Smith & Williamson

# Land and Farming

A bulletin for landowners and farmers
**Winter 2017**

## In this issue

# Foreword
# A new beginning

Landowners and farmers have had to adjust and change to survive. This has always meant adapting to the climate, unpredictable weather, local politics, global markets, and changing technology. Today is no different, with Brexit and the fluctuating value of the pound posing both challenges and opportunities to land-based businesses.

In this edition of *Land and Farming*, we seek to explore some of those challenges - not least the end of the EU's Common Agricultural Policy in the UK and its replacement being considered by the Department for Environment, Food and Rural Affairs. We also look at some of the emerging possibilities presented by the use of renewable energy sources and new technologies, as well as the ways in which dairy farmers can either reduce costs dramatically or increase yields by taking an active decision on how calving should be handled.

This edition also explores the issue of inheritance tax, including how to navigate the potential pitfalls and mitigate the impact on family members. Farmers and landowners may also be reassured to discover insights on how to use the capital allowance scheme to claim for investments such as new machinery. In some cases, this may mean the farmer or landowner is eligible for a lower tax band - potentially helping to free up a little more capacity for the changes that lie ahead as we move towards March 2019.

We hope you find *Land and Farming* informative and as always, we welcome your opinions, comments and suggestions on the issues that are of most concern to you for the next issue.

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# Safeguarding your estate for the next generation

Recent increases in the value of land and property pose the prospect of significant inheritance tax bills for many landowners. Efficient tax planning can help.

Inheritance tax poses a dilemma for landowning families. The government can change the tax rules at every budget and it can be difficult for farmers and owners of landed estates to determine how to best protect their family's inheritance. Most want future generations to inherit and take on 'custodianship' of the estate when they die, retaining the estate in the family for the long term.

Historic planning for agricultural land assumed Agricultural Property Relief would cover the value of most of the estate assets on death. Over the years land values have risen significantly and many estates have diversified their activities. Buildings that were used for agriculture may have been converted for either commercial or residential use and farm cottages are now frequently let to "outsiders". Agricultural Property Relief is only available on property actually used for agriculture and the relief is restricted to the agricultural value: in other words, the value assumes the land can only be used for farming in perpetuity. A considerable percentage of the value of estate may not be covered by the relief.

The solution will be different for each case, depending on the particular circumstances, but the best advice is to plan early. Tax planning is certainly more restricted now than in the past and those who have entered contrived schemes are finding that the liabilities haven't necessarily gone away. However, sensible planning, making legitimate use of specific reliefs for certain assets, is perfectly valid. It is often well worth reviewing the position with a specialist.

A starting point is to make use of available exemptions. One can potentially make tax-free gifts to family where the gift is made seven years prior to the death of the donor. So if there is substantial wealth, it may be better to ensure that children and grandchildren benefit during your lifetime, rather than being saddled with a large inheritance tax liability after your death. Passing on 'non-relievable' assets early in this way may be preferred, particularly where the emphasis may be on preserving the estate as a single unit while also providing for those who are not expected to inherit the core assets; but watch out for capital gains tax.

Care has to be taken to make sure children and grandchildren have full enjoyment from their gift to ensure there is no "gift with reservation" which would mean that the assets remain in the estate of the donor at death for inheritance tax purposes.

Trusts are still particularly relevant in these scenarios: they offer protection for assets and for the younger generation, preserving the asset until any concerns over age and responsibility are allayed.

Trading businesses, agricultural property or woodlands, can benefit from inheritance tax relief. Valuable works of art, or a 'heritage property', can also benefit from inheritance tax exemptions, provided certain undertakings are given and continue after your death, including allowing the public reasonable access.

Making a will is vital, as is revisiting it regularly, ensuring that it is drafted in such a way that where possible, it does not encumber your inheritors with a significant tax liability.

Birthplace is also a factor to be considered: individuals born outside the UK who have not lived here for more than 15 years will usually not be liable for tax on their non-UK assets and they may also be able to benefit from use of overseas trusts. Families of UK citizens who die after they have permanently retired overseas may also face a lower tax bill.

While the themes may be similar, each case is unique. By spending a little time looking at your own situation with a tax adviser, you can help to keep significant assets in the hands of your family.

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# Brexit: coping strategies

As the UK hurtles towards Brexit, now is the time to consider how you can best prepare your farming business or landed estate.

2017 sees the 406th anniversary of the first performance of Shakespeare's The Tempest, at Whitehall Palace in London in 1611. A "violent windy storm" is a fitting analogy for 2017, a year that has been full of uncertainty and turbulence.

Centre-stage is Brexit, which continues to dominate the thoughts of many business owners as negotiators attempt to hammer out one of the most complex deals in recent history.

Although the final deadline for Brexit may be March 2019, landowners and farmers cannot simply wait for the final deal to take shape before deciding what to do next.

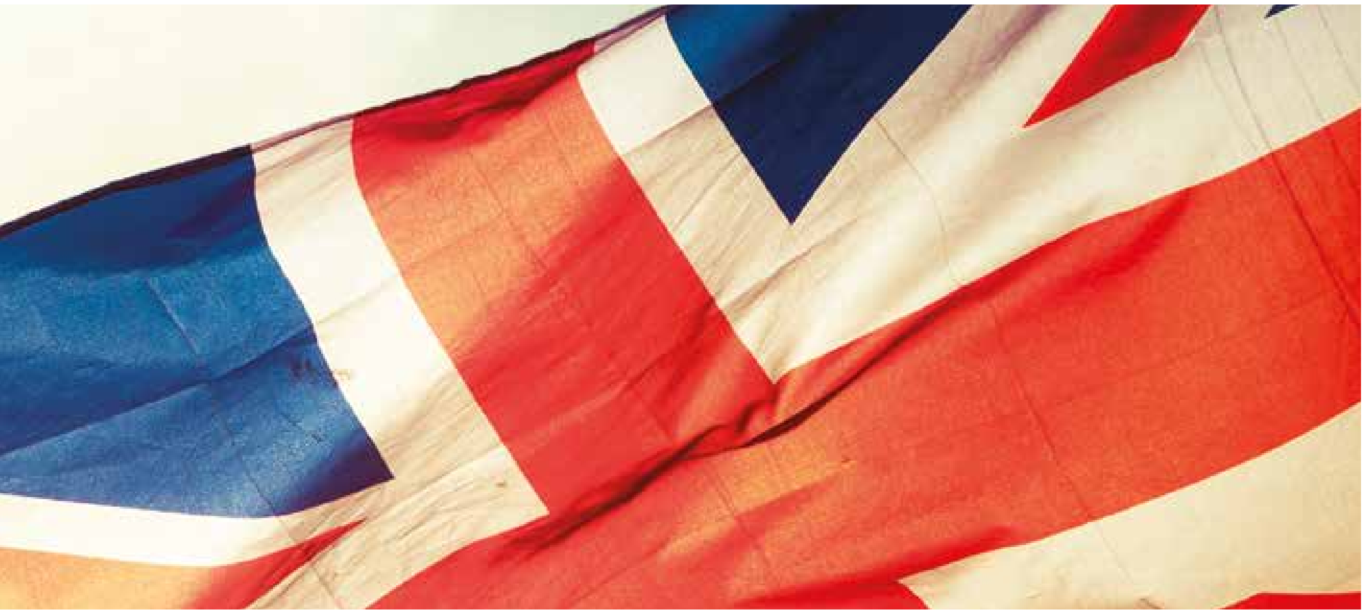
The adage "knowledge is power" has never been truer; well-informed landowners and farmers will be better placed to counter the risks ahead and take full advantage of any opportunities.

> SMEs are anxious about Britain's departure from the EU

## Understanding the nature of the problem

It would be surprising if landowners and farmers were not concerned. The Smith & Williamson Enterprise Index, which tracks sentiment among small and medium enterprises (SMEs), shows that they are anxious about Britain's departure from the EU. The first step to solving a problem is to identify it, so here are a few potential pitfalls to be aware of:

- **Cost control:** Foreign exchange movements have been masking changes to the Basic Payment Scheme (BPS) and crop prices. The fall in sterling has increased the value of payments, while inflation is yet to bite for many input costs. The BPS is up around 5% on 2016, but if sterling strengthens, next year's BPS could reduce: payments won't simply be 5% higher. Given that DEFRA will replace the BPS with an unknown mechanism when the UK leaves the EU, and early indications suggest support payments are likely to be lower, keeping costs down will help to ensure your business can weather the transition.
- **Access to workforce:** As sterling weakens and other economies improve, there is less incentive for migrant workers to enter the UK labour pool. Potential immigration restrictions and negative public reactions to incoming workers could also have an impact.



## Taking action

Understanding the potential difficulties is the first part of the solution. The second is to take action to mitigate them. Here are some of the steps that can help you to adapt your business:

1. **Maximise communication** with your bank. Your goal should be to ensure sufficient headroom to grow or diversify your business and secure long-term debt at favourable rates and with sufficient capacity to cope with leaner times.
2. **Revisit your accounts** and make a forecast. Do you have up-to-date information on the running costs, revenues and profits of your farming business or landed estate? Timely accounting information is vital to effective planning.
3. **Consider profit averaging** (two and five-year) to reduce tax liabilities, as well as how you can make use of capital allowances (for expenses such as investments in farming machinery) and lower-rate tax bands. You may see lower taxable profits, at lower rates of tax after claiming capital allowances, because the full cost of any eligible items might be fully deductible from taxable profits.
4. **Weigh up investments carefully** Current headline prices for dairy products look strong, while lamb prices dropped significantly at the end of September. Farmers may be tempted to increase dairy production, but if that happens, expect to see dairy prices fall off a little as production increases, as has been seen previously. It might be a good time to think through your options: invest in a particular sector or system of production for the long term or change tack and diversify while prices for dairy livestock and equipment are good.
5. **Digital-ready** Businesses must prepare for Making Tax Digital (MTD), which starts to come into effect into effect from April 2019 and will ultimately require every business to use the MTD system to comply with their VAT obligations and potentially report all income in the coming years. Only the smallest businesses are expected to be exempted. Cloud accounting services may be useful to help meet this requirement and putting appropriate systems in place at your own pace, ahead of MTD, could well be beneficial.
6. **Work out the indirect links** between your cash flow, your use of allowances, and the tax you need to pay. For example, if cash flow is tight or profits are expected to fall, you need to be aware of the impact on capital allowances. Reduced cash for investment might mean less capital expenditure and therefore lower capital allowances. In this context, profits may appear to be reducing but taxable profits (and liabilities) could be on the rise. When in doubt, seek advice.
7. **Consider introducing partners** where appropriate. The advantages of a partnership could include lower tax (since the partners are only taxed on their share of any profits, so lower rate tax bands might become available), as wells as more efficient use of labour and economies of scale.

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# Farming subsidies post-Brexit

**The Common Agricultural Policy will be replaced by new UK policies from 2019 onwards. With Department of Environmental Food & Rural Affairs (DEFRA) talking of a need to 'earn' support, farming subsidies are forecast to fall.**

Support for agriculture has been directed by the Common Agricultural Policy (CAP) since the UK joined what was then the European Economic Community in 1973. However, the vote to leave the EU means the UK will effectively have a 'blank sheet of paper' with which to set its future farm policy. But until Brexit formally occurs, the CAP still applies, which means farmers will continue to receive support under all the existing policies, including the Basic Payment Scheme and the Rural Development Programme.

Article 50 of the EU's Lisbon Treaty was invoked by the UK government on 29 March 2017 commencing a two-year period of negotiations between the EU and the UK. This means that BPS payments are certain for 2018.

The government has also announced support for agriculture will remain at the same level of funding until the end of the current Parliament, scheduled for 2022 (but an earlier general election is quite possible). However, while funding has been guaranteed, this does not mean the 'system' cannot be changed.

Nevertheless, it is doubtful that DEFRA and the devolved administrations would be able to draw up a new system in such a short timeframe, making it likely that a scheme similar to the BPS will be rolled over until a new policy can be drawn up, possibly in 2021.

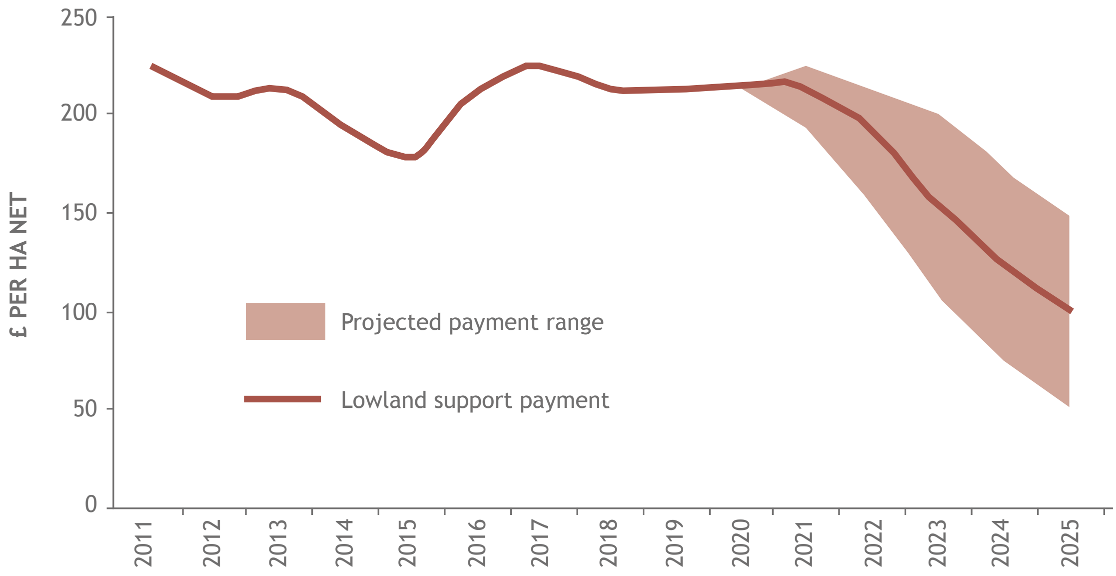
Although there have been 'positive' comments by Theresa May and the DEFRA Secretary Michael Gove with regard to future farm policy, there has been little detail. Future trade talks are also likely to have a bearing on policy, as there may be more political backing for farm support if agriculture receives a 'bad deal'.

Going forward, any new farm policy will have to be set within the UK budget and with other sectors such as education and the NHS competing for the same money, most people expect the level of support to be cut. Any reduction is likely to be phased, but by 2025 some commentators believe it is plausible that the level of support to agriculture may have reduced by 50%.

Once the UK has left the EU, there are many options open to policy makers; Michael Gove has said that subsidies will need to be 'earned'. Some options that have been talked about include:

- More emphasis on agri-environmental schemes, including more support for natural resources such as flood management and irrigation measures.
- Incentives such as payments to farmers who are willing to allocate farm ecosystems or natural resources to help alleviate challenges to society, such as flooding.
- Targeted support for sectors that are deemed to be more at risk, such as hill farms, small family farms and suckler cow farming.
- Support to increase the productivity of farming, including training and knowledge transfer.
- Insurance schemes to help farmers cope with volatility in the markets.
- Possible support to promote the British food brand to new export destinations. Support like this might not be seen in farmers' bank accounts but if it helps secure business, it is good for every producer.

**Figure 1:** Projected range of support payments for Lowland English holdings




*Source: The Andersons Centre*

Whatever the total amount of funds allocated for agricultural policy, if it is allocated according to a new policy with different objectives, the amount received by each farm will inevitably vary.

The concept of earning the subsidy suggests some effort in exchange for the support too, so changes to the farming landscape or practices might be expected. In the future it is quite feasible that there will be a range of support for farmers, some even getting a little more in per hectare terms, others much less (or even nothing) depending on what 'public good' hoops they are prepared to jump through.

All current recipients of farm support should be examining their management accounts to understand just how important the subsidy receipts are for the farm business and whether they could survive profitably if they were halved. It's a sensible preparation for the future.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**S&W comment**

Through our Land and Farming series, we will keep readers updated regarding key CAP announcements.

Support is likely to fall, that much is clear, though there may well be new opportunities if the focus for support changes.

In the meantime, businesses must plan accordingly for a reduction in support, through development of existing and new income streams, improving efficiency, as well as finding ways to add value to their produce wherever possible.

With interest rates forecast to begin to rise in the near future and inflation gathering pace, time may be running out to secure the lowest-cost longer term borrowings, which might enable businesses to invest now to increase diversification and establish new income sources ahead of the forecast reducing BPS income.

# A dairy dilemma for farmers?

The most profitable dairy farms per litre of milk produced are the top seasonal calvers but the UK market is dominated by all year round calving – time for a rethink?

A recent report by the Agricultural and Horticultural Development Board (AHDB) entitled *Delivering a more competitive industry through optimal dairy systems* recommends that UK dairy farmers should focus on one of two systems:

- **Block calving** – calving in a 12-week window either in the autumn or spring. All cows are served, meet peak production and are dried off together.
- **All year round calving (AYR)** – no seasonal emphasis on calving, no period where the entire herd is dry.

Contrary to perception, AYR is still by far the most common system followed by British dairy farmers. According to AHDB, 81% practise AYR compared with just 4% spring and 8% autumn block calving, raising the question of ‘how many have actually made a conscious strategic decision to follow an AYR calving system or have they just ‘fallen’ into it?’

The AHDB is encouraging producers to choose a system that “enables them to compete, matches their market segment, complements their mind-set and takes account of any on-farm limitations or opportunities”.

The table below shows the results for the five-year average to 2015/16 for the different systems, separating them into the average and the top 25% of producers for each.

| | Spring Calving | | Autumn Calving | | AYR | |
|---|---|---|---|---|---|---|
| Yield/Cow (L) | 5,572 | 5,418 | 7,878 | 7,859 | 8,005 | 8,161 |
| | Average ppl | Top 25% ppl | Average ppl | Top 25% ppl | Average ppl | Top 25% ppl |
| Income (Milk & calf sales) | 31.2 | 31.8 | 31.3 | 32.4 | 31.2 | 32.3 |
| Herd Replacement Costs | 3.3 | 3.3 | 2.6 | 1.9 | 3.0 | 2.5 |
| Variable Costs | 10.8 | 9.2 | 12.7 | 11.4 | 13.8 | 12.5 |
| Overheads (Cash and non-cash) | 13.8 | 12.0 | 13.7 | 12.3 | 13.5 | 11.7 |
| Cost of Production | 27.9 | 24.5 | 29.0 | 25.6 | 30.3 | 26.7 |
| Net Margin | 3.3 | 7.3 | 2.3 | 6.8 | 0.9 | 5.6 |

*Source: AHDB*

This demonstrates that, for each system, there is a large difference between the average producer and the top 25%. It also shows that the best AYR producers can achieve a margin comparable with the block calving systems, but it is crucial that the decision to operate an AYR system is consciously made rather than just by default.

Overall, the most profitable farms per litre of milk produced (and per cow) are the top seasonal calvers, primarily spring calvers. However, seasonal calving does require a higher level of farm and herd management to retain tight calving dates, meaning good fertility, effective oestrus observation and strict replacement policies to name but three management procedures that have to be robust.

Furthermore, the greatest opportunity of seasonal calving patterns is to reduce overheads by substantial levels, such as staff and labour. This is not so evident from the table but, at the extremes, the highest and lowest cost producers are likely to have overheads that differ by potentially 10ppl.

The AHDB notes: “Currently few milk buyers offer incentives large enough to justify the additional costs incurred by the farmer to produce a level milk profile.” All year calving is inherently more expensive as costs are incurred year-round.

Yet, to successfully run a herd in a block calving pattern requires discipline and tight management practices to prevent calving patterns from slipping and to keep costs as low as possible. AYR calving herds tend to yield more milk per cow than seasonally calving herds. Whilst higher yields mean there is more milk to sell per cow, there are also higher costs including concentrate feed per litre of milk.

For example, the *John Nix Pocketbook for Farm Management for 2018* quotes feed requirements of 0.325kg per litre of milk for an average all-year-round herd, costing 6.5p per litre. Meanwhile, the spring calving herd is fed 0.15kg per litre of concentrate feed, costing 2.7ppl.

Whilst the milk yield for the spring calving herd is 2,750 litres less per cow, the costs have remained far lower.

If you are a dairy farmer, have you made a conscious decision regarding your calving system? Those partway between the two are often in the worse situation, with high costs of production and low yields.


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**S&W comment**

Labour costs (and labour availability post-Brexit) are key considerations, particularly for larger dairy producers and practicalities such as availability and cost of appropriate seasonal labour should be considered.

Where profitability is changing, either through changing output prices or input costs, consideration should be given to the resulting movements in the tax position.

For example, changing profitability might result in the ability to make use of two or even five year farmers’ averaging, or planning for the efficient use of losses arising for tax purposes, reducing tax liabilities and payments on account due.

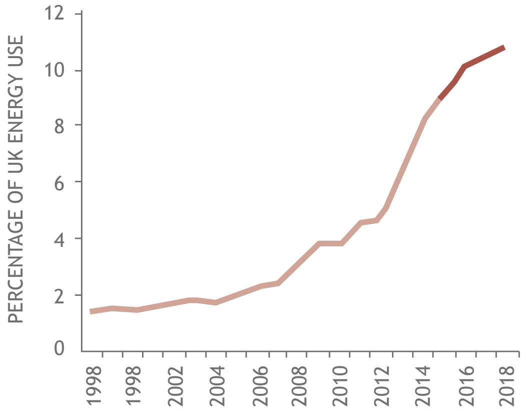
Understanding the immediate impact of the changes being implemented might result in tax payments on account needing to be reviewed, if perhaps there is a short-term reduction in profits during a period of change, preserving cash for investment in the business.

# Renewables: is a new opportunity emerging?

The UK is legally bound to provide 15% of its energy needs (including 30% of its electricity, 12% of its heat, and 10% of its transport fuel) from renewable sources by 2020. This is regardless of its relationship with the EU as this is a commitment from the Paris Climate Accord, an agreement within the United Nations Framework Convention on Climate Change.

In 2015, renewable energy accounted for just nine percent of the energy consumed in the UK, led by renewable electricity.

### Renewable energy use in the UK; percent of total energy use.




*Source: DUKES, Digest of UK Energy Statistics*

### Subsidies for renewable energy projects have slumped...

Whilst landowners and businesses with established renewable energy projects have guaranteed support via the respective incentive schemes, (primarily the Renewable Heat Incentive and Feed in Tariffs), the support available for new installations is considerably less than when they were first introduced. For example, the Feed in Tariff (subsidy) for electricity generated from small (10kw) solar panels in 2010 was 36.1p/kWh whereas it is now 4.07p/kWh, an 89 percent fall.

### ...but potentially profitable opportunities are emerging

This doesn't mean that there will be no new installations; indeed, capital and fitting costs have also more than halved, suggesting manufacturers were enjoying a slice of the generous subsidy, although cost of production has reduced also. However, it does mean that more careful calculations are necessary, to ensure there is a business case before investing. In some situations, renewable energy technologies are viable without subsidy at all, particularly where the energy produced can be used within the business itself.

The rise of the Smart Grid presents landowners and farmers with an opportunity to create new revenue, despite the drop in subsidies supporting renewable energy technologies.

> In some situations, renewable energy technologies are viable without subsidy at all.

The future of renewables in their current structure is limited by the divorce between supply (windy or sunny days) and demand (half time on a winter evening). However, a change is happening and the advent of Smart Grid technology means that some devices are able to use electricity to recharge when supply exceeds demand. Electric cars are expected to become commonplace in the coming years, and these might be a typical example.

The storage of electricity, which has hitherto been prohibitively expensive, is becoming viable, specifically to serve peak demand, again facilitated by Smart Grids.

It is early days yet, but the localisation of the electricity network, coupled with the mismatch between renewable electricity production and demand, means that lithium-ion battery storage may present an opportunity for some with substations adjacent to their land. Renting very small spaces to electricity network firms to locate such batteries, especially if linked to the renewable electricity generation technology on your farm, will, for some, be a lucrative use of a small corner of a farm.

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**S&W comment**
There can be various tax considerations to be made when evaluating renewables projects. Depending on its scale and nature - renewables projects may have implications for a wide range of taxes from VAT to inheritance tax and professional advice should be sought before entering any agreements or committing to a scheme.

# Interview:

## Tom Raynham talks with *Land and Farming* about inheriting and modernising an estate

# Setting a course for the future of the land

For the younger generation inheriting or taking over a historic house or farm (or possibly both), the question of how to adapt the estate for the needs of the 21st century poses a unique set of challenges.

Today's young inheritors often face a dilemma: the estate may be asset-rich but cash-poor. So what is the best solution to balance the desire to hold onto an inheritance that may have been passed down over generations, versus the need to adapt to a modern and post-Brexit world?

Tom Raynham used to be chair of the Historic Houses Association's next generation group, which seeks to answer some of the concerns its young members have, to find solutions and to develop a way forward. Having left a career with Knight Frank in London he is now CEO of an estate and farm near Fakenham, Norfolk.

"I want to make sure we don't rely on one or two sources of revenue," said Tom. "Historically, we focused entirely on arable and poultry farming. The business wasn't diversified enough."

Tom's farm is now a diverse business. The crops grown include wheat, barley, oil seed rape, beans and sugar beet. There is also a chicken farm, an Aberdeen Angus suckling cow herd, as well as a solar farm, an anaerobic digester, houses let out to locals, and a five-acre walled garden used for events. Plans are also afoot to partner with other businesses to make better use of the farm's historic buildings and stables – for example by partnering with a farm shop, a restaurant or a hotel – as well as potentially building log cabins for holiday visitors.

"I'm bringing a more modern take on farming," said Tom. "The first challenge after 15 years away from the estate was working out the role of a traditional country estate in modern times."

His approach involves using new technologies and techniques such as precision farming, using GPS connection in tractors to allow variable rate application of sprays and fertilisers having mapped out the farm with satellite imagery. This monitors the variations in soil quality (one part of a field may need more fertiliser than another). But perhaps the most impressive example of modern technology is the big investment that Tom made installing an Anaerobic Digester (AD) plant, which he uses to produce gas directly into the mains supply. The feed material is all sourced from the farm and is fed into the AD plant, where it is broken down to produce methane, which is in turn fed into the gas mains. Meanwhile, the by-product of the process, digestate, is used as fertiliser – which allows the farm to reduce its reliance on environmentally damaging chemical fertilisers.

"I'm very keen that the different parts of my business complement each other", said Tom. "For example, we add value to the stock we produce by placing them under our brand to sell to local markets, restaurants and then through the different outlets that we aim to have on the estate."

Tom's estate also rents out an old airfield to a company that has installed a solar farm over 225 acres – one of the largest in the UK – which produces enough electricity to power 12,000 homes.

Broadband access has been another area of focus for Tom, who recently spent the best part of a year battling with BT Openreach to get broadband installed. In the end, he turned to a private company, Air Broadband and got them to lay a private cable to get fibre-optic broadband to the farm. Tom believes broadband is a priority for the next generation of landowners, and says the government could be doing more to improve access to high-speed internet connectivity in rural areas.

"There are third world countries with better broadband and phone signal than the UK" said Tom. "That is partly because their governments helped to drive private and foreign investment into the sector, they also do not have a monopoly that we have seen with BT Openreach."

One of the most notable things about Tom's estate is the positive approach he uses to find solutions. For example, the farm is located near Fakenham in Norfolk, with the main arterial road to the coast, the A1065 road, running through the middle of it.

"Nearly two million vehicles pass along that road each year," said Tom. "We have great buildings and a fantastic location, but we are not currently in a position to renovate these buildings ourselves. What we're focusing on now is attracting businesses that will benefit from our location as we are at the gateway to the coast. We are aiming to partner with operators of farm shops, cafés and retail outlets to give these buildings a new lease of life."

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