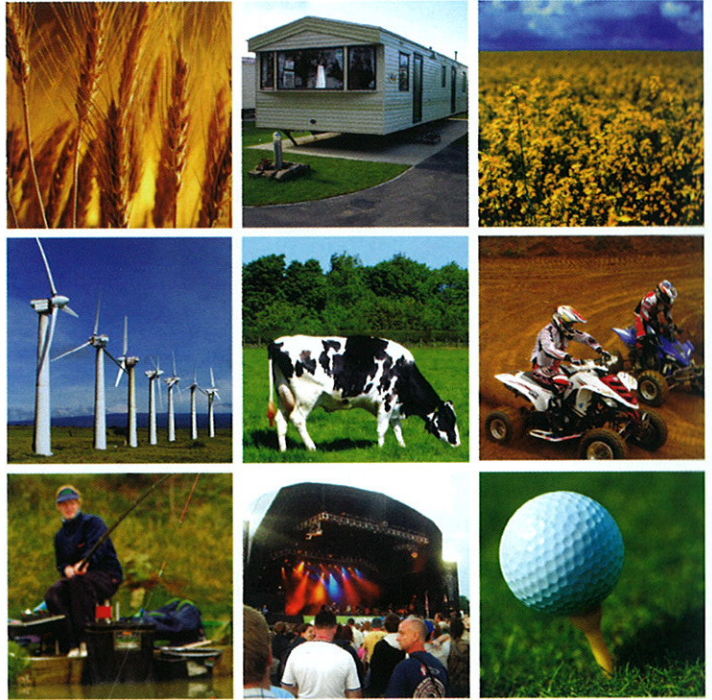


DIVERSIFY OR DECLINE?



A farmer's best friend can be an accountant, as the taxman seeks to reap a bumper harvest from the changing landscape of rural Britain, finds **Philip Smith**

When once diversification was a word never mentioned in polite farming company, it is now **an essential ingredient for the continuing viability of many farms**

This is one of the most beautiful views in England,' enthuses Julie Butler as her son drives their Landrover into the Meon valley, nestling beneath the South Downs in Hampshire.

Butler, the managing partner of an accountancy firm that specialises in helping rural businesses, is taking *Accountancy* to meet one of her farming clients. Yes, the view is impressive, but so too is the effort that farmer Jamie Butler (no relation) has put in to diversifying his farming business. While his family maintains 400 cows and 700 acres of combinable crops on a 1,200 acre estate, Butler also runs a fly-fishing and clay pigeon shooting operation, a storage business and is beginning to grow a tree dedication venture. Over the last few years, he has embraced the spirit of diversification and seen his businesses prosper while maintaining a living off the land.

However, the view over the rural economy of Britain is not so impressive – global commodity prices, animal diseases and the taxman are all taking their toll.

UK farming contributed £5.6bn to our economy in 2006. It uses around three quarters of this country's land area, and employs more than half a million people. It might only contribute 0.5% to the UK's GDP, but it still matters.

However, farming is often depicted as a sector in decline, and many farmers will tell you they feel they are under attack. Tax policy is changing, the subsidy system

is going through a major shake-up, while political issues such as the ban on fox-hunting has led to a general feeling of unease. And outbreaks of foot and mouth, blue tongue and avian flu combined with drought and flooding have done nothing to ease this tension.

Perhaps this is why many are leaving the farming game altogether. According to the Department for Environment, Food and Rural Affairs (Defra) the total farm labour force in the UK in June 2007 was down 2% on the same time in 2006 to 526,000. Within this, the number of full-time principal farmers had fallen by 4% to 146,000.

The UK's total income from farming (a measure of profit) averaged £4.3bn during the mid-1990s. This figure fell dramatically during the late 1990s, but has rallied in recent years. It stood at £2.7bn in 2006, an increase of almost 7% on the previous year.

This is a picture backed up by the ICAEW's Farming and Rural Business Group, which has recently published research that suggests many farms would be in dire straits were it not for the subsidies they receive. Its survey of agricultural accountants, published last month, reveals the average farm turnover for 2006/07 was £312,600, yielding an average net profit of £46,300. This figure coincided with average drawings and was very little more than the average receipt from subsidies of £45,000.

However, although final figures from Defra will not be published until March this year, the signs are that some sections of agriculture will have had a good 2007, while others will have struggled. This has largely been caused

Biofuels: wind in the willow

Biofuels are this year's new black stuff, bolstered by soaring oil prices, but farmer Lionel Hill has been producing his own fuel crop for more than 20 years now. Based in Feckenham, Worcestershire, Hill grows willow, which is harvested every two to three years for biofuel production.

'I went into this project long before diversification was on the radar,' Hill says. 'We had acquired an estate with a large number of buildings that we wanted to use for various purposes, and realised that to heat them was going to be expensive, and this led me down the path of using willow.'

So, Hill's original intention was to be as energy self-sufficient as possible, but he then found there was a demand for his product, demand which has increased over the past five years as the price of other fuels has gone up.

'We are a registered supplier of willow and poplar propagation material, and we also produce and sell wood chips,' he says, adding that the willow side of his business accounts for around 25% of the overall farm business, which is mainly cattle.

In the last five years Hill has also looked at other forms of diversification, such as using old barns that were too small to house modern farm machinery for office space. Here, Hill highlights one of the problems of this form of diversification: 'As more and more of these properties are converted into offices, so the rent commanded is becoming depressed,' he says.

This is why market research is very important for farmers considering any form of diversification. 'Make sure that there's a market for whatever you are going into, and know what is going on around you,' he urges. This will often be a new skill for a farmer, Hill believes. 'Some farmers might nail me to a wall for saying this,' he explains, 'but many farmers have been brought up to believe that there was a market for whatever they produced. They are now having to learn what nearly all businesses have to learn: understand your market and who your customers are and whether you are producing what your customers want.'

This inevitably creates a dilemma – many farmers do not have the time to do their research, and they certainly do not have the spare cash to pay someone else to do it.

Hill, as president of the National Federation of Young Farmers' Clubs, is also concerned about the next generation of farmers. 'More needs to be done to invest in young rural people – even very small grants will allow them to test the water with their diversification ideas.'



by the increase in global grain prices – arable farmers have benefited, but livestock farmers have suffered as the cost of feed has increased, while the picture is further complicated by increasing fuel and fertilizer costs.

The dramatic fall in income of the 1990s, caused by BSE and falling commodity prices around the world, in part explains why the rural economy has shifted away from farming towards other forms of income. When once diversification was a word never mentioned in polite farming company, it is now an essential ingredient for the continuing viability of many farms.

An important role

Diversification, which Defra defines as 'the entrepreneurial use of farm resources for a non-agricultural purpose for commercial gain', can play two important roles in a farmer's life. First, it will help provide an alternative income if the traditional crop or livestock fails, and secondly, it forces the farmer to think more in business terms. As Bill Ballard, chairman of the Farming and Rural Business Group, says: 'It has been good for the farmers to think like businessmen. It has been healthy for them to ask themselves how they are going to survive and run their businesses to make money rather than knocking out what father used to.'

A certain amount of diversification comes down to the desire to secure the income from what is produced, according to Mike Harrison, a partner in Saffery Champness' landed estates and rural business practice. 'You will have farmers who want to take the product they are producing all the way to the end consumer, and you typically end up with a farm shop,' he says. Some shops, he says, will only sell what the farm has produced, while others will expand to stock many other products.

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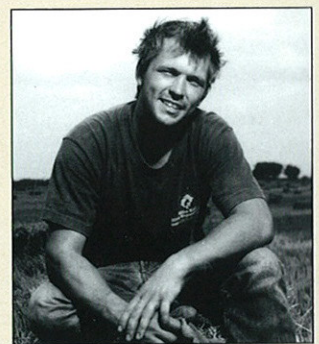
Where once it was enough to have farming and husbandry skills, today's rural business scene demands a whole set of new insights into business performance and profitability to deliver success. Behind the headlines about flooding and outbreaks of disease, advisers and finance professionals are working with rural businesses that have been part of the family for generations and often include the family home and heritage.

This conference will ensure that delegates are able to keep one step ahead of these events by having forward tax planning and accounting mechanisms in place to ensure the survival of farms and rural businesses while offering an overview of the current planning opportunities open to farmers today.

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Jimmy's Farm TV celebrity among speakers

Jimmy Doherty of the Essex Pig Company, whose farm featured in the TV programme *Jimmy's Farm*, will be among the speakers at the conference. He will tell delegates about his experiences and share some of his thoughts on the pitfalls, problems and successes of farm diversification.



Other speakers will include tax, legal and estate management experts who will look at topics such as property development, opportunities arising from renewable energy, capital gains tax, the single farm payment and succession planning.

A very country practice

You would normally expect to find copies of *The Economist* and the *Financial Times* on the reception table when you call on an accountancy firm. But at Butler & Co, you can spot the latest copy of *Horse & Hound* sat on top of the pile of newspapers, a clear reflection of its clients and its expertise. And of the fact that managing partner Julie Butler is the local fox-hound master.

Butler set up the firm in the mid-1980s at her home in Bramdean, Hampshire, moving into offices in the Hampshire village of Arlesford in 1992. Two further offices were opened during the 1990s, by which time Butler had carved a niche as a farm and equine tax expert. As the author of *Tax Planning for Farm and Land Diversification* in 2002, she had seen the emergence of a new breed of farmer and land agent that needed to understand tax. 'I thought there was a new market out there – I had clients that were well educated, sitting on assets of, say, £7m, and who wanted to protect them for their children and themselves,' she says.

She originally saw the need for farm diversification in the mid-1990s shortly after the price of corn fell through the floor. 'I linked up with some land agents and planning consultants, walked around the farms and saw things like broken down old barns that could be used for storage, or some pony paddocks, or other ways of unlocking the value of the land through planning permission. We also looked at different ways of raising finance,' Butler recalls.

During this time she has also seen the rise of the 'lifestyle' farmer, a trend that also caught the eye of Revenue & Customs as rich individuals attempted to claim their farmhouses were exempt from inheritance tax. Several court cases later and it is now possible to see a more clear definition of a farmhouse, but have the lifestyleers spoilt the party? 'No, I believe the lifestyleer can often add value in an integrated way,' Butler argues. 'They often have the funds that the traditional farmer doesn't have available to restore farms. At a rural level I actually think the government and the rural economy have embraced the lifestyleer more than perhaps the outside world would imagine. They keep the rural economy employed; rural inhabitants can stay in the rural places because they [the lifestyleers] need builders, they need fence builders, they need advisers, they need cleaners, they need the services of the rural community and infrastructure while they are building up and diversifying.'

But Butler also has the opportunity to practise what she preaches – married to a farmer herself, she is now looking at various possibilities for another farm she recently inherited. Such possibilities include woodland burials, a growing trend among those concerned about the carbon footprint left behind through cremation.

Through her position as fox-hound master, Butler is able to hear first hand the views of the rural community, and she is optimistic for the future. 'But so much will rest with the general economy, food prices, property prices, what happens in the City, and what the government's continued response to taxes is,' she says, adding: 'And I get the feeling that, no matter what happens, some of the farmers will not give up, they will carry on – it is a passion.'



Harrison adds that diversification can help mitigate the impact of fluctuating food prices. 'That's when the farmer sees an old building and converts it into offices or holiday lets,' he says.

Harrison also points to the impact that the change in how farming subsidies are calculated has had on farmers' business decisions. 'The support system from the EU moved from encouraging people to grow or produce as much as possible to a situation where it

doesn't matter what you produce because you are still going to get the same amount of money,' he says. He is referring to the single farm payment, which was introduced two years ago to replace the plethora of grants and subsidies that were often blamed for producing food mountains. Administered by the Rural Payments Agency (RPA) in England, the single payment scheme places more emphasis on the size of farm rather than on what is actually produced. Not without its own

Fishing for profits

Cast and blast is proving very popular, according to Jamie Butler, farmer and genial proprietor of Meon Springs, a fly-fishing and shooting operation in the heart of the Hampshire countryside. Located half way between Winchester and Petersfield, Meon Springs is a classic example of farm diversification – a traditional arable and livestock farm that has exploited its own facilities to create additional income for the enterprise.

The 'cast and blast' Butler refers to is a corporate day of fishing in the morning, and clay pigeon shooting in the afternoon, all set in beautiful surroundings.

The fishery, which has two lakes stocked with brown and rainbow trout, is served by a recently built angling lodge that can host corporate events such as away-days and training sessions.

'Our aim is to remain a farming business,' Butler explains, 'yet balanced with non-farming enterprises.' He reckons that about 30% of the farm's whole turnover is now non-farming.

Meon Springs is based within the larger Whitewool Farm – 1,200 acres in size, with 400 cows and 700 acres of combinable crops.

Butler is the third generation of Butlers to have worked at the farm – his grandfather bought the land in the 1930s, selling and buying it back in the 1950s. The fishery itself was started in the mid-1980s and the shooting was introduced in 2004.

'Dad did the fishing lake after a conversation with a keen angler, who saw the potential,' says Butler. 'It has two financial benefits – one is to create a non-farming income stream and the other is that it has added significant value to the property.' Butler also set up a storage business in the same year. He is now developing a tree dedication service, making the most of the tranquil surroundings, where trees can be planted to mark special occasions or act as a natural focal point to remember loved ones.

'Our future plans at the moment are to develop the existing businesses, to make sure that we are doing what we are doing well,' Butler says.

To farmers considering a similar move he says: 'Diversify for the income and accept the capital increase as the perk. My personal advice would be to diversify into something that you enjoy, then you will have the enthusiasm to see it through the early years, which can be financially lean.' To make the point, he says that it took 15 years to develop the fishery into a viable business and another five for it to be considered anything more than a sideline.

Accountant Julie Butler (no relation) has been working with Meon Springs for seven years, ensuring a structured approach to the businesses. 'The tax advice and advice on how to structure the businesses has been hugely valuable,' Jamie Butler says, 'but above all she is enthusiastic.' And enthusiasm in the rural community counts for a great deal.



teething problems – the RPA was the subject of a harsh National Audit Office report recently – the system will undoubtedly lead to greater diversification.

But inevitably, Revenue & Customs is looking very carefully at any change in land and building use in the countryside. For instance, a traditional farm, including the farmhouse, can benefit from 100% agricultural property relief for inheritance tax purposes. This means that the farmhouse can pass from one generation to the next without creating an inheritance tax bill. But a change of use at the farm can jeopardise this relief. A number of legal cases, mostly aimed at so-called 'lifestyler' farmers who have bought farms with little intention of rolling their sleeves up in the farmyard, have sought to clarify

what is, and what isn't, a farmhouse (see box on p28).

Loss of flexibility

A move away from farming can also move farmers away from a certain amount of flexibility, for instance in offsetting losses. As Martin Pickering, a private client tax director at PricewaterhouseCoopers, explains: 'All farming in the UK is treated as being part of a single trade, which means that if you have a number of different farming activities on a number of different sites you have the flexibility to offset losses against each other. But as soon as you step out of the farming trade environment you lose some of that flexibility.' As an example, Pickering says that if a farmer starts to run a haulage business, it will be treated as a standalone business and does not collect any

When is a farmhouse not a farmhouse?

Agricultural property relief from inheritance tax can be a very valuable commodity as it can allow 100% relief.

There are two considerations that have to be met for a property to qualify:

1. It must be agricultural property, this includes not only the agricultural land but also any property on the farm, farm buildings and farm houses which are 'of a character appropriate' to the agricultural land.

2. The property must be occupied by the taxpayer 'for the purpose of agriculture' for the two years prior to death, or owned for seven years and occupied 'for the purposes of agriculture' for that duration, whether by the taxpayer or someone else, such as a tenant.

General guidance can be found within three landmark decisions – *Antrobus (I)*, *Antrobus (II)* and *McKenna*. The latter emphasised the importance of 'hands-on' involvement in the farm operation, creating an adverse effect for lifestyle farmers, elderly and even semi-retired farmers.



residual losses from the farm. 'Every time you diversify away from your core farming activity you have to have in mind you are stepping into a completely different set of rules,' Pickering says. He adds that if a farmer decides he wants to be a landlord with tenant farmers working on his land, then he needs to be careful that these tenants do not move away from agriculture, thereby placing his own agricultural property relief benefit at risk. And by switching from a business to an investment, which can happen when a farmer becomes a landlord either by renting out his land or his buildings, he might not be entitled to business property relief either.

There are many other areas that can catch out the unsuspecting farmer as he tries to do the right thing in securing the long-term viability of the farm – which is why farmers like Jamie Butler in Hampshire will always be pleased to see their accountant. And accountants maintain a positive view for the farmers. As Julie Butler says: 'I am more optimistic about the survival of the farming community now than a year ago...and the farming community is telling us that the recent corn shortage has emphasised how the UK must still continue to produce food.'

'Diversification and true farming also seem to be integrating efficiently and with less stress to the farmer.'