COULD DIVERSIFICATION BE THE RIGHT DIRECTION FOR YOUR AGRICULTURAL BUSINESS?
Introduction

It has been well publicised that certain parts of the agricultural sector are currently experiencing considerable difficulties.

For example, the average Farm Business Income (FBI) on dairy farms fell by around £10,000 (9%) driven by lower milk prices and £70,200 for cotto & sheep (lowland) farms.

What are agricultural businesses doing in response to these difficulties and what does that mean for the future profile of the sector?

In response to these questions, Hugh James has worked with the Country Land and Business Association (CLA) to explore trends around the diversification of agricultural businesses. With additional commentary from respected agricultural entrepreneur David Morgan MBE (owner of Trostrey Court Farm and founder of Morgans of Usk), both Hugh James and the CLA discuss how diversification has the potential to increase income and the factors to consider before embarking on such a venture.

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Diversification among agricultural businesses, in place of or alongside traditional farming activity, has grown exponentially over the past 20 years. It seems likely that this trend will continue, in light of both the financial challenges facing farmers and agricultural landowners in the current economic climate, and the obvious opportunities that diversification offers.

Diversification is a broad topic, for example, tourism and leisure is in a very different category from energy production, but any form of diversification presents its own advantages and challenges. This document explores the views of individuals operating or advising within the sector as to the future of diversification, the potential benefits to doing so and the issues to be aware of.

Rebecca Williams
Director – Wales, CLA
rebecca.williams@cla.org.uk

Rebecca leads the CLA in Wales. The CLA is a membership organisation that represents the interests of farmers, foresters and rural business owners in England and Wales through lobbying and government in Cardiff, London and in Europe.

Matthew Evans
Head of Wealth Management Services, Hugh James
matthew.evans@hughjames.com

Matthew has overall responsibility for Hugh James Wealth Management Services and works closely with the specialist partners. Matthew also possesses a wide and substantial expertise in agriculture related tax, trusts and estates.

Rob Phillips
Partner, Head of Property Litigation, Hugh James
robert.phillips@hughjames.com

Rob advises on agricultural tenancy disputes, energy sector property disputes, contentious planning, improvements and easements and construction law for property disputes.

Andrew Jones
Associate within Tax, Trusts and Estates, Hugh James
andrew.jones@hughjames.com

Andrew specialises in wealth preservation and estate planning with a particular emphasis on tax planning for those with farming or business interests, and overseas issues.

Around 3,100 farm businesses in Wales were engaged in producing output from diversified activities during 2013-14, with 2,100 farm businesses generating diversified output other than rent.

Authors

Foreword
What is agricultural diversification?

Farmers often simply just want to farm but the reality of the current market is that they frequently need additional income streams to ensure the ongoing viability of their business. Diversification typically involves broadening a business’s activities away from its existing or traditional core operations and using land and assets in new or innovative ways.

Common examples of intra-agricultural diversification are moving into food production and rearing different stock such as rare breeds. Diversification away from agriculture often takes the form of tourism activities, contracting or, in recent years, renewable energy production. The CLA is seeing a whole host of new ways in which farmers have diversified their businesses.

Why is diversification becoming more prevalent?

The increase in diversification is perhaps not so surprising. Clearly the main driver is economic and the need to get additional income, to keep the family on the land.

Government policy has also been supportive of diversification. For example there have been a series of grants made available under the Rural Development Plan to support diversified enterprises.

Looking to the future, there are major changes on the horizon that make the future funding for agriculture uncertain. For example, if Britain votes to leave the EU, the whole position could change dramatically, which is something the debate on the subject does not really seem to have yet touched upon. That lack of certainty is another reason why farm businesses are looking for alternative and secure income streams.

Changes under the Common Agricultural Policy have also increased the emphasis on environmental benefit over direct subsidies. Accordingly, the emphasis on production has decreased over time. Furthermore, the percentage of European Union funding that goes into the Common Agricultural Policy has also decreased over time and it seems highly likely that it will continue to decrease as the challenges facing the EU change (for example terrorism and migration).
What trends has the CLA seen in relation to types of diversification?

In recent years there have certainly been opportunities to use land to generate alternative income through renewable energy but changes in Westminster government policy have led to uncertainty and may affect this in the future.

Creation of ‘glamping’ (glamorous camping) to meet the ‘staycation’ market is an attractive option for many but, as with many other trends, we will in time reach a point of market saturation in some areas (in a similar way to farm B&Bs previously).

The popularity of different diversification schemes ebbs and flows over time and in response to external influence. It may be that the next big thing is just around the corner; the challenge is to know what that next big thing will be and to make the most of the opportunity.

What practical advice would the CLA offer to landowners/farmers who are considering diversification?

As with any business, planning and research are key. It goes without saying that what is required will depend on what is being considered and the proposed scale. You should always seek appropriate advice and ensure that you obtain appropriate planning guidance, where necessary.

Speak to your bank manager and consider the impact of the diversification project on your core business.

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David Morgan Case Study

David Morgan MBE is an entrepreneur from Usk who has embarked on a number of diversification projects.

Following the death of his father when David was just six years old, and the decision of his mother to keep the family farm and rent it out to tenant farmers, David eventually took over Trostrey Court Farm in 1961, aged 19.

In the half century that followed, David transformed the run down farm into a cutting edge and diversified business. From small, cash-strapped beginnings as a predominantly arable farm, Trostrey Court now has a 250-strong pedigree herd, is virtually self-sufficient in producing the herd’s foodstuff, rears 300 tonnes of chickens every six weeks, produces and exports heat and electricity from a state of the art biomass plant and has associated farm buildings and a farm shop on the farm estate.

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David Morgan Interview

Have you always been a farmer?

I was born at my family farm near Little Mill in Gloscester and grew up in the same area. My father bought Trostrey Court Farm in 1948. It only really went into profit after three years when I was just 13. As a family business, it was our ambition to build and run buildings and developments. We built a new house on the farm and lent a sizeable amount to a neighbour. It was the first time he had built himself a new house and that was the beginning of Trostrey Court. I built all of the modern buildings here too. Trostrey Court, I built all of the modern buildings here too. I suppose it is.

Do you think of yourself as an inventor?

Yes. Now we’re building the robotic systems working in automated milking parlours to Wales. Yes, we were the first people to bring robotic milking parlours to Trostrey Farm, so it’s important to keep standards high. We also sell the power we don’t use and we rotate our crops so there is always something useful growing. We also sell the power we don’t use and we rotate our crops so there is always something useful growing. If you can’t give it 100%, don’t bother starting. If you can’t give it 100%, don’t bother starting.

Do you use technology in the milking shed?

Yes, we were the first people to bring robotic milking parlours to Trostrey Farm, so it’s important to keep standards high. We also sell the power we don’t use and we rotate our crops so there is always something useful growing.

What about the poultry?

Computers manage the feeding and climate within the broiler houses where we rear our chickens, but it’s still very hands-on. We need to walk through and inspect them twice a day to check for illness and so forth. We have a great safety record at Trostrey Court. We also use the residual heat for the chicken sheds, and we are about to use it to dry the slurry from cows, so I don’t have to dry the slurry from cows, so I don’t have to drive the alternators to generate the electricity. Computers manage the feeding and climate within the broiler houses where we rear our chickens, but it’s still very hands-on. We need to walk through and inspect them twice a day to check for illness and so forth. We have a great safety record at Trostrey Court.

In all this though you have got to be enthusiastic.

Yes, it was, but as the government put pressure on us to generate more of our own green power I decided I would look into it a bit more.

Do you use technology in the chicken sheds?

Yes, we were the first people to bring robotic milking parlours to Trostrey Farm, so it’s important to keep standards high.

What was your first experience with renewable energy?

We also use the individual feed for the chicken sheds, and we are absolutely sure it is saving the chicken farm, so I don’t have to feed the chicken farm, so I don’t have to feed the chicken farm.

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Agricultural businesses require the correct legal structure. This structure should always be supported by written documentation and this is absolutely the case whether the business is incorporated or otherwise. Our experience tells us that unincorporated agricultural businesses, particularly partnerships, often are not supported by such documents. This can mean that the mechanics of the business are, sometimes unbeknownst to the partners, governed by law with which they are not wholly familiar and can at times lead to unexpected outcomes. By way of an example, in the case of partnerships, the absence of any formal partnership agreement results in them being governed by the Partnership Act of 1890. Amongst other things, the operation of this act means that, upon the death of a partner, the partnership is dissolved, with potentially disastrous consequences.

It is therefore crucial to ensure that the constitutional documents of the business are correct and up to date before embarking on a diversification scheme. It is also crucial to keep them under constant review thereafter to ensure that they remain suitable as the business grows and potentially diversifies further.

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### Grant and Subsidy Information

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**Grants**

- **Business Rates Relief**
  - **Purpose:** To reduce the financial burden of business rates for eligible businesses.
  - **Eligibility:** Businesses that meet the eligibility criteria outlined in the scheme guidelines.
- **Rural Rate Relief**
  - **Purpose:** To provide financial support to businesses located in rural areas.
  - **Eligibility:** Businesses located in designated rural areas.
- **Energy Efficiency Grants**
  - **Purpose:** To provide financial support for energy efficiency improvements.
  - **Eligibility:** Businesses that meet the eligibility criteria outlined in the scheme guidelines.

**Subsidies**

- **Rural Development Scheme (RDS)**
  - **Purpose:** To provide financial support for rural development projects.
  - **Eligibility:** Projects that meet the eligibility criteria outlined in the scheme guidelines.
- **Environmental Stewardship Scheme (ECS)**
  - **Purpose:** To provide financial support for environmental improvement projects.
  - **Eligibility:** Projects that meet the eligibility criteria outlined in the scheme guidelines.

Before considering diversification projects, it is important to seek advice on which grants and subsidies may be applicable to the schemes envisaged and whether they are likely to be successful. It is also important to ensure that any diversification projects are in keeping with any formal partnership agreement or similar items being governed by the Partnership Act of 1890. Grants and subsidies can also provide a significant drive for diversification.
It is imperative that owners of agricultural businesses have adequate succession planning in place to ensure a smooth transition upon their death and on the terms that they wish. This planning should include professionally drafted wills for each of the owners of the business, written with consideration being given to the constitutional documents of the business to ensure that the two work in harmony. This is to avoid, for example, a business owner’s estate passing by virtue of the intestacy provisions, which are arbitrary, inflexible and could lead to assets passing to unintended individuals, possibly even outside of the business.

All such succession planning remains should be reviewed periodically, and especially prior to embarking on any diversification project, to ensure that they will remain compatible with the business post-diversification.

It is equally important that the business is in place to ensure business continuity should one of the owners lose the ability to take part in the business. Ideally this is done by way of lasting powers of attorney. These should be reviewed as part of any diversification exercise to ensure that they remain compatible with the diversified business, with particular consideration being given to who the key personnel in the diversified business will be.

Tax Issues

The main tax issue for diversification is that the business, post-diversification, may no longer be categorised as a farming business, with all of its tax consequences, but is instead seen as a business of another type, for example:

- a letting business, or
- a trading business.

On the whole, agricultural businesses are taxed quite favourably when compared with others. One key point to bear in mind, therefore, is that there is a definite advantage to continuing to run a true agricultural business and ensuring that the business as a whole remains a farm, in spite of the diversification.

Inheritance Tax

Most farmers will be aware of the existence of Agricultural Property Relief (APR) against inheritance tax. The importance of this relief is readily apparent as farming could not continue if, in each generation, every farm needed to be sold to fund a large inheritance tax bill.

Farmers may not be aware, however, of the potentially precarious nature of the relief and the steps that must be taken to ensure that it is available to them and is not exposed to unwarranted risks. That is particularly pertinent if diversification is being considered.

Here are a few pointers as to the issues to be borne in mind:

APR is only given on the ‘agricultural value’ of a farm. What this means in practice is that any value in the farmland that can be attributed to other things (for example, non-agricultural purposes or the ‘hope value’ of it obtaining permission for development) does not count as part of the value that receives the relief. So, in a simple example where a farm is worth £1 million as a farm, but can actually be sold for £2 million for redevelopment, the value for inheritance tax purposes is £2 million but the APR is only £1 million, leaving £1 million to be taxed in full.

APR is only given on agricultural assets. It isn’t given on the value of the farm business itself. However, the business of farming itself is a business and can qualify for another relief known as Business Property Relief (BPR). The conditions for that relief are generally such that the business must be a sizeable trade or partnership, or it is incorporated that the individual’s family company, investments made by an individual in a larger enterprise generally do not attract BPR.
Diversification presents a particular challenge from the perspective of both APR and BPR. From an APR perspective, it is important to understand that an asset would not be an agricultural asset if it was being used solely for a non-agricultural purpose. For example, a field that had once been used for grazing, but now has solar panels on it and is no longer available for grazing, would not be considered a land resource and therefore would not attract APR.

That particular problem has been resolved in some cases by technical means and innovative design. For example, in the case of solar panels, there are cases where they have been erected on poles six feet above the field, the advantage being that it is then possible to continue to graze sheep beneath the solar panels and therefore the land continues to be used for agricultural purposes. However, its value is perhaps diminished for the purposes of APR because some of its value may be attributable to the fact that some panels can and cannot be used.

From a BPR perspective, the biggest challenge comes from the fact that the exploitation of land for rent is not a business in the BPR sense of the term. The simplest example of this would be the letting of a field to another farmer. That would not be a business enterprise in the hands of the farmer who let the field, it would merely count as a letting and not attract BPR. However, there can be borderline cases.

The Farmhouse

Particular care must be taken in relation to farmhouses, particularly for active farmers. The issue is that, unlike businesspeople outside the agricultural world who do not get any inheritance tax exemption for their homes, farmhouses do in appropriate circumstances qualify for APR. There are many conditions and restrictions upon that relief and individual advice should be sought.

The core issue is that the farmhouse only qualifies for APR where it is actually used as part of a working farm, and it follows that a person living in it must be considered the farmer of that land. This is a particular problem for active farmers because if they wish to retire (or become too ill to work) at the end of their lives but wish to continue living in the farmhouse, it suddenly ceases to be a farmhouse on an active farm; there is not an active farmer living in it.

Planning

For a farm diversification project to be successful it is vital that the planning permission is in place at the outset. It is never too early to consider planning implications in the context of a farm diversification project. Each location will have its own unique planning perspective. It is vital to understand the scope of diversification activity that is likely to be acceptable to planners before leaving any decision on the planning perspective. While we can often assist farmers in reaching a successful outcome in such circumstances, dealing with planning as an afterthought often leads to frustration, delay and increased costs.

It is never too early to consider planning implications in the context of a farm diversification project.

Both locations will have their own unique planning perspective. It is never too early to consider the scope of diversification activity that is likely to be acceptable to planners before significant investment of time and money is put into a diversification project.
Family considerations

It is conceivable, however, that such
issues could arise during diversification.
That is particularly so if the diversification
involves the land being placed beyond
the hands of the farmer (for example
into a corporate structure), the nature
of the land being irrevocably changed
or another member of the family
becoming involved in the business
with expectations that conflict with the
existing expectations of somebody else.

Consideration should therefore
be given by those considering
diversification as to what their family
have been led to believe will happen
in the future, whether that is still
viable and, if not, whether anyone
has relied upon an expectation to
their detriment.

Issues then most frequently arise either when
the land is gifted to somebody else or is sold.

There have been several widely
reported cases in the press
over the last couple years
regarding family disputes over
farming assets. Often these cases
arise where a member of a family
(most usually a child) perceives that
a promise made to them upon which
they have relied to their detriment
has been reneged upon. This can
potentially give rise to a claim
found on the legal doctrine known
as estoppel.

Most commonly the promise that
it is alleged has been made is that
somebody will eventually inherit the
farm in exchange for working on it for
a reduced wage or for free. Issues
then most frequently arise either
when the land is gifted to somebody
else or is sold.

Diversification appears to be on the rise within the agricultural sector
and, as can be seen from David Morgan’s story, can bring with it great
success. It is also clear, however, that each potential diversification
project must be considered on its own merits. There are myriad considerations
from a practical, legal and family point of view and detailed thought must
be given to each of those aspects, particularly with the benefit of professional
advice from the earliest stage.

The increasing number of farmers and landowners entering into diversification,
however, demonstrates that, with the right advice, these issues can be
overcome. Should the current trends continue then it would appear that
diversification is here to stay and it may be that farmers and landowners
consider that it is the only option if their business is to survive and prosper.

For further information, please contact
Matthew Evans on 08082 787 102

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Conclusion

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