VAT rates will not exceed 20% and the reduced rate of VAT will not exceed 5% and the lock will prevent the relevant statutory provisions being used to remove any items from the zero rate of VAT and reduced rate of VAT for the duration of this Parliament.

Business Taxes

Corporation Tax rates

In a move to ensure 'Britain is open for business', the main rate of Corporation Tax will be cut from 20% to 19% in 2017, and then to 18% in 2020, which is estimated to benefit over a million businesses to the tune of £6.6bn by 2021. This gives the UK the lowest rate of corporation tax in the G20 and it is hoped that it could increase GDP by between 0.1% and 0.2% in the long-term (£1.8bn to £3.6bn in today's prices).

Capital allowances

The Annual Investment Allowance, which gives 100% relief on capital spending such as plant and machinery, was due to reduce to £25k from 1 January 2016 but will instead be set permanently at £200,000 per annum from that date.

Payment dates for large companies

The quarterly instalment payment dates for companies/groups with profits in excess of £20m will accelerate from April 2017 to the third, sixth, ninth and twelfth months of their accounting period (currently they pay quarterly from the seventh month).

Corporate debt

This complex area will be reviewed as previously announced and revised from 1 January 2016. The changes are expected to be wide ranging, and include clarification of the relationship between tax and accounting for corporate debt and derivatives, new reliefs for 'corporate rescues' and new regime-wide anti-avoidance rules.

Acquisition of goodwill

The government will deny corporation tax relief on the cost of acquired goodwill and certain customer related intangible assets on all acquisitions on or after 8 July 2015. Any loss on the sale of goodwill will be treated in future as a non-trading rather than a trading expense which could limit relief. Tax relief for such payments currently follows the accounts amortisation.

Related party transfers of trading stock and intangibles

From 8 July 2015, the rules on such transfers will be tightened to ensure that they take place at market value for tax purposes.

Anti-avoidance

Unsurprisingly, the clampdown on avoidance continues with new funding and various new initiatives. To improve tax compliance among small businesses, the government will legislate to give HMRC the power to acquire data from online business intermediaries and electronic payment providers to help identify businesses that are trading but not declaring or paying tax. HMRC will consult on these proposals in July 2015. Other proposals include:

- extra investment between now and 2020 for HMRC's work on evasion and non-compliance.
- tripling the number of criminal investigations HMRC can undertake into complex tax crime, concentrating on wealthy individuals and companies.
- allowing HMRC to access more data to identify businesses that aren't declaring or paying tax.
- clamping down on the organised crime gangs behind the illicit trade in tobacco and alcohol.
- making sure international companies pay tax on profits diverted from the UK.
- introducing a 'general anti-abuse rule' penalty and tough new measures for serial avoiders, including publishing the names of people who repeatedly use failed tax avoidance schemes.
- legislation in the Summer Finance Bill 2015 to require financial intermediaries (including tax advisers) to notify their customers about the common reporting standard, the penalties for evasion and the opportunity to disclose.

Company distributions

The government will consult on the rules for company distributions in Autumn 2015.

A Business tax roadmap will be published by April 2016, setting out its plans for business taxes over the rest of the Parliament.

Employment Taxes

National Living Wage

In a move that is bound to please many, the government will introduce a new National Living Wage (NLW) of £7.20 an hour for the over 25s. This will take effect from April 2016 and will rise to over £9 an hour by 2020.

National Insurance

The government will raise the National Insurance Contributions (NIC) Employment Allowance from £2,000 to £3,000 a year from April 2016. As a result, up to 90,000 employers will no longer pay Class 1 secondary NICs. This increased allowance means that firms employing up to four workers full time on the new NLW will not see their contributions increased. Also, in Autumn 2015 the government will consult on abolishing Class 2 NICs and reforming Class 4 NICs.

Personal Service Companies

The government recognises that many individuals choose to work through their own limited company. However, where people would have been employees if they were providing their services directly, anti-avoidance legislation commonly known as IR35 introduced in 2000 requires that they pay broadly the same tax and NIC as other employees. The government has reiterated it is clear that the IR35 provisions are not effective enough. Non-compliance in this area is estimated to cost over £400m a year.

The government has asked HMRC to start a dialogue with business on how to improve the effectiveness of existing IR35 legislation. The government is keen to find a solution that protects the Exchequer and improves fairness in the system.

From April 2014, most businesses, charities and community amateur sports clubs have been entitled to an annual "employment allowance" of £2,000 to reduce their liability for Class 1 secondary NICs.

To ensure that the NICs Employment Allowance is focussed on businesses and charities that support employment, from April 2016, companies where the director is the sole employee will no longer be able to claim the Employment Allowance.

Employment intermediaries and tax relief for travel and subsistence

As announced at March Budget 2015, the government has published a consultation document alongside the Summer Budget on detailed proposals to restrict tax relief for costs incurred in relation to home to workplace travel for workers engaged through an employment intermediary. This could be an umbrella company or a personal service company where someone is working under supervision, direction or control. This will bring those individuals employed through an employment intermediary in line with others. Tax relief on home-to-work travel and subsistence expenses is not generally available to other workers. The changes will take effect from 6 April 2016.

Salary Sacrifice

Salary sacrifice arrangements can allow some employees and employers to reduce the income tax and National Insurance Contributions that they pay on remuneration by opting to exchange gross pay for certain non-cash benefits. Such schemes, most commonly involving pension contributions or childcare vouchers, are becoming increasingly popular and consequently the cost to the Exchequer is rising. The government has left the door open to cutting back on salary sacrifice and will actively monitor the growth of these schemes and their impact on tax receipts.

Termination Payments

The government announced that they are to consult on the simplification of tax and NICs on termination payments.

Indirect Taxes

Insurance Premium Tax

The standard rate of Insurance Premium Tax (IPT) will increase to 9.5% from 1 November 2015. This will apply to all premiums received by insurers using the cash accounting scheme. Insurers that use the special accounting scheme will have a transitional period whereby premiums received that relate to policies entered into before 1 November 2015 will continue to be liable to IPT at 6% until the end of February 2016. From 1 March 2016, all premiums received by insurers will be taxed at 9.5% regardless of when the policy is entered into.

Extension of VAT use and enjoyment rules for services

For repairs carried out under insurance contracts, use and enjoyment provisions will be introduced to ensure that all UK repairs made under UK insurance contracts will be subject to VAT in the UK. This is an anti-avoidance measure to deal with VAT planning structures in this area.

Further services such as advertising will be reviewed and possibly become subject to the use and enjoyment test to counteract VAT avoidance tactics of off-shore based structures used by VAT exempt businesses.

Vehicle Excise Duty

With a focus on generating funding to develop and improve the nation's roads, the government plans to significantly reform the Vehicle Excise Duty (VED) regime. From 1 April 2017, rates will vary as they do now based on emissions, but the policy goal is to ensure that those who can afford expensive cars, no matter how efficient, pay some tax on them. There will be no VED on zero emission cars. For all other vehicles there will be an annual tax of £140 but also a first year rate varying from £10 to £2,000 depending on the emissions. In addition, any car with a list price of greater than £40,000 will pay £310 supplement on the £140 standard charge, so a total of £450 each year for the first 5 years.

Existing cars won't be affected and the cash raised will be put into a roads fund in England (discussions are needed as to how an allocation will be made to Scotland).

Investor and Management Shareholder Incentives

There were a significant number of changes to the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trust (VCT) rules. Following a consultation on a number of features of the schemes and new state aids rules, changes will be made to:

- Specify the age of a company that is eligible for investment under EIS and VCT. Companies will need to raise money for the first time within 7 years of starting to trade, or 10 years for 'knowledge intensive' companies. In practice this is probably unlikely to affect many companies, as fundraising under EIS is usually secured in the early years.
- Cap the total amount of tax-advantaged investment a company may receive over its lifetime. The new lifetime limit will be £12m or £20m for 'knowledge-intensive' companies. There is an existing annual limit of £5m and these new limits will probably only affect a very small number of companies, most likely 'knowledge-intensive' companies now with a £20m lifetime limit.
- Stop the use of EIS and VCT money for acquisitions of businesses. This is unexpected but aligns the rules with a change that was made in 2012 to stop EIS money being used to acquire the shares of another company. Acquiring a business will not now qualify.
- Ensure that investors are independent from the company in which they invest. This will have more impact on existing shareholders in a company because the rule works by requiring that shareholder to have been a qualifying EIS investor already. There are already complex rules to prevent connected individuals from getting EIS relief.
- Introduce higher limits on total investment, age of company and number of employees to provide support for knowledge-intensive companies that are considered particularly likely to struggle to access finance. These new 'knowledge-intensive' companies will be companies heavily reliant on R&D and the 'carrot' for these companies will be the ability to raise much more under EIS or from VCTs.
- Simplify the interaction between SEIS and EIS. This is very welcome and will allow companies to raise money under both SEIS and EIS at the same time when shares are issued after 5 April 2015. This had been flagged in advance.

As well as these detailed changes, a new test will require companies to use the money raised under the EIS or from VCTs for the 'growth and development' of the company. This is in addition to the existing condition that money must be used for a qualifying business purpose and so is likely to have been brought in to help HMRC stop reliefs for contrived arrangements. This new test should not pose any difficulty for the vast majority of companies seeking to raise money under the schemes.

There are also two new technical changes that are likely to affect very few companies. The rules dealing with the clawback of EIS relief will be changed to allow the redemption of SEIS shares without affecting EIS relief, provided the original SEIS relief is repaid. In addition, the definition of farming is to be changed to make it clear that farming outside the UK is not eligible for EIS, SEIS or VCT support. UK farming is already prevented from qualifying for the reliefs.

Most of these changes will apply from Royal Assent.

Tax Reliefs and Incentives - a Food & Drink Focus
Research & Development Tax Incentives

R&D tax credits - encouraging innovation in the food and drink industry

The UK's research and development (R&D) tax credits scheme is amongst the most generous forms of tax relief available to companies. More than 15,000 companies claim over £1.4bn in relief each year; but too many companies in the food and drink industry that are carrying out eligible R&D activities are missing out on the opportunity to claim relief.

The Government are therefore actively seeking to improve uptake and raise awareness of the scope of the relief, and from a policy perspective, this makes perfect sense. R&D tax credits are designed to stimulate economic growth by promoting innovation. To achieve this, the R&D tax credits regime needs to drive investment decisions, which requires increased awareness of the scope of the relief amongst company decision-makers.

What are the benefits?

There are two schemes of R&D tax relief, with the more generous applying for smaller companies.

Smaller companies

Smaller companies are those with fewer than 500 staff, and either annual turnover not exceeding EUR 100m or an annual balance sheet total not exceeding EUR 86m.

Expenditure on R&D by smaller companies can qualify for a super-deduction at a rate of 230%. So a company with R&D expenditure of £100,000 in a year could deduct £230,000 in calculating its profits for corporation tax purposes.

If a small company is loss making, the additional loss arising from the relief can be carried forwards or

backwards, surrendered as group relief or surrendered in exchange for an immediate cash payment from HMRC.

For expenditure incurred from 1 April 2014, the cash repayment is 14.5% of the surrenderable loss. In the above example, if the company incurred £100,000 of R&D expenditure, the repayment would be up to £100,000 x 230% x 14.5% = £33,350.

Large companies

For companies not qualifying for the smaller companies' rate of relief, expenditure on R&D generally qualifies for a super-deduction at a rate of 130%. However, the regime has recently been made more generous by the introduction of the R&D expenditure credit (RDEC). This is currently available by election, but will completely replace the super-deduction from 1 April 2016. The RDEC is equal to 11% of the qualifying R&D expenditure. It can be offset against the company's corporation tax liability or, where conditions are met, taken as a payment from HMRC. This allows companies to account for the R&D tax relief as a grant.

Which activities are eligible?

The scope of R&D is much wider than commonly thought. R&D activity is not the preserve of scientists working in laboratories, neither is it limited to any particular industries. A project to reduce salt content in food products would be subject to the same eligibility criteria as work to develop a more cost-effective production process in a distillery.

What are the requirements?

To make a successful claim for R&D tax relief, a company must demonstrate that there is a project that seeks to achieve an advance in overall knowledge or capability in a field of science or technology through the resolution of scientific or technological uncertainty.

There are guidelines and conditions for the relief, which companies will need assistance to understand. But the scope of activities that can qualify for relief is broad and can be demonstrated by the following examples.

Advancing overall knowledge or capability

The advance must be novel to the industry as a whole, not just the relevant company. For example, the requirement relates to published or publicly available information, so if the particular advance has already been made, but details are not readily available (for example, because it is a trade secret), a project that sought to duplicate that advance could still qualify for relief.

An R&D project could also seek to use technology to duplicate the effect of an existing product, process or service, but in a new or appreciably improved way.

Scientific or technological uncertainty

Whether or not something is sufficiently uncertain is tested objectively. Uncertainty would exist where knowledge of whether something is scientifically or technologically feasible, or how to achieve it in practice, is not readily available or deducible by a competent professional working in the field (e.g. through discussions with peers or through established methods of analysis).

Provided it can be demonstrated to HMRC that the uncertainties would not be readily deducible by a competent professional in the field, the requirement for uncertainty should be met.

False starts and failures

A feature of the uncertainty involved in R&D is that not all projects will be successful. Projects that do not succeed or are not ultimately taken forward are still eligible for relief.

R&D activity outside the UK

There is no requirement that any proportion of the R&D activities is performed within the UK.

Outsourcing

Relief may be available for costs where the company has subcontracted specialist R&D activities to another party.

Case studies

The qualifying activities being undertaken by companies in the food and drink industry include:

- reducing salt content, whilst maintaining flavour and shelf-life.
- reducing packaging and increasing use of recyclables.
- recipe developments, including reducing content of particular ingredients either for health reasons (e.g. gluten-free ranges) or to reduce manufacturing costs. Likewise, developing products with increased content of particular ingredients.
- maximising production in aquaculture through innovative parasite control methods.
- development of innovative additives in food stuffs for livestock to maximise meat production.
- innovation in manufacturing processes (e.g. seeking cost savings through increased efficiency).
- innovative re-use of previously wasted materials (e.g. generating biofuels from waste products).
- extending the fruit growing season and maximising production through innovative pollination methods.

All companies in the food and drink industry should consider the extent to which they have been undertaking R&D and consider the benefits of claiming relief.

Enterprise Investment Schemes

Food and drink businesses

As well as providing targeted tax reliefs for businesses in the form of generous reliefs for capital expenditure and innovation, the Government is keen to provide reliefs for individuals investing into early stage and growing companies.

Two key schemes which many in the F&D industry benefit from are the Enterprise Investment Scheme (EIS) and The Seed Enterprise Investment Scheme (SEIS). Both aim to encourage individuals to invest in unquoted trading companies to help them to raise capital with the investor taking advantage of a variety of tax incentives in the form of both income tax reliefs and CGT reliefs. What is not widely appreciated it that with the right planning, it is also possible to deliver these benefits to the founders as well as future investors.

What are the EIS reliefs?

Income tax relief is given by way of a tax reducer, with an investor eligible to receive tax relief of up to 30% of their investment in a qualifying EIS company, up to £1 million. The relief however, will be withdrawn if the shares are disposed of within 3 years.

Capital Gains exemption - On the condition the shares are held for at least 3 years after the investment in the trading company, the gains on disposal of EIS shares are exempt from Capital Gains Tax (CGT). Capital losses on the disposal of EIS shares are allowable and can be set against income, after adjustment for income tax relief already given. The CGT exemption may be restricted if an investor does not get full income tax relief on the subscription for EIS shares. Losses are restricted by the amount of the EIS income tax relief still attributable to the shares disposed of.

CGT Deferral - Gains arising on the disposal of any asset can also be deferred if an investment is made in a qualifying EIS company. The gain is deferred and will become chargeable when the EIS shares are disposed of. There is no upper limit on the amount of deferral relief available to the investor.

What type of investment?

Qualifying EIS companies - Tax relief is available only for investment in a qualifying EIS company. A qualifying EIS company:

- Must be unquoted at the time of share issue, and no arrangement should be in place at the time for it to cease to be unquoted.
- Must have fewer than 250 full time employees and gross assets must not exceed £15 million.
- Cannot raise in any 12 month period more than £5 million under EIS.
- Must meet the financial health check requirement and must not be considered to be in difficulty.
- May be registered outside of the UK, but needs a place of business in the UK to qualify.

- Must be a trading company. Any company where the majority of income is derived from 'excluded' activities will not qualify for EIS purposes.

Qualifying EIS Investor - In order to obtain tax relief, the investor must not be a 'connected person' at any time during the period beginning 2 years prior to the issue of the shares and ending 3 years after the issue. Broadly this covers directors and employees and certain family members or has more than 30% of shares and/or votes.

SEIS relief

For SEIS relief, the rules are slightly modified:

- The investor is eligible for tax relief at a flat rate of up to 50% of their investment.
- For CGT purposes shares sold at a gain after, broadly, 3 years of issue should be exempt from CGT. Any shares sold at a gain within 3 years of issue may qualify for Entrepreneurs' Relief if certain conditions are met.
- As with EIS, any capital loss may be eligible for income tax relief after taking account of an SEIS relief is previously given. This can be deducted in computing the investor's net income.
- A qualifying investor will be able to invest up to £100,000 into qualifying companies in a tax year.
- The amount of relief cannot exceed the investor's tax liability for the year however; any unused relief can be carried back to the preceding tax year provided the limit for relief in the earlier year is not exceeded.
- A qualifying company cannot raise more that £150,000 under SEIS.
- The company must have less than 25 full time equivalent employees .
- The company's gross assets must not exceed £200,000 before any SEIS investment.
- The trade must be a 'new' qualifying trade, i.e. not one carried out by either the company or any other person for longer than two years when the shares are issued.
- The company cannot have previously raised funds through the EIS or VCT schemes.
- The investor or anyone associated with them must not be an employee of the company.

Case studies

We have assisted various F&D business raise funds under these schemes. The summaries above show how complex the rules can be, and it's essential to ensure proper planning and liaison between tax and legal advisers to achieve optimal results. Please find below, some examples of investments under these schemes:

- Producer and exporter of ready to eat products – SEIS on initial funding for founders and EIS on later funding rounds.
- Producer and exporter of ready to eat products – SEIS on initial funding for founders and EIS on later funding rounds. Funding raised under the schemes critical in helping it to get products onto the shelves.
- Producer of healthy snacks using innovative food preparation technologies – raised money under EIS which was key in supporting the development of the new technology.
- Manufacturer of traditional food supplement – capital secured under EIS helped to support early product development and now widely available at retailers.
- Whisky distiller – with very significant capital spending upfront a new distillery company raised significant new capital using the EIS. The tax reliefs will have been a key part of the equation for potential investors, although a fondness for the product may have played a part.
- Bottler and retailer of spirits – using EIS was key to securing the future of the business by allowing management to further develop markets and products.

To find out more on how to maximise R&D tax reliefs or EIS investment schemes, please contact one of the Johnston Carmichael F&D team.

VAT and Excise duty matters for Micro Brewers and Distillers

A reduced rate of spirits duty for Micro Distillers

Micro brewers have enjoyed a reduced rate of beer duty for over 10 years, and there is now a window of opportunity to lobby at an EU level for something similar for craft distillers.

In the UK all distilled spirits are subject to excise tax at a rate of £27.66 per litre of pure alcohol, on top of which 20% VAT is applied. The effect is that a 70cl / 40% vol. bottle of spirit pays £7.74 in excise tax before VAT which applies irrespective of the size of distillery and length of time it has operated.

An EU Directive provides for reduced rates of excise tax to be applied on the output from independent micro-distilleries but the thresholds were set in the 1980s and do not reflect current market conditions. The Directive currently allows for a reduced rate to be applied to the output from distilleries that produce less than 1000 litres per annum, an extremely low output which any commercially viable distillery would most likely exceed. A review (which is currently ongoing) of the Directive provides an opportunity to secure improvements that would benefit craft distillers.

The initial step would be to liaise with the Commission officials undertaking the review. Johnston Carmichael are in discussions with industry specialists who are preparing submissions to consultants employed by the EU Commission to carry out the early stages of the review. We would welcome any interested parties to get in touch as we continue to build an economic case and garner political support for change. If we can demonstrate that a groundswell of interested parties are calling for a reduced rate of excise duty in parity with the rates allowed for small brewers, the greater will be the chances of success.

Crowd Funding

Crowd funding is becoming an increasingly popular way to fund expansion and is proving particularly effective for breweries and distilleries as it has some obvious advantages. Notably, costs of raising finance are low and no financial return on investment is realistically expected by the majority of investors who are normally rewarded with a host of benefits other than dividends.

The benefits for investing can typically include a selection of the company's products, a membership that allows discounts on future purchases and preferential access to limited outruns. Access to the AGM which takes the form of a social event at the brewery or distillery is also obtained through the holding of shares. Reward with these types of goods and services are not only highly valued by the investor but also benefit the business with increased sales and customer loyalty.

One potential fly in the ointment is that where investors are provided with goods and services of considerable value, normally in excess of the real value of their shares,

HMRC could decide that VAT is due on the invested amounts. This would mean that 20% of the amounts raised are lost as VAT.

In February 2014 Johnston Carmichael approached HMRC for clearance of their views on the VAT liability of crowd funding. HMRC's position is that every crowd funding project will be considered on its own merits taking into consideration the contractual arrangements, the way the funding is advertising and any other relevant terms and conditions.

If the value of goods and services provided in exchange for investment is approximately equal to the amount the business receives, and the value of benefits given in exchange for funding increases in proportion with the value of the investment, it is likely HMRC will decide that VAT is due from the business.

If considering whether to raise funds through crowd funding, please speak to your local Johnston Carmichael contact or F&D team member beforehand to mitigate the risk that VAT becomes due on the amounts raised.

JOHNSTON CARMICHAEL

in association with

SCOTLAND OF FOOD & DRINK

Where sharp minds meet

Aberdeen
01224 212222

Edinburgh
0131 220 2203

Elgin
01343 547492

Forfar
01307 465565

Fraserburgh
01346 518165

Glasgow
0141 222 5800

Huntly
01466 794148

Inverness
01463 796200

Inverurie
01467 621475

Perth
01738 634001

Stirling
01786 459900

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