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Agriculture & Rural Business **Newsletter**

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Now, for tomorrow

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Looking back at 2020
- and forward to the future

David Missen | Head of MHA Agriculture

Welcome to the first of the MHA Agricultural Newsletters and farewell to what can only be described as a tumultuous year. For most people 2020 will be remembered as the year of Covid 19, lockdowns, furloughing and in some cases, acute financial hardship. For the agricultural sector, it may, in the long term, end up being equally memorable but perhaps for different reasons.

Certainly one should not play down the impact of the pandemic on the sector. Some businesses, particularly in horticultural production, saw considerable disruption in their staffing, and in the early days there were real problems on some dairy farms as contracts were unilaterally reduced or terminated.

However, for many agricultural businesses, so far at least, the impact of the virus has been relatively muted. Most arable farmers do, by the nature of the job, lead a fairly isolated existence, so lockdowns have not led to major changes in the day's work.

Prices of most commodities have held up fairly well, and disruption has mostly come second hand with delays in the supply chain (sometimes in both directions) and of course the cancellation of the rare chances to get away from the farm at county shows or events such as Cereals and Lamma. No doubt many clients will also regret missing the opportunity to meet friends and neighbours on the shooting field or even to meet their accountants in the office (but no doubt will be hoping that the missed meeting may result in a lower fee!).

When the dust finally settles however, 2020 is still likely to be seen as a memorable year. We have seen a number of fundamental changes in the way the industry works, which will probably be with us long after Covid has either been forgotten or become part of life.

Firstly, the passing of the Agriculture Act marks a key change in the way farms will earn their keep in future. Without going into the detail, we will see, over a relatively short timeframe, the removal of a subsidy regime which has, in one form or another, been with us since the Second World War. In future, subsidy will not be linked to food production, nor to land ownership, but will instead depend on environmental performance. However it is worded, many farmers are to be encouraged to move away from being producers of food towards becoming guardians of the environment. It is not entirely clear how this will work in global terms, since reduced food production in the UK would seem to lead to more intensive exploitation of the land elsewhere in the world, but, staying with our own backyard, there will need to be a complete and detailed reappraisal of how a farm will be run, what it will produce, and how to continue making a living.

Secondly, we are already in the midst of what Michæl Gove has called "the fourth agricultural revolution" – it is an interesting exercise to identify the three previous ones, and some would argue that we are probably on the fifth or sixth. Nonetheless, he is right that major changes are in progress, in artificial intelligence, robotics and gene editing, all of which may lead to significant improvements in productivity. In addition to all these, and unforeseen when he made his speech in 2019, Covid 19 has had the side effect of putting the entire middle-aged population of the country through an intensive course in IT skills over the last 9 months, which may help the revolution on its way. At the same time, we have discovered that, for a huge proportion of the population, working from home is a real alternative – with knock on effects on the rural economy in future which might include more jobs, better services, better broadband, more vibrant rural communities and probably a rebalancing of property prices between the urban and rural sectors.

Finally, we are seeing the effect of Brexit, which will, rightly or wrongly, overturn nearly 50 years of history, disrupt trading patterns and extract the UK from a post-war philosophy of protectionism. After numerous delays and complications, the protracted negotiations on a new trade deal finally concluded just before Christmas. Barring any last minute upsets in the ratification process, we now know that the impact of Brexit on agriculture will be profound but not as catastrophic as some feared. It is to be hoped that it will enable the positive outcomes inherent in the Agriculture and Environment Acts to be achieved and will enable productivity to increase unrestricted by EU bureaucracy. At the least, we will continue to have good access to and from our neighbouring markets which, if not frictionless, will be free from tariffs. At the same time we will have greater freedom to develop new and perhaps more promising markets elsewhere. Time will tell how these issues will pan out.

So yes, whilst the farming industry has not suffered from the pandemic in the way that has happened for the hospitality, leisure or high street retail sectors, the changes which have occurred in 2020 have been profound, and the consequences will work through over the next few years.

For some, this will be a period of great opportunity. Others may decide that now is the time to hand over the reins to the next generation, whilst there will also be those for whom this will be a change too far and they may consider leaving the industry altogether. As accountants, we have normally been quick to embrace new technologies (even if the cutting edge is not always the best place to be) and as the changes start to bite, we will be there to help our agricultural clients plan their way.

Pain Today Jam Tomorrow?

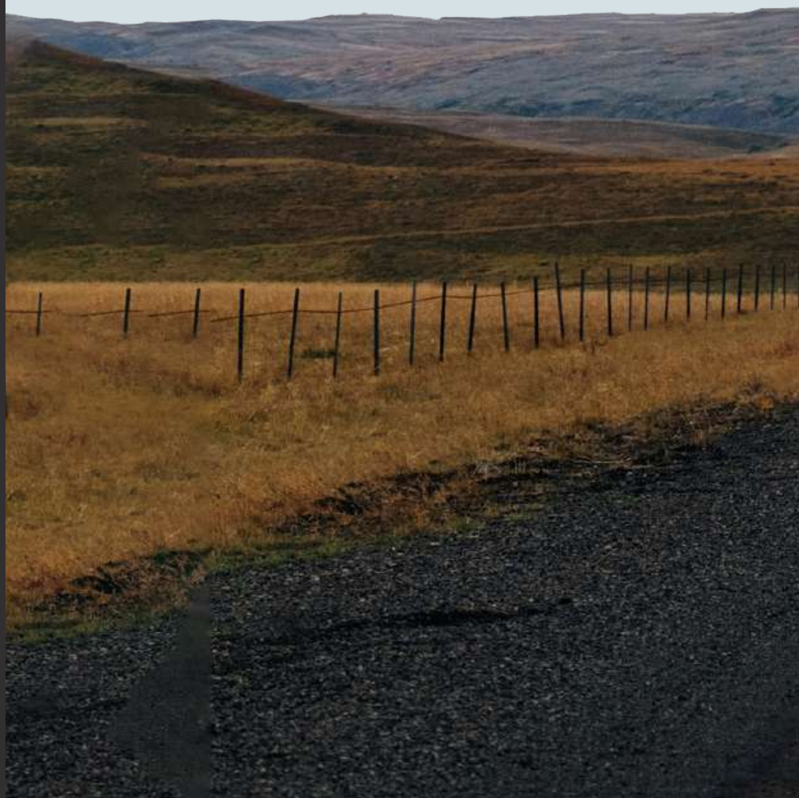
It is not often that agricultural finance makes it into the front pages of the daily newspapers, but George Eustice's presentation to the Oxford Farming Conference on 30th November did precisely that.

Andrew Perrott
MHA Monahans

The whole document runs to some 66 pages, so unsurprisingly has been paraphrased by commentators. It gives some further details of a range of new initiatives, but more importantly for most farm businesses, it also elaborates on the effect which the first few years of the new regime will have on existing farm subsidies.

The withdrawal mechanism is set out in tabular form, but it is actually surprisingly simple. In 2021 the Basic Payment Scheme (BPS) subsidy will be reduced by 5% on payments up to £30,000, 10% on the next £20,000, 20% on the next £100,000 and 25% on anything above £150,000. The deductions are cumulative, so for example, a recipient of £40,000 in 2020 would see his 2021 payment reduced by 5% on the first £30,000 and 10% on the balance leaving him with £37,500. Over the three succeeding years all recipients will see 15% annual

> **Farmers have been waiting for this news for some time and it contains little to surprise us other than a certain amount of jam tomorrow.**



reductions, so his subsidy cheque will drop by £6,000 each year until by 2024 it will be £19,500 only. No detail is given of reductions in the last three years of the scheme, but we do now know that by 2024 all farms will have lost at least 50% of their direct payments and some may have lost nearly 70%.

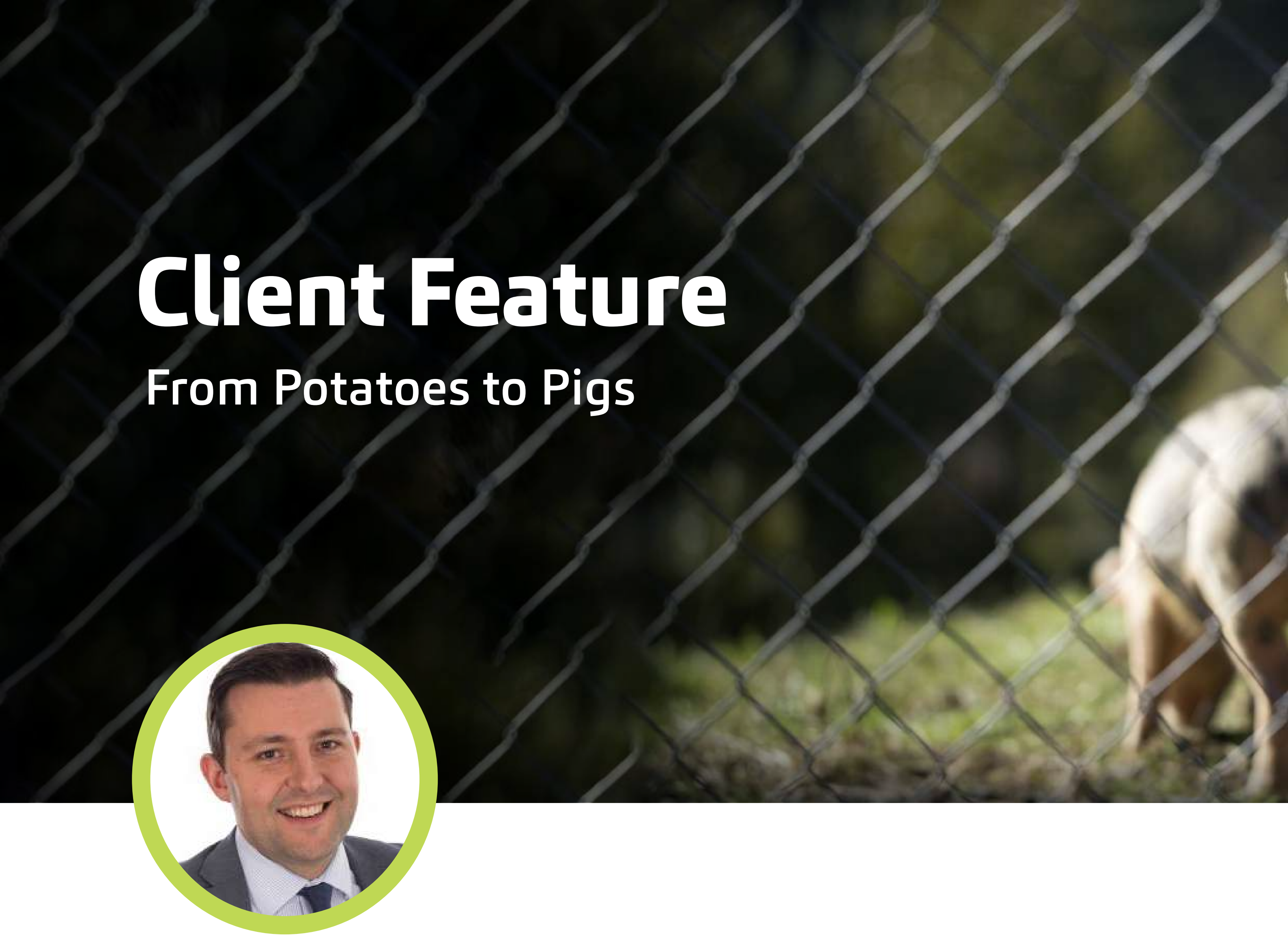
In addition to confirmation of expected bad news, the paper also offers some comfort. There is confirmation that the agricultural support budget will, in aggregate, remain unchanged over the life of this parliament, with the direct payments that have been withdrawn flowing into alternative and more targeted measures. In 2022 there will be a "Sustainable Farming Incentive" (SFI) scheme which will reward those whose farming methods "improve soil health, enhance hedgerows and promote integrated pest management". The existing Countryside Stewardship schemes (CSS) will continue to be available until 2024 – although there would seem to be some overlap, benefits provided under SFI must be additional to those provided under CSS. Looking further into the future, SFI looks very much like the basic level of earlier environment schemes such as the old Entry Level Scheme, and it has been designed as one which most farms will be able to easily adopt. The higher tiers of the Environmental Land Management Scheme (ELMS) will become available after 2024 and broadly will involve habitat creation or restoration on a local or landscape level.

In addition to ELMS, the paper offers several new initiatives in the future, including:

- A slurry investment scheme from 2022 to give funding for the improvement of slurry systems
- Schemes for tree planting, peatland restoration and nature recovery from 2024
- A specific and time limited package to help those farming within "protected landscapes"
- Measures to promote animal health and welfare including grants towards handling facilities, diagnostic testing and some associated veterinary input.
- Grants for water storage, precision farming machinery, specialist forestry equipment and some sorting and processing plant
- Help for new entrants from 2022 partly via the County Farms Network
- An exit scheme from 2022 to help farmers who wish to retire by way of enabling them to take remaining subsidy payments as a lump sum.

It will be noted that whilst the withdrawal of BPS is outlined in some financial detail, the precise terms and amounts of the successor schemes are still somewhat vague.

Farmers have been waiting for this news for some time and it contains little to surprise us other than a certain amount of jam tomorrow. The BPS payments represent a major source of income for many farming businesses and now that the timescale for their removal has been confirmed, there can be no excuse for failing to grasp the nettle of restructuring and re-organising.



Client Feature

From Potatoes to Pigs

Joe Spencer
MHA MacIntyre Hudson

Father and son, Nigel and Callum Bates, farm 600 acres in partnership on fenland on the outskirts of Peterborough - and since 2017 their farm has undergone significant development.

Previously, the farm had produced a mixture of cereals and potatoes but Nigel and Callum calculated that the cost of producing the potatoes on their scale, and with an element of tenanted land thrown into the mix, was not sustainable, so a decision was made to move away from this crop.

Following advice, they looked at an Anærobic Digestion (AD) Plant, coupled with some housing to undertake Pig Bed & Breakfasting (PB&B). The plan was that the AD Plant would be fed by maize grown on the land and the energy produced would not only be sold back to the grid but also used to heat agricultural buildings which would house the pigs. Furthermore, the pig muck could then be used as a fertiliser for wider farming cropping.

However, following further investigation into the cost of the AD build, how this would be structured and what tariffs could be achieved in respect of the energy production, it was realised that the figures were just not viable and as such the AD Plant element was shelved.

Undeterred, Nigel and Callum were even more keen to ensure that their PB&B project did stack up, both from a financial perspective and a wider farm operational perspective too. Callum now joined his father in partnership and, like many other farms, the impact of a new partner

With Callum having finished at agricultural college and Nigel recognising “something had to change” both realised that to improve margins and returns they had to make better use of the farm’s natural assets through diversification projects and the embracing of technology.

in the business meant that the farm needed to be financial sustainable in order to support two households.

With this in mind, various financial modelling work was undertaken to consider the impact of the projects, both on ability to fund and income generation. The implementation of the PB&B resulted in a regular cash flow into the farm, which enabled Nigel and Callum to be more flexible and responsive when new opportunities arose - something that has been key to growing the business and diversifying further.

Even without the AD plant, the pig units still benefited from climatised conditions, which has enabled the farm to be a top performer in terms of mortality rates - increasing the margin of return on this activity. Callum, who takes the majority control of the pigs, can review and monitor the barn temperature at the touch of a button – ensuring the pigs are growing in a high welfare environment. Further developments will be an underfloor heating/cooling system – enabling the pigs to be kept at the perfect temperature in both summer and winter.

The pig muck is still used as fertiliser on the farm and this has benefited both crop performance and cashflow - and with these two activities running hand in hand both Nigel and Callum are delighted with this diversification and the variation it has bought to the farm.

With the PB&B project underway, father and son were able to act responsively when new opportunities arose - one of which was for them to increase the amount of contracting work undertaken in the most recent harvest year.

Of course, on the horizon is the loss of Basic Payment Scheme income from 2021, so Nigel and Callum, like many others, have been working on exploring ways to replace this lost income. They are keen to learn as to what the new ELMS will bring, but the detail is yet to be provided. Instead of waiting, they have been working on installing a Bund - to effectively store surface water run-off and prevent soil erosion, one of the elements of ELMS.

Key to the decision making and implementation of these plans has been the relationship Nigel and Callum have with their advisers, MHA MacIntyre Hudson. By taking time to assess and test the projections, the correct decisions have been made in terms of diversification, which has provided the farm with a springboard to grow further.

Commenting on the project, Callum said “Though it was decided that the AD Plant was not the route to take, lessons were learnt by my father and myself, particularly around how to consider planning of future projects, the timing of when the work would be required and also the use of renewable energy options. It was a demanding project but worthwhile

Can British agriculture survive in world market?

It seems like a lifetime ago that one could attend live agricultural shows and gaze at the latest gargantuan piece of machinery.

Keith Porter
MHA Moore & Smalley

Occasionally a client would wistfully remark that although they would like to own such kit, it would do all the work on the farm in a week and then sit in the shed for the rest of the year – if only there were a shed big enough, and indeed if it could make its way down the farm drive in the first place.

The conclusion was generally that these machines were almost display models only, with barely a handful being sold in the UK and the bulk of production destined for Canada or Australia where they could operate, unhindered by a network of hedges and rural lanes which were set out to widths defined by a horsedrawn cart.

The more serious point is that of how the UK will be able to compete, particularly in the field of commodity crops, when other parts of the world are engaging in production on a far more massive scale. Evidence of this comes not only from the ever-increasing size of machinery, but also from the growing involvement of multi-national companies (and sovereign wealth funds) in agricultural production. The tenor of the current trade talks with both the EU and the USA are also indicative of the development as is the growing move towards larger farming units. Within Europe and the UK such growth in farm size has been limited (some would say because of the protectionist nature of EU rules) with UK farms currently averaging 86Ha in 2019, only 4 Ha higher than the figure 9 years ago. By comparison, in Australia the figure is 4300 Ha, in Canada it is 340 Ha and in the USA and New Zealand it is about 250Ha. Over 40% of the Ukraine is in farms of over 500Ha. In Europe as a whole the average is 16Ha, with only the Czech Republic having a larger average size (130Ha) than the UK.

Notwithstanding the disparity in farm sizes, cereals are a global commodity and with low worldwide transport costs, a tonne of wheat is worth much the same anywhere in the world. Part of the reason for this must be protectionist policies and this might provide at least part of the explanation for the small size of European holdings. It does not, however, give the whole story. Whilst there are certainly economies of scale at the machinery and labour level, when one looks at input costs per tonne of production (rather than per Ha), there is a remarkable level of similarity worldwide. In a 2015 Australian benchmarking study*, Australia and North America both showed input costs of about£60/ tonne of production, almost exactly the same as the Nix figure for the UK. Interestingly the same study showed labour and machinery costs per tonne as being much the same in both Australia and Europe (though about 30% lower in North America.

When one looks at worldwide wheat yields, the position becomes slightly clearer. We know that bumper harvests in Canada, Australia and the Black Sea area have the potential to destabilise world markets, but these countries have a far greater degree of volatility than mainland Europe and, specifically, the UK. Australian wheat yields over the last ten years have averaged about 2 t./Ha and in some years as little as 1.6T – indeed in some areas of low rainfall there is sometimes no harvestable crop. In the breadbasket of the Ukraine yields are up by 30% from 20 years ago but still only stand at 4T/ha. Again, late frosts can significantly reduce the cropped area - if not the tonnage/Ha where crops do survive. In the USA and Canada yields are also typically around 3T/Ha. By comparison, and despite what most would regard as a far higher level of environmental awareness, the average UK yields have been between 8 and 9 T/Ha over the last 5 years. Given that production costs are not dissimilar worldwide, the impact of yield disparity will be one of the major drivers behind land price differentials, with European land being roughly double the price of that in the USA and ten times that of Australia.

Perhaps, then, the outlook for UK agriculture is not as black as it is painted.

We certainly do not enjoy the economies of scale that can be seen elsewhere, but we do benefit from consistent output, highly fertile soils and generally favourable weather patterns, as a result of which our profitability per Ha is comparable with other producers and at least partly as a consequence, our land is significantly more valuable – if only we had more hectares!

Shooting

Don’t shoot yourself in the foot with HMRC

Marissa Lebeau
MHA MacIntyre Hudson

Going shooting is often part & parcel of life in the countryside but what considerations should you be mindful of regarding possible tax implications?

A shoot becomes a business once the attendees extend beyond family and friends. If this happens, then HMRC will consider the shoot as commercial. Any advertising or mention on a website is a sure sign of commercial shooting and again HMRC will decide that any contribution made is a supply for VAT purposes.

Understanding who is VAT registered, who owns the shooting rights and where all the costs of the shoot sit, is fundamental. If an individual is making various supplies, then the VAT threshold of £85,000 will extend across all supplies regardless of whether they are treated as different sources for accounting or tax purposes.

For VAT purposes, if you, as an individual are VAT registered then it is important to prepare a shoot account each season to demonstrate that any contributions made to the shoot by family and friends can be considered contributions and not subscriptions, which are treated as vatable supplies.

Watch out for the extent of losses, are they enough to cover at least one gun? Remember to recharge the use of machinery, vehicles, labour used by the shoot, from your VAT business to the shoot account. Make sure all of this sits in your private account, in drawings or completely outside of any business accounts. This includes the purchase of poults.

With those owning steep and wooded valleys, planted for shooting, having your own shoot is one of the benefits of your estate. It is important though to consider all tax consequences, by annually reviewing the status of your shoot. Is it still private, or have you crossed into a trade for VAT purposes, for example?

One supply often missed is the right to shoot. If the right is owned in a company or business, especially non corporate entities with land on the balance sheet, the right to shoot is a deemed supply and as such attracts VAT. It is important to get a valuation of this annual supply, to establish the value of VAT which should be accounted for. You may be surprised how valuable this is. Watch out too, for benefits in kind in companies and other hidden tax consequences.

If you are part of a shooting syndicate, your share is rarely a business expense. The business element is seen as incidental, just like a golf subscription. Care must be taken that this is not included in business accounts.

On top of the consideration of business versus private and VAT, it is important to understand the requirements of employing gamekeepers and paying casual staff.

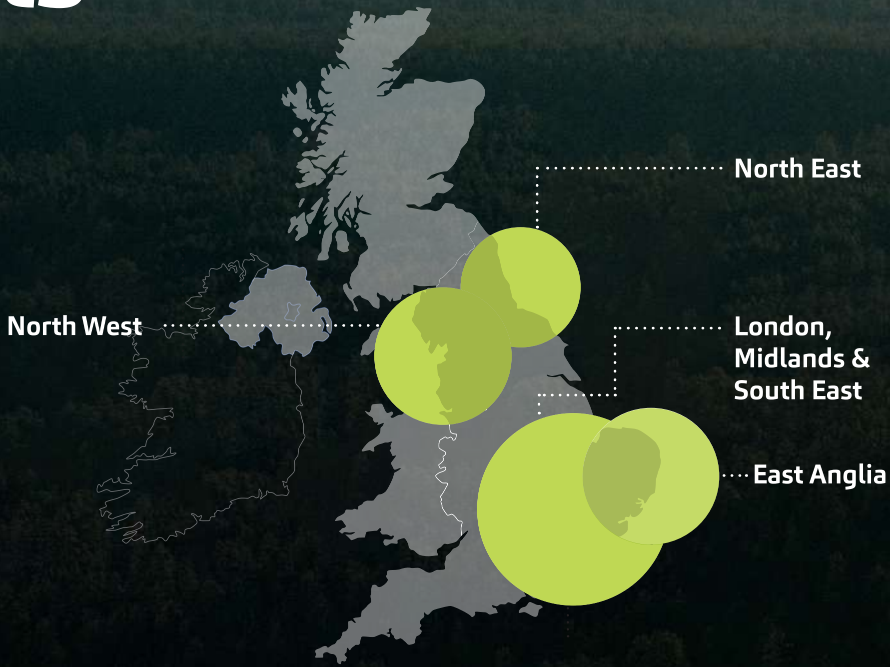
If an employee is used across different businesses on the same estate, then a joint employment contract should be in place. If this is done than there is no supply from one business to another for labour services. As such these costs should not attract VAT. Don't forget to consider the wider costs of employing the employee, such as housing costs, training and other sundry items. These should be shared.

PAYE and Real Time Information (RTI) requirements can be onerous for hiring casual labour such as beaters. These requirements affect all shoots including private and syndicates.

Where an casual beater is paid below the NI lower earnings limit (currently £120 per week) the employer will be outside the scope of RTI. However, this does not absolve you from your responsibilities which come with paying an individual. Payroll records must still be kept.

On top of all the above operational considerations, is the strategic question. Should the shoot be run commercially to improve the inheritance tax position. This is were the whole position should be kept under review. Having a good adviser, actively meeting with you and included within your estate professional team is vital.

MHA Agricultural Contacts



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