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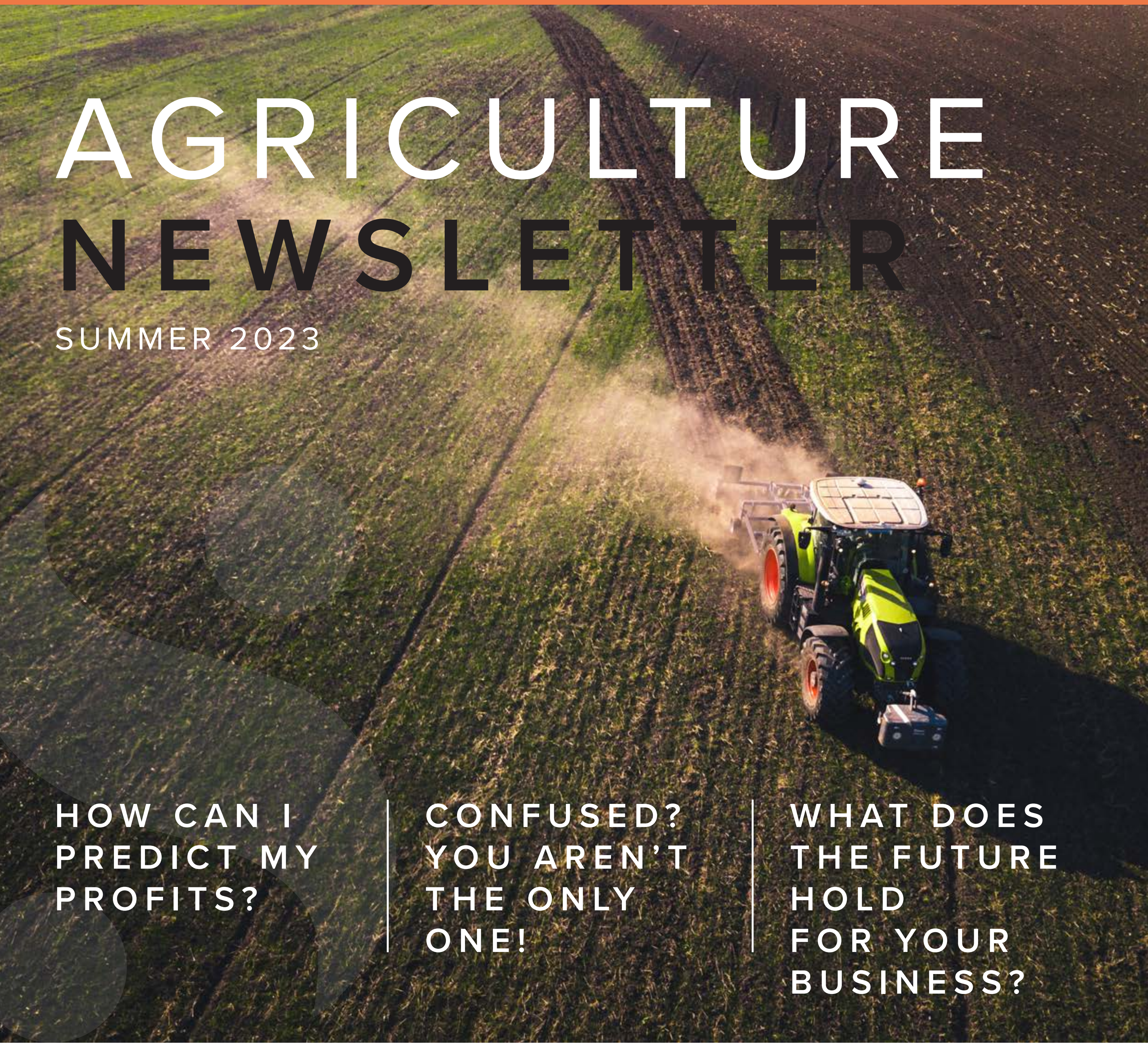

AGRICULTURE NEWSLETTER

SUMMER 2023

HOW CAN I PREDICT MY PROFITS?

CONFUSED? YOU AREN'T THE ONLY ONE!

WHAT DOES THE FUTURE HOLD FOR YOUR BUSINESS?

"There is a famous saying that 'nothing is certain, except death and taxes', but I would add that change is also a certainty, and one which we have had to get used to in abundance over the last 12 months.

In that time, Britain has seen Boris Johnson resign from office as prime minister, another prime minister come and go, and a third come to office. There have been four chancellors, two mini budgets, an autumn statement and a full budget.

The war in Ukraine shows no sign of ending, and we are still experiencing problems due to it. We are also still suffering supply chain issues in the aftermath of COVID and BREXIT. The economic and financial climate continues to move at a rapid pace across all sectors, and farming is no exception.

However, amongst all of the unwelcome changes and unexpected challenges, there are so many opportunities for investment and new income streams for farming businesses. The Sowerby team are here for you every step of the way, to advise you on the opportunities available to you, to provide practical and technical support to you and your business, and to keep you up to date with all the regulatory changes."

Richard Skewis

PARTNER - FCCA

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IN THIS ISSUE

HOW CAN I PREDICT MY PROFITS?

WHAT CAN WE TAKE FROM THE UPS AND DOWNS OF RECENT GROWING SEASONS TO HELP US DECIDE WHAT MIGHT HAPPEN IN THE FUTURE?

As every farmer knows, no two growing seasons are the same – after all, farmers have been dealing with the unpredictable British weather since the beginning of time! But recently there have also been other major external events thrown into the mix; I am of course referring to the war in Ukraine and the ongoing after-effects of COVID-19.

The past year alone has been a rollercoaster of opportunities and challenges, starting with a heatwave during the 2022 harvest which meant that many farmers had completed the harvest by early August. However, what should have been a relaxing time whilst they waited to sow the following year's crop was filled with anxiety over the increasing cost of inputs.

Then, with all of the winter crop in the ground, the springtime was overshadowed by more anxiety as it didn't seem to stop raining between February and May. This caused significant delays to the sowing of spring crops, especially potatoes and peas.

Pictures of flooded fields with the caption of fishing for potatoes or peas seemed to be the norm within farmers WhatsApp messages. Fortunately, the belated sun at the end of May has enabled most farmers to sow all their spring crop and catch up.

Meanwhile, costs continued to be challenging, and supply chain issues (for everything from fuel to fertilisers to farm machinery) have added significantly to the growing list of challenges facing farmers.

WHAT WILL THE EVENTS OF THE LAST TWO GROWING SEASONS MEAN FROM A FINANCIAL POINT OF VIEW?

2020/21 Growing season – 31 March 2022
The financial position for many farmers following the 2020/21 growing season was very positive.

2021/22 Growing season – 31 March 2023
In the Spring of 2022, the news in the farming sector was understandably dominated by the rising cost of fertilisers and chemicals. The reality, however, was that the cost of the inputs during the sowing season were not that different to the prior year, and with the heatwave during harvest, the amount of fuel needed was significantly reduced. It also seems to have been an extremely good year for yields.

This, coupled with the increase in cereal prices, means that many farmers will have seen a significant increase in profitability in this year.

This won't have been true for every farmer of course; profits will always depend on yields and on how well each farm has sold the crop. Those who chose to sell the crop forward early will have missed the significant increase in prices.

In truth it is the average price that each crop has been sold for that is the most important, not the highest or lowest price per tonne. Even for those who have sold forward early, the average will have been significantly better than previous years.

WHAT EFFECT IS THIS LIKELY TO HAVE ON FUTURE PROFITS?

The increased profitability of the 2021/22 growing season will however cause a potential issue with an increased tax liability due in January 2024, once tax returns have been submitted.

For unincorporated businesses, the availability of farmers averaging may offer a degree of relief but ascertaining the tax payable as early as possible will be crucial.

2022/23 Growing season – 31 March 2024
It is always dangerous to forecast what the outcome will be for farmers before the crop has actually been harvested, however that is what accountants and business advisors need to do.

The cost of inputs for this growing season will be significantly increased, so the financial position of the farm will depend on the yield and the price for the crop.

If we assume that the yield will be lower than those achieved in the previous year, we get back to the average price per tonne for the crop. It will come down to whether farmers have sold forward their crop to understand the overall position.

WHAT EFFECT IS THIS LIKELY TO HAVE ON FUTURE PROFITS?

The significant fall in cereal prices could mean that some farmers who haven't sold any of the crop forward are left looking at a breakeven position, or - worse still - a loss. Although, whilst writing this, the price of cereals has increased again, but not to the same degree as last year.

This is likely to come at a time when the farm business will have a significant tax liability due to the profitability of the previous years, as previously mentioned. Once again, the averaging provisions may offer a degree of relief if profits have fluctuated significantly.

Obviously, the results for each farm business will vary depending upon individual circumstances.

WHAT DO WE NEED TO BE AWARE OF WHEN PREDICTING FUTURE PROFITS?

CASH IS KING

Everything that has happened in recent growing seasons highlights the overriding view that cash is king, or to be more accurate 'the availability of cash is king'. Profit does not necessarily mean that the farm business has surplus cash to cover large tax liabilities, particularly if the farm business has decided to invest in new projects or diversity. In these circumstances extreme care must be taken to ensure that any such projects are adequately funded, without impacting on the ability of the farm to settle its existing liabilities.

It is imperative that a farm business forecasts and plans for the future, to

ensure that it can manage its cashflow. It is likely that any forecast and plan will need to be amended along the way, however that is to be expected and does not make them useless.

RISK MANAGEMENT

I know that many farmers do not like selling their crop forward, or those that do, don't like to sell forward too early out of fear that they may be unable to fulfil any contract that they enter. However, it's essential to manage risk, especially in these uncertain times.

The significant cost increases in inputs may mean that farmers need to sell some of the crop forward, to ensure that they can offset the costs against the high sales prices. I know there is always the 'Fear Of Missing Out' (FOMO, as the youngsters call it), but hedging against the down side is sometimes required.

At Sowerby we understand the financial demands of agriculture, and between the partners we have over 100 years' experience in helping farm businesses optimise their cashflow and risk management. If you would like to talk to one of our farming experts please call us on 01482 888820.

RICHARD SKEWIS

Richard Skewis has over 30 years of expertise helping farming clients diversify.

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CONFUSED? YOU AREN'T THE ONLY ONE!

With all the changes in government, a mini budget, autumn statement and then the spring budget, what has actually happened to taxes and allowances?

TAXES AND ALLOWANCES ON INCOME AND PROFITS

INCOME TAX

There have been no changes to the rates of income tax, only a freezing of the allowances.

The main change is a reduction in the level at which the additional rate of tax, 45%, is paid. You now only need to earn £125,140 in 2023/23 before you start to pay the additional rate of tax.

Whilst the additional national insurance levy was removed for trading profits, it has remained for tax on dividends. This means that dividends are still taxed as follows:
Basic Rate Taxpayer – 8.75%
Higher Rate Taxpayer – 33.75%
Additional Rate Taxpayer – 39.35%

Averaging
There have been no changes to the rules on averaging, either for 2 years or 5 years.

Pension Saving Tax Allowance
I know that many farmers do not like to use pensions as a tax planning tool, however the increase in the allowance from £40,000 to £60,000 could be of help to many whose profits take them into the additional rate of taxes.

CAPITAL ALLOWANCES

This is an area that the government seem to have tinkered with significantly over the years.

Annual Investment Allowance (AIA) - there were concerns that this was

to be reduced significantly, however, following the budget they confirmed that this would remain at £1 million. This means that any business receives 100% relief on the first £1 million of plant and machinery purchased in the year.

Super deduction – this was only available to Limited Companies, and was introduced so that they didn't defer capital expenditure until corporation tax rates increased to 25%. This meant that companies would receive 130% relief of the cost of plant and machinery purchased, or 50% for assets in the special rate pool. Whilst this ceased on 5 April 2023, it is still relevant where an asset is sold after that date.

Full Expensing – again this is only available to Limited Companies, and allows a full 100% tax deduction on qualifying plant and machinery with no upper limit. This could be useful for larger farms who have spent more than the £1 million AIA.

Electric Car Charging Points – you receive 100% allowance for the cost of these which falls outside the £1 million AIA.

Structure and Building Allowance (SBA) – you receive 3% straight line allowance each year.

There are complex rules to follow for each of the above allowances and it is therefore vital to seek professional advice.

CAPITAL TAXES (SALE OF A CAPITAL ASSET, CAPITAL GAINS TAX, AND INHERITANCE TAX)

CAPITAL GAINS TAX (CGT)

The rumour mill has been working overtime again on likely changes to CGT. Will we really see the rate of tax on CGT aligned with income tax? If so, this will have significant implications when selling assets, as the current rates of 10% to 20% would be replaced by rates of 20%, 40% or even 45%.

However, there have been rumours of changes for years and we should not let the 'tax tail wag the dog'. You should make plans as normal.

Most farmers are not natural sellers, instead they tend to leave the farming assets to the next generation, so this should not have a significant impact. For those that do not have any succession in place, they will need to take advice on the full implications before making any decision.

One area that has changed is the reduction in the annual exemption for capital gains, which has been reduced from £12,300 pa in 2022/23 to £6000 from 2023/24 onwards.

There was a significant change to Entrepreneurs' Relief a couple of years ago, now called Business Assets Disposal Relief (BADR).

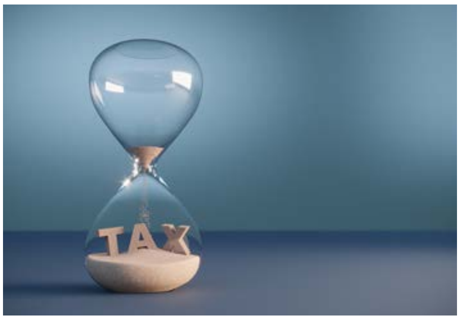
There have been no changes to Rollover or Holdover relief.

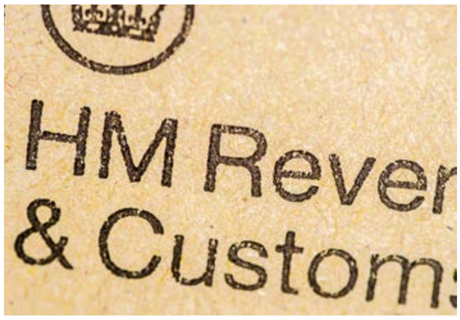
WEALTH TAX

There have been rumours for many years now about the potential creation of a one-off wealth tax to help fund some of our public services. The issues within our healthcare sector are well documented, and a commission set up in the Spring of 2020 has reported on the options available to the government. We will not discuss this in this article but you may need to consider this if there are any future comments from the government about its potential introduction. It would seem extremely difficult to implement such fundamental changes during the current cost of living crisis.

INHERITANCE TAX (IHT)

Again the rumours circulating around changes to IHT have been extensive, with suggestions that some of the reliefs available to farmers could be removed or amended. The rumours relate predominantly to the potential abolition or amendment of Business Property Relief (BPR) or Agricultural Property Relief (APR), which for most farmers significantly reduce their exposure to inheritance tax, and in many cases remove it altogether. There does however, seem to be a concerted effort by H M Revenue & Customs to attack APR and BPR claims. This may indicate that rather than abolishing the reliefs, which would be extremely politically sensitive, the government have decided to attack what they see as abuse of the current tax system.





Another possibility being discussed would be the abolition of the CGT uplift at death, which would be extremely far reaching both within the agricultural sector and the wider community.

Whilst it is dangerous to make plans based on rumours, it is important to be aware of the changes to tax legislation. At Sowerby we have a team of tax experts who are up to date with the latest developments and can give advice on your specific circumstances.

JAMES MAY

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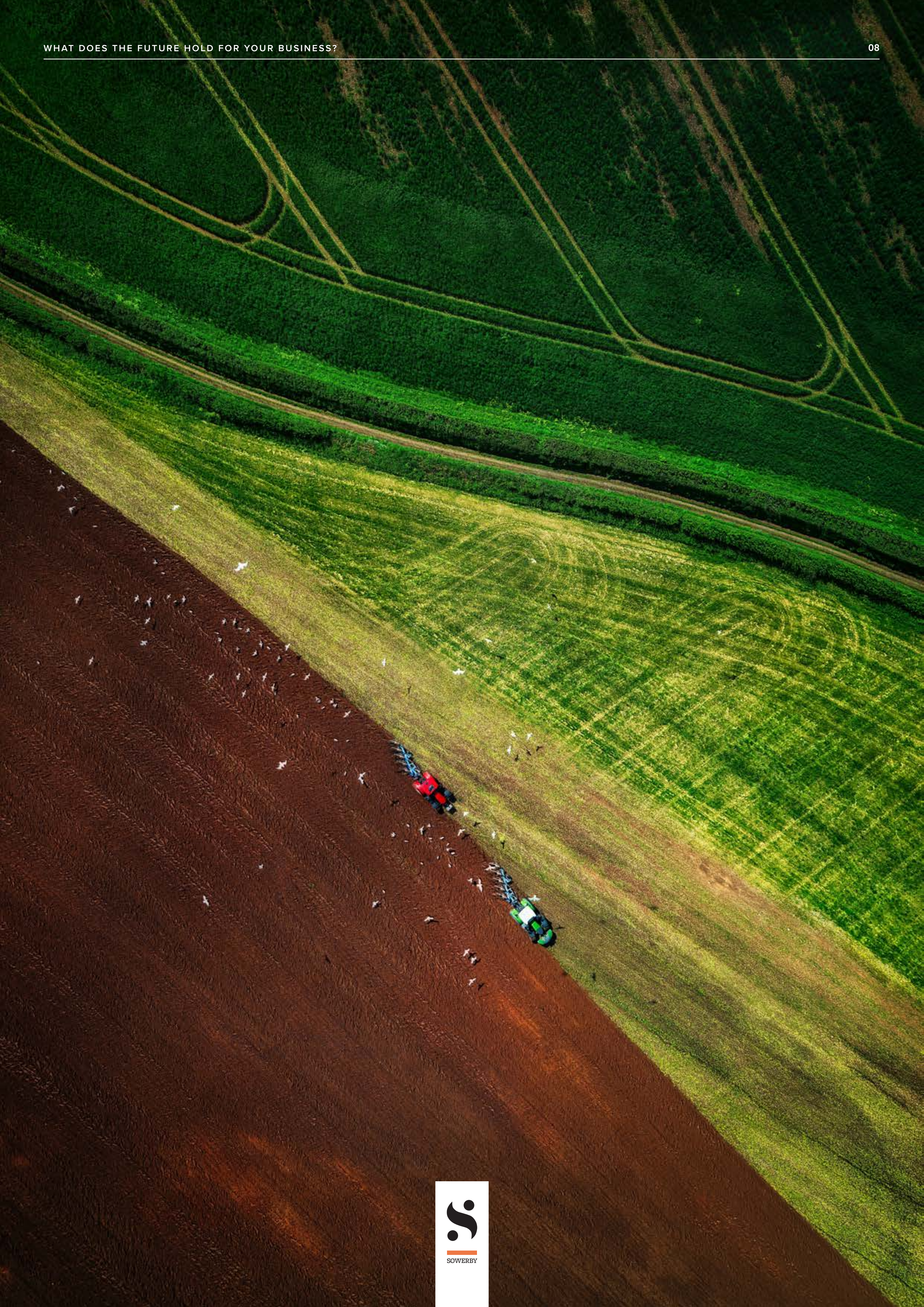

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WHAT DOES THE FUTURE HOLD FOR YOUR BUSINESS?

WHEN WAS THE LAST TIME YOU STEPPED BACK FROM RUNNING YOUR BUSINESS TO ASK "DOES IT DELIVER WHAT I WANT?"

Most larger companies will regularly take time to consider the future of their business, and ask whether it addresses the requirement of its owners and is able to cope with any future challenges.

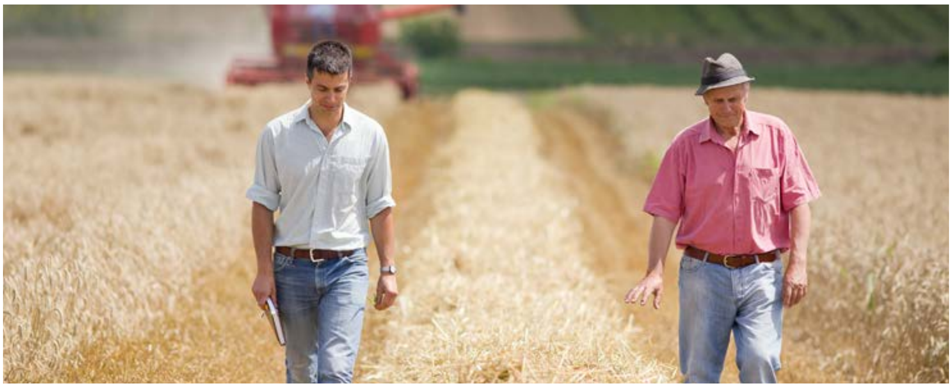
Farming businesses are no different; the owners need to review the business and ensure it is fit for the future. However the problem for many farmers is that they are too involved in the day-to-day running of the farming operation, and either don't have the time or the expertise to undertake a review.

There are often further complications within a farming business due to the sensitivity of the family. A farming business tends to only implement changes when there is a generational change.

What should you consider as part of your review?
The main question centres on what the objectives are of the business owners (current and potential future), and how the business can best achieve these. There will always be a need to balance any contradictory aims, especially between generations and family members.

The review should cover the following:

- Establish if the present system is meeting the owners' objectives
- Identify if there is scope for the business to perform better and how that will impact the business
- Assess if the system will continue to function effectively in the future
- Identify what challenges lie ahead and how the business will deal with these
- Identify potential opportunities and the actions needed to take advantage of these
- Confirm that the business structure is consistent with the objectives
- Put a succession plan in place



It's essential that a business review of this kind is conducted periodically rather than as a one-off exercise; changes to legislation and a number of other internal and external factors can easily affect the outcomes.

Who should be involved?
It is important to ensure that all interested parties are included to ensure that everyone's views are considered and everyone commits to the plan. It is also important to involve your professional team, accountants, solicitors and land agents.

What happens once it is complete?
It is vital that once the plan is complete, all parties actually implement the roadmap. Regular reviews are necessary to judge if there is a need to make changes to the plan to achieve the stated goals, or to change the goals if further information has come to light.

PHIL SILVESTER

Phil Silvester became a partner on 1 April 2023 after over 15 years service at Sowerby. He specialises in helping farming businesses implement their future plans.

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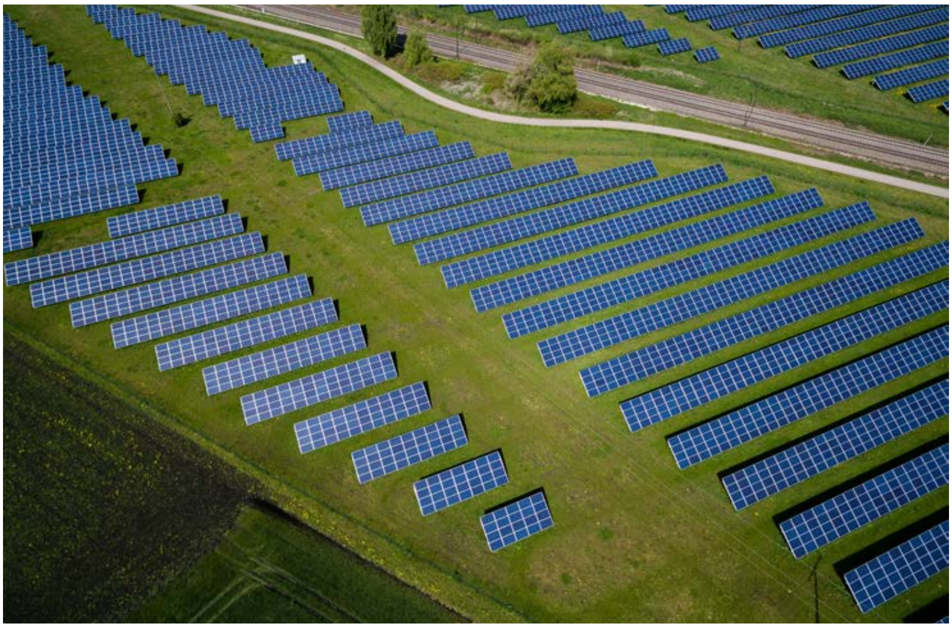
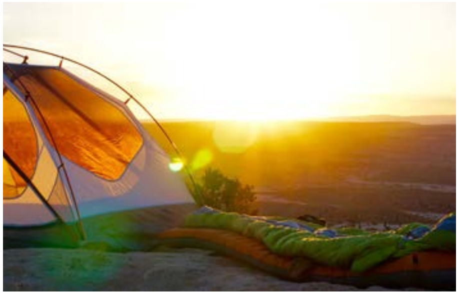
DIVERSIFICATION - BUT INTO WHAT?

WITH THE RECENT ANNOUNCEMENT THAT MANY BUSINESSES WILL HAVE TO WAIT 10 YEARS FOR A GRID CONNECTION IF THEY WANT TO INVEST IN SOME FORM OF RENEWABLE ENERGY PROJECT, WHAT SHOULD FARMERS CONSIDER WHEN THEY LOOK AT DIVERSIFICATION?





There are so many opportunities available to farmers, whether that be glamping, adventure park, fishing lake, petting zoo, or many more alternatives.

Any farm business needs to consider the following:

What do we have in terms of property and people?
The first point to consider is what is available on the farm to develop, which should not only include buildings, sheds, or stables, but also any lakes, forests or land that always under-performs in terms of yield.

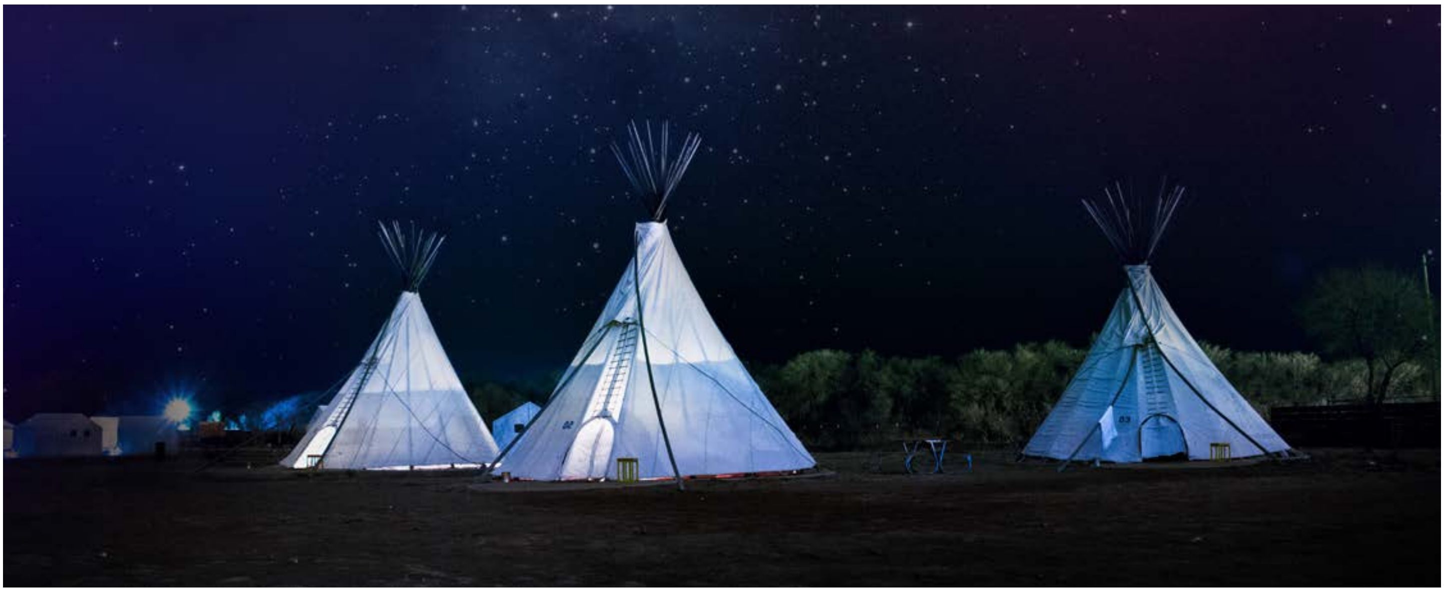
You should then consider how the development might affect the local community, as this will help with any planning applications that you will need to submit. I appreciate that many people love or hate Jeremy Clarkson, but the problems he has encountered with his Diddly Squat Farm highlight how local opposition can affect your plans.

Location is a critical consideration, as it is pointless having a project that no one can visit due to limited or difficult access.

You must then consider whether you will be able to staff the new business. Do you and your team have the necessary people and customer services skills needed for interacting with the end users of the proposed new business? For example, one of our clients recently explored the option of glamping but conceded that they were too anxious about dealing with the general public.

The business plan
One of the most important parts of any successful new project is the ability to fund the initial investment, so ensuring that you have the necessary financial resources is key. However you intend to fund the project, it is important that you prepare a good business plan which includes cashflows.

You will then need to review the risk, not only for the new business, but any risks that might be caused to the existing business. If you need to borrow money to invest in the new project could this cause problems for the existing business?



I mentioned above the potential need for planning permission, but you will need to consider all the relevant legal requirements that the new business will be subject to.

Finally, you will need to consider the tax implication for the new business including taxes on profits, VAT and any capital taxes. You also need to give due consideration to the business structure.

How the new venture impacts Agricultural Property Relief (APR) and Business Property Relief (BPR) needs considering too. There are many instances of farmers diversifying and finding they have lost APR or BPR due to the way that the new venture has been structured.

Are you considering a farm diversification project? At Sowerby, we have many years of experience in helping farming clients to diversify, so contact one of our dedicated team to discuss your ideas and get professional advice on the way forward.

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RENEWABLE ENERGY & YOUR BUSINESS

In our previous newsletters we've covered a number of topics surrounding green initiatives and the impact of energy costs, including a detailed commentary on domestic solar panels and a consideration of how businesses can become more energy efficient using their current resources.

However, the subject of sustainability is not one that is going to fade into the background, and we increasingly see our clients asking us for advice on how they can improve their 'green' rating. They also frequently ask what the benefits of renewable energy really are.

Whilst various incentives initially provided by the government are no longer open to new applicants, such as Feed-in Tariffs (FIT) and the Renewable Heat Incentive Scheme, there are still numerous options for businesses to consider if they are keen to become more carbon friendly and boost efficiency along the way.

A renewables-focused approach to sustainability can cover many options, not least:

- Solar Panels
- Wind Turbines
- Heat Pumps
- Biomass Boilers

SOLAR FOR BUSINESS

Solar panels are perhaps the most recognisable element of renewable energy, and installing such visual items can often clearly boost your green credentials.

If your business has adequate roof space, then installing solar panels can earn you a return on investment and offers a modicum of certainty in the current unstable energy market. However, despite falling costs of installation there is still a substantial outlay.

The approach you take to commercial solar panels will be dictated by the amount of space your business has available. A smaller roof space where you pay for the installation yourself will normally start receiving a profit after ten years, with an average small system costing between £5,000 and £10,000. However, if you have a large piece of land, you may look to rent the space out to an energy company or solar panel installer / investment company, removing the risks of investment and construction. Whilst less common, if you share ownership of a building with other businesses, there is always the option of collaborating to bring down the costs and provide a more sustainable investment and resulting energy profile.

WIND POWER

Less accessible to all than solar panels is the option of Wind Turbines. A large requirement of land in a non-urban area is the general prerequisite for Wind Turbines, though there are possibilities regarding building-mounted turbines.

Generally, Wind Turbines have a greater initial cost than solar, an average life of 25 years and will incur maintenance costs. And whilst planning permission is rarely an issue with solar panels, planning permission is much more likely to be needed for a Wind Turbine.

Turbines bring many of the same benefits as solar panels. If your business owns a large area of rural land, however, and is considering renting this out for renewables construction, it is important to note that despite the large area needed for the installation of turbines, unlike solar panels a very small percentage of the land is actually taken up by the turbines.

For both of these options, with the removal of FIT incentives for new entrants, the major initial benefit is the fact that you are effectively forward buying your electricity at a set cost.

This makes it much easier to consider financial forecasts, and provides a level of protection against fluctuating energy costs.

The Smart Export Guarantee (SEG) also took effect in January 2020, and businesses can potentially experience financial gain from exporting excess energy back to the national grid. There are also options regarding battery storage, which allows your business to store its unused energy for future 'rainy days'.

HEAT PUMPS

Heat pumps can be a long-term cost-effective solution for heating a busy office. The most common heat pumps are Air or Ground based, though they all work in relatively the same way to draw valuable heat energy from the air, land and water around us and use a small amount of electricity to transfer this into properties.

Heat pumps, once installed, shouldn't need regular maintenance and could last between 10 and 25 years. They are shown to improve air quality, emit minimal noise and can also be used for air conditioning.

They can cost in the region of solar panels for initial investment, but they are significantly more efficient than electric heating alone. Heat Pumps can also fall under the Boiler Upgrade Scheme provided by the government, meaning your business could get a grant to cover part of the cost of replacing fossil fuel heating systems with a heat pump or biomass boiler. It is important to note however, that whilst heat pumps are being used more and more in new commercial buildings, older properties tend to have too many cavities and drafts to make the return worth the investment.

BIOMASS BOILERS

Biomass is a renewable energy source, generated from burning wood, plants and other organic matter, such as manure or household waste. It releases carbon dioxide when burned, but considerably less than fossil fuels.

As with all the items considered here, it does have a significant outlay, though depending on your business it can also help with the disposal of waste wood material, creating a system that is self-sustaining.

Biomass boilers do fall under the Boiler Upgrade Scheme, but will require maintenance and repairs throughout their life.

OVERALL CONSIDERATIONS

It would be impossible to outline all the pros and cons of renewable options in one article. However, the above should make it clear that there are a few fundamentals that should be considered before your business moves into a detailed consideration stage. At the time of writing, the first consideration must be whether a grid connection will be granted, and if so how long you will have to wait. Recent reports do suggest in some cases this could be up to 10 years. This should be considered even before planning is sought. Following this, next thoughts should be as follows:

- How much physical space does your business have to utilise?
- How much will a prominent, public facing projection of your green values benefit your business?
- How much are variable energy prices currently affecting your business?

All of the options above have a significant outlay (excluding land rental) and in terms of return on investment it is likely to be a number of years before this is seen. However, all possibilities have supportable useful lives, so it is relatively simple to draw up forecasts showing the on-going impacts of any installations.

The grant and support opportunities for initial funding are currently strong. You can also claim capital allowances when you buy energy efficient, low-carbon or zero-carbon technology for your business. This reduces the amount of tax you pay.

Whilst the above options may not currently be a necessity for many businesses, for those looking at future proofing, utilising unused land, or boosting sustainability, there are numerous benefits available (not least a more sustainable outlook for future generations).

Should you be interested in discussing how renewable energy can form part of the next steps for your business please do not hesitate to contact your Relationship Partner or Elizabeth Blanchard.

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