

Taxation Implications of Compensation

There is concern that FMD compensation may trigger a large tax bill. Compensation is treated differently depending on whether or not a herd basis election is in force.

Herd basis

The simple answer is that if a herd or flock on the herd basis is culled and not replaced then the compensation proceeds are tax-free. If animals on a herd basis are replaced within 5 years at a lower cost than the compensation then the 'profit' may be taxable.

Where replacement animals are of a lower quality than the animals replaced, the taxable proceeds for each animal are limited to the cost of the replacement and the balance is not taxable, e.g. compensation £1,100 per cow, replacement cost £700 then provided the replacement cow is of lower quality then the £400 'profit' is not taxable. If animals of the same quality are bought as replacements, but the compensation proceeds exceed the cost of replacements then the 'profit' is taxable.

Faced with a potential tax bill it may be worth bringing in a new partner and making a fresh herd basis election before replacing any stock. The new partnership or business would then be able to build up numbers without the original proceeds becoming taxable.

No herd basis

Compensation for youngstock and animals not on the herd basis will be treated as a trading receipt and any profit compared to their purchase cost or opening stock value is taxable.

However, where slaughter is compulsory and this includes slaughter of dangerous contacts, the farmer has a fresh opportunity to make a herd basis election for the breeding flock or herd. The rules outlined above would then apply. Take informed advice, this election may well be advantageous. By Inland Revenue concession, compensation under the welfare scheme is also treated as compulsory slaughter compensation and if not on the herd basis the farmer has a fresh opportunity to elect for the herd basis.

The profit on animals where no herd basis election is available e.g. youngstock, can be deducted from the taxable profits for the year when received and spread in three equal instalments over the following three years. This together with averaging provisions and loss relief should mean that the 'profit' escapes the most punitive rates of income tax.

Chartered Accountants Nick Dee, Hazlewoods

Group Activity Brings Benefits

The formation of farming groups is occurring around the country in the effort to make the best use of resources and to collaborate in producing quality products and services. This co-operation can be either formal or informal and groups can operate in a number of different ways. Firstly they can co-operate in production where they share resources such as labour and machinery in order to complete operations more cheaply and efficiently with considerable benefits for both parties.

Secondly, co-operation in purchasing by accumulating smaller orders within the group, enables farmers to obtain goods more competitively through placing bulk orders which can qualify for discounts and often obtain better services.

Marketing co-operation is another group benefit which involves co-ordinating the production of numerous small units within a programme based on consistent quality and a regularity of supply, thus gaining access to new markets. This may also involve a degree of quality assured processing and packing.

Other forms of co-operation include training and education for farmers and their staff. This will enable the use of modern technologies and skills which may improve efficiency and access to new markets or enhance returns from existing markets.

For farmers directly affected by Foot and Mouth through the loss of livestock and/or income, there is the potential to rebuild their businesses as part of a farmer group.

If you are interested in developing a group and would like assistance in planning and establishing this activity, there is the opportunity to obtain funding for a dedicated group adviser through the Farm Business Advice Service. For those interested please contact Ciaran Gannon at the Rural Development Service, Nobel House, 17, Smith Square, London SW1P 3JR or telephone 020 7238 5791.

Business Recovery Contact Service Helplines

The Rural Development Service (RDS) is now operating *Business Recovery Contact Helplines* for all farmers affected by the foot and mouth outbreak. These helplines are manned by RDS staff with extensive knowledge and experience of farming and farm business matters. The helplines, based at RDS offices around the country, have been established to help farmers take their ideas forward in the wake of foot and mouth. The regional numbers for farmers to contact are shown below:

South West:

Taunton 0845 6015064

West Midlands:

Worcester 0845 6015069

Wolverhampton 0845 6015067

North West:

Crewe 0845 6015053

Penrith 0845 6015062

North East:

Newcastle 0845 6015056

Yorks and Humber:

Northallerton 0845 6015058

East Midlands:

Lincoln 0845 6015427

Eastern:

Cambridge 0845 6015423

South East:

Guildford 0845 6001720

This newsletter has been prepared as a topical guide for farmers affected by the foot and mouth outbreak. The Editor, Martin Ryan, would welcome any comments or suggestions you may have concerning this newsletter. Martin can be contacted via, RDS, Room 334, Nobel House, 17 Smith Square, London SW1P 3JR



farming progress

DEFRA
Department for
Environment,
Food & Rural Affairs

Rural
Development
Service

FMD Recovery Newsletter

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Planning the Future of your Farm Business

Ciaran Gannon, Agricultural Policy Adviser, RDS

For those farmers culled out as a result of foot and mouth disease, this summer will appear to be unreal. No livestock, no daily routine, forage to be made but no stock to feed. A tragic time. A traumatic time which will never be forgotten. However, you do have a unique opportunity now, to assess how to take your business forward so that its future is based on a secure and robust footing and better able to respond to the challenges that the whole industry will have to face.

Your approach will relate to your business and personal objectives and the hopes and ambitions of your family. Every farm is different, but you need to recognise how your business was performing before the outbreak and put this into the context of the likely economic situation for most farm enterprises in the near future. If you do not aspire to be a top 20% performer in terms of profitability, you need to ask yourself: 'what are my farming aims and will I be able to generate enough profit through farming alone to meet the needs of myself and my family'.

Some farmers may decide to retire or there may be opportunities to buy or lease land and increase the size of your enterprise. You will need to ensure that this form of expansion is profitable and does not put your whole business at risk. In recent years UK farming has lost a significant number of full-time staff and it may be difficult to retain skilled workers. This may lead to greater use being made

of family labour. If you intend to rely more on the family are they all happy with this prospect? If access to skilled staff and employing family members is a problem, is there potential for sharing labour and machinery with a neighbour?

Collaborating with neighbours to reduce costs is one opportunity for you to consider. What are the others?

Some farms are adding value to their products and developing brands. Some are balancing food production with conservation activities, in effect they are marketing their farm environment. Some are developing a whole range of non-farming sources of income and some are collaborating to give themselves more personal freedom. Many farmers are now classified as part-time and some have retained ownership of all their farm assets but someone else undertakes the farming.

There is much to think about. Make sure you understand the changes that are around the corner for farming and discuss and clarify with the whole

family what they want out of the farm business for the future. Seek advice on how to take your business forward so it can respond to opportunities.

Get involved...

There is currently a wide range of business advice available to farmers to help over the coming months. You will find details of some of these services in this newsletter.





What is the Rural Development Service?

The main function of the Rural Development Service (RDS) is to implement the various schemes under the England Rural Development Programme (ERDP). These schemes include the Energy Crops Scheme, the Rural Enterprise Scheme (farm diversification), the Vocational Training Scheme, the Processing and Marketing Grant Scheme, the Farm Woodland Premium Scheme, Woodland Grant Scheme (run by the Forestry Commission) and the agri-environment schemes (Countryside Stewardship, Environmentally Sensitive Areas and Organic Farming Schemes). The RDS operates throughout England via regional offices with staff from farming, environment and rural economy backgrounds. If you want to discuss any of the schemes mentioned above, contact RDS via the numbers given on the back page.

The Farm Business Advice Service

This service is available to farmers to help them plan their businesses. Between 3 and 5 days of free business advice is available from experienced business advisers who are contracted through Business Link to deliver the service. More information can be obtained via the RDS contact numbers on the back page.

The Red Meat Market

Duncan Sinclair, Meat and Livestock Commission (MLC)

The confirmation on 20 February 2001 of an outbreak of Foot and Mouth Disease in the UK has had, and will continue to have, consequences for red meat supplies over the coming years. This article presents a brief outline of initial MLC analysis of the impact on the domestic cattle, sheep and pig sectors.

Cattle

- Over 720,000 cattle have so far been lost to FMD and associated culls including the Welfare Disposal scheme. This represents 6%* of the UK cattle herd. Of this an estimated 40% are breeding cows while the remainder are a combination of potential slaughter stock or animals retained for future breeding.
- The loss of this slaughter stock will directly impact on UK beef supplies through until 2003. Prime cattle supplies are estimated to fall by 13% in 2001 as a direct consequence of FMD.
- There has been some reduction in beef consumption. Despite this and the loss of potentially 60,000 tonnes of domestic production in 2001 due to FMD, there is expected to be some increase in imports of beef to meet demand.
- Once re-stocking begins, there is a strong possibility that heifers originally destined for slaughter will in the short-term be retained for breeding. This may lead to a further decline in UK beef production in 2002.
- EU beef consumption is slowly recovering. However some important EU export markets such as Egypt remain closed and beef is being stored in intervention once again. Irish supplies are expected to be plentiful this autumn.

Sheep

- To date an estimated 16%* of the sheep breeding flock (at least 2.8 million head) has been lost to FMD and associated culls, including welfare disposal.
- The loss in breeding sheep, and despite some reduction in flock productivity due to management problems and poor weather at lambing, is expected to result in a 20% decline in UK prime lamb supplies in 2001.
- Over 30% of UK sheep meat production is exported annually. Despite the loss in domestic lamb supplies, due to lack of export markets, it is anticipated that there will be an excess of lamb supplies over demand of at least 1 million lambs.
- With exports of sheep meat in Great Britain unlikely until at least next year, the loss of the export market is expected to place lamb prices under severe pressure when supplies are at their seasonal peak this autumn.
- Re-stocking and recovery in the sector is likely to be a slow process and unlikely to occur before 2002.

Pigs

- FMD-related slaughterings of pigs have reached 380,000, equivalent to over 6%* of UK pig numbers.
- The UK pig breeding herd contracted by 28% in the 3 years to December 2000. Numbers are still declining in 2001 due to a combination of FMD, the Pig Industry Restructuring Scheme, disease problems and continuing unprofitability of production.
- The number of pigs caught up in FMD infected areas has been less than for cattle or sheep. More significant for the pig sector has been the ban on exports, which historically have represented over 20% of national production.
- Pig slaughterings are forecast to be down by 15% in 2001, the lowest for over 30 years. No significant recovery is likely before 2003.

*Once the June 2001 census results are published, these estimates may be subject to revision

Milk

what is the market potential?



Predicting the future has always been a risky business, but those producers who have had their dairy herds culled as a consequence of the FMD outbreak need to look closely at the industry and make some well informed decisions about the future of milk production in Britain.

Farmers need to ask themselves if they want to return to milk production, if it is a viable option and if so, at what level? To answer these questions professional advice is essential. A starting point is to look at the market for the product. The short term estimates of the market for milk show in theory a potential shortage of milk due to the culling process.

As far into the future as we can envisage, milk and milk products are going to be consumed. There is a market for the product. But where is the milk going to be produced? Of the approximately 14 billion litres of milk produced in Britain roughly half goes to the fresh pasteurised market. Unless the consumer takes a sudden liking to UHT, the market is substantially isolated from competition from imports and the consequent impact of world prices.

With the continuing shift of milk from doorstep delivery to the supermarkets, control of the retail market has moved into a very few hands. The supermarket business is itself very competitive and milk is seen as a commodity, therefore the chances of a substantial price re-alignment are remote both in the short and longer term. So the market for 50% of milk produced is likely to be tightly controlled for the foreseeable future probably not giving much better returns than are currently being experienced.

The other 50% of milk goes into manufactured milk products where the potential returns from the market are directly related to international competition. Production continues to increase across the world and there are areas, such as Eastern Europe, which have the potential for significant increases. On the flip side to this the market for dairy produce grows. There is a view that around the rest of the world cheese consumption will continue to grow but liquid milk sales are likely to suffer erosion, as lifestyles change and competition from other drinks grows.



supermarket retail domination and world prices, British ex-farm milk prices are destined to move within very limited upper and lower levels with little or no upward movement in real terms.

For a producer contemplating re-investment in milk production he/she needs to give detailed consideration to efficiency and cost of production to provide a substantial margin within these relatively static price parameters.

In light of this it is important to evaluate the past performance of the dairy business. Can compensation payments be used to improve the efficiency of the business? Are there opportunities to be found in niche markets?

Brian Peacock, Milk development Council

Is organic farming for you?

Elizabeth Bowles, ADAS Adviser delivering the Farm Business Advice Service in the South West

Over the past two years there has been extraordinary interest in converting to organic farming systems with the area of agricultural land being managed organically doubling in this time period.

Before deciding to convert to organic production you need to ask yourself the following questions:

1. Are you committed to the ideals of organic farming?
2. Is it practicable?
3. Is it economically feasible?

You are entitled to a free day-and-a-half of advice from Organic Conversion Information Service (paid for by DEFRA). An experienced organic adviser will visit you and help you to look carefully at the potential of your business for organic conversion. Telephone. 0117 922 7707 for more information.

If conversion is practicable then the economic feasibility should be looked at including cashflows for the conversion period. This is very important especially as for many farmers conversion to organic farming will reduce output and hence cashflow may be affected.



Financial aid may be available to assist you with the costs of conversion under the Organic Farming Scheme operated by DEFRA as an ERDP scheme. The payments currently offered under this scheme are shown in the table below.

Year	AAPS Eligible land and permanent crops £/ha	Other Improved land £/ha	Non Improved land £/ha
1	225	175	25
2	135	105	10
3	50	40	5
4	20	15	5
5	20	15	5
Total	450	350	50