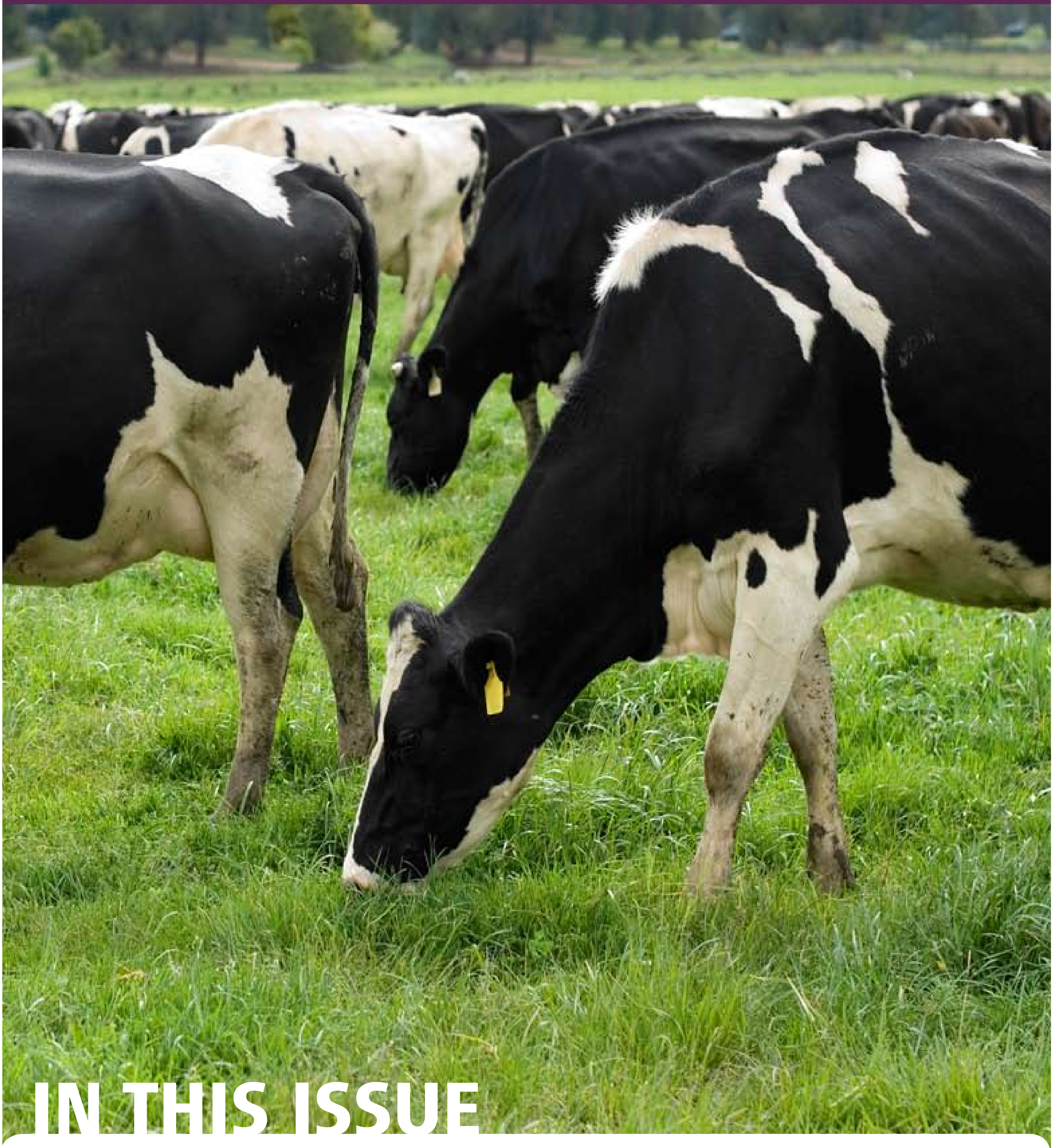
# AgriMatters

AIB supporting the Irish Agricultural Industry

Spring 2011



## IN THIS ISSUE

Distribution of EU Agricultural Funds / Economic Outlook

# Contents



## Our Agri Adviser Team

TADHG BUCKLEY
AIB MALLOW

PATRICK BUTTERLY
AIB DROGHEDA

PATRICK O'MEARA
AIB NENAGH

EAMONN O'REILLY
AIB TULLAMORE

DONAL WHELTON
AIB BANDON

# Welcome to the Spring Edition of Agri Matters

## Michael Dowling, Head of Agri Strategy, AIB

As is usual for the first edition of the year, we start with a review and outlook. And it is with some pleasure that we look back at what was, in general, a very good year for the agri sector and anticipate a further good year in 2011. Much has changed in 12 months.

We include two very topical features. Declan McEvoy assesses the limited company option in the context of tax planning for farmers. Laurence Shalloo looks at milk quota management, which is becoming increasingly important in a context where if we stay within quota this year it will be by a whisker and we run the very serious risk of quota excesses in the four years up to quota abolition on 31 March 2015.

One of the issues that will become increasingly topical over the next few years is the question of the shape of the post 2013 CAP, the negotiation on which will begin seriously late this year. The distribution of EU agricultural funds among Member States will be a major issue in that negotiation and, to give some background on this, we have included an article on the current position in that regard. We will come back to the broad topic of this negotiation in future issues.

This edition also includes:

- Our usual general economic analysis and outlook;
- An article by Patrick Butterly, one of our Agricultural Advisers, on banking the agri sector; and,
- A piece on the convergence of European and international agricultural commodity prices which has become a modern phenomenon.

I hope that all our readers will find something of interest in the mix.

Michael Dowling
Head of Agri Strategy

## Dates for your Diary

| | |
|---|---|
| April 20: | Bio Energy Conference - Tullamore Court Hotel |
| April 29-30: | Emerald Expo, Cillin Hill mart complex, Kilkenny |
| June 15: | Derrypatrick Beef Open Day - Grange Research Centre, Co. Meath |
| June 23: | Crops and Energy Open Day - Oak Park, Carlow |
| June 29: | Dairy Open Day - Moorepark, Co. Cork |
| August 14: | Tullamore Show and AIB National Livestock Show, Butterfield Estate, Tullamore |
| September 20-22: | National Ploughing Championships, Athy |

# Distribution of EU Agricultural Funds

The agri-food sector is an important part of the Irish economy. Given the way in which agriculture is supported at EU level, it is inevitable that EU agricultural expenditure in Ireland would be important to the Irish economy generally: as well, of course, being of great benefit to Irish farmers, processors and all those who depend on the agri sector for their livelihoods.

In the debate now beginning in regard to CAP reform, the question of the future distribution of EU agricultural funds, and especially of expenditure on direct payments, is undoubtedly the main issue. So, it is probably worthwhile looking at the current position in a little detail.

Many commentators believe Ireland gained a lot from the way agricultural funds are dispersed in the EU. Irish agricultural receipts from the EU are about €1.6 billion per year, of which the single farm payment accounts for about €1.3 billion. This amounts to about €379 per head of the population and, measured in that way, Ireland is the top recipient of EU agri funds.

That is not, however, a very sensible way to look at the distribution of the agricultural expenditure of the EU, as it is determined more by the size of the agricultural sector within national economies than by the efficiency or fairness of the distribution. The Netherlands, for instance, is the third lowest recipient of agri funds per head of the population. Yet, when its receipts are looked at from the point of view of the relative extent to which they support the agriculture sector, it is close to the top of the league.
It is an assessment of the relative support that the agri expenditure provides to the national agri sectors that is the most appropriate comparison method. The most logical way to do this is by looking at the expenditure per hectare of eligible land.

Table 1 below shows the relative position for the top three and bottom three Member States in terms of direct payments per eligible hectare; the Irish figures; and the averages for the EU as a whole and for the 'old' and 'new' Member States.

The table indicates that there are substantial differences between Member States in terms of agricultural receipts. The figures for the 'new' Member States reflect the position when their direct payments are fully phased in. It is clear that, even then, payments will, on average, be less there than in the 'old' Community. It is clear also, however, that the differences narrow substantially when all agricultural expenditure, and not just expenditure on direct payments, is taken into account. The differences are likely to be even less if comparisons are made based on the relative value of the payments in the various Member States, i.e. in terms of purchasing power.

The table shows clearly that Ireland is not a disproportionately high recipient of EU agri funds. Direct payment receipts per hectare here are exactly equal to the EU average and Irish overall agricultural receipts per hectare are somewhat below the EU average. In league terms, we are in 12th position in the case of the former payments and in 18th in the case of the latter. The same picture emerges when the comparisons are made per holding or per person employed in agriculture.

That is not, however, to imply that direct payments, and the single farm payment in particular, are not of paramount importance here. In the dairy sector direct payments normally account for less than 20% of farm receipts and less than one third of farm income. In all other sectors these payments are, on average, the principal element in farm income. In the cattle and sheep sectors, for instance, direct payments normally make up on average about 50% of farm revenue and over 150% of family farm income. The single farm payment alone is on average equal to 100% of farm income in the cattle sectors. Over all sectors it accounts for almost three quarters of average family farm income.

The nature and distribution of the single farm payment and the budget to be provided for it in the future will be central to the negotiations on CAP reform now commencing and due to be concluded over the next 18 to 24 months. Their outcome will be of critical importance to Irish farmers. Given our position in the league table of recipients, there is no reason to assume that the outcome will not be a reasonably favourable one for us. But there is a lot to play for. We intend to return to this issue in future editions of *Agri Matters*.

**Table 1: EU Agricultural Funds**

| Direct Payments per hectare (€) | | Total Agriculture Expenditure per hectare (€) | |
|---|---|---|---|
| **TOP THREE** | | **TOP THREE** | |
| 1. Malta | 801 | 1. Malta | 1836 |
| 2. Belgium | 462 | 2. Slovenia | 580 |
| 3. Netherlands | 459 | 3. Italy | 557 |
| Ireland | 271 | Ireland | 347 |
| **BOTTOM THREE** | | **BOTTOM THREE** | |
| 25. Lithuania | 145 | 25. Estonia | 251 |
| 26. Estonia | 118 | 26. Lithuania | 242 |
| 27. Latvia | 95 | 27. Latvia | 193 |
| EU 27 Average | 271 | | 364 |
| EU 15 Average | 295 | | 372 |
| EU 12 Average | 207 | | 335 |


*Robbie Henneberry, Managing Director AIB ROI, presents the AIB award for Outstanding Contribution to Communications in Rural Ireland at the Guild of Agricultural Journalism Awards to Ray Ryan, recently retired Agriculture Correspondent with the* Irish Examiner.

# Review and outlook

### Review

What a difference a year makes in the agri area generally and, indeed, what a difference a few months make in the grain sector.

This time last year we were reflecting on one of the worst years in price and weather terms that anyone could remember. As late as the end of spring we were anticipating another almost equally bad cereal harvest. How everything has changed.

Better weather, rapidly rising international commodity prices and a marked tightening of the beef and sheepmeat markets all combined to transform the scene. Only the pigmeat and potato sectors in the second half of the year failed to share in the bounce.

In the beef sector, prices rose by about 2% and slaughterings by some 8%, giving an overall increase in the cash value of output of about 10%. Beef prices were at their second highest level in the past 10 years (see figure 1).

In the pigmeat sector, on average over the year as a whole, prices were virtually unchanged but throughput rose by about 10% (due to the restocking after the dioxin crisis of the end of 2009). In the second half of the year, however, a drop in price, combined with a sharp rise in feed costs, pushed the majority of producers into a loss-making situation. The rise in feed prices also put a squeeze on margins in the poultry sector, where prices were slightly down on 2010.

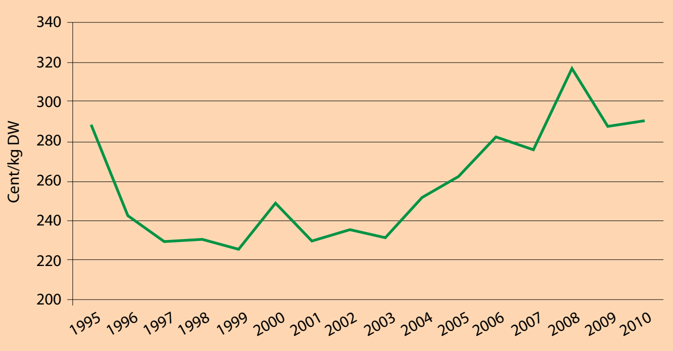
**'Beef prices were at their second highest level in the past 10 years'**

In the case of sheep, slaughterings were down by about 13% but prices rose by over 17%. As a result, 2010 was a year of generally improved profitability in the sector.

In a huge turnaround from the previous year, average prices in the milk sector, at about 30c/litre, were up by about 30% and deliveries by over 8%. As a result, the value of milk output rose by more than 40%.

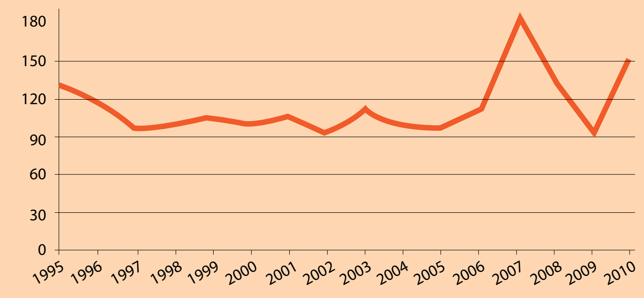
In an even bigger turnaround, cereal prices rose by some 60% and output by about 10%. Improving economic conditions internationally - resulting in increased demand and reduced production, especially in Russia and the Ukraine which were forced to apply export restrictions - dramatically changed the market situation which, up to the end of the spring, had been expected to be only marginally better than in 2009. There was, however, no

**Figure 1: Cattle Prices Ireland/Steers/R3**




Source: Bord Bia

**Figure 2: Grain Price Index 2000 = 100**




Source: CSO

such favourable outcome for potatoes, the other main tillage crop. Here, main crop prices were down some 15%-20% by the end of the year. On the other hand, this was at least partly offset by the fact that harvesting conditions had been very much better than in 2009.

Over the year as a whole, input costs were slightly down but from August onwards, driven mainly by higher feed and energy costs, were consistently above the levels of the previous year.

This favourable market situation, combined with a level of direct payments of close to €1.8 billion (slightly down from 2009), resulted overall in 2010 being a very favourable year for farm incomes. The preliminary CSO estimates put the aggregate income increase at 32% and at 50% when interest and land rental costs are taken into account. While these are impressive figures they have to be seen against the background of declines of 40% and 50% respectively in these two measures over the previous two years. Looked at in a longer timeframe, based on the CSO figures, aggregate incomes last year were about 9% less than the average of the previous five years and 7% below the average of the 10-year period 2000-2009. Aggregate inflation over the 10-year period amounted to about 27% and to some 7% over the most recent five years.

### Outlook

Price levels at the start of the year were favourable in almost all sectors and the outlook is for that situation to continue.

European and international dairy markets are very firm, with very strong demand and production increases limited due to climatic factors and high feed prices. Milk prices should, therefore, remain strong. We would expect Irish prices to remain noticeably above the 30c/litre level of 2010. Production rose to a point where the level of the quota was threatened in the current milk year. As of now (late March) it is touch and go as to whether we will exceed quota this year and current indications are that the quota will be filled in 2011/2012 and there is, therefore, a real risk of super levy for a significant number of dairy farmers, especially those who have embarked upon a medium to longer term expansion plan. This will require very careful management by farmers and purchasers over the next 12 months and, indeed, over the next few years - see Laurence Shalloo's article on page 10.

Last year, beef and sheep prices reached their second highest levels in the past 15 years. The indications are that sheep prices will this year exceed the 15-year peak and that beef prices will be very close to a similar peak. The European beef deficit will increase, Irish supplies will be tighter and, internationally, prices will be at record levels. Sheep supplies in Ireland will be reduced but the pace of reduction will be considerably less than in recent years.

Currently (late March) pig producers remain in a loss making, or breakeven, situation. The recovery in prices, however, began in early February and is expected to accelerate in coming months. We estimate that most producers will be back in reasonable profitability in the second half of the year.

**‘The grain market remains very strong and indications from futures markets and other sources are that it will stay very firm throughout the year.’**

The grain market remains very strong and indications from futures markets and other sources are that it will stay very firm throughout the year. Irish prices last year were the second highest in the last 15 years (see figure 2). We expect them to strengthen further in 2011 but to remain below the 2007/2008 peak. Recent estimates from the US underline the strength of the market. For instance, expectations there are that the end of year stock/use ratio in maize will be the lowest for 60 years and that maize prices will be at record levels. The maize position is being partly driven by strong demand for maize for ethanol but the market for wheat is also very strong, although not as tight as the maize market.

Given the likely price scenario as set out above, and the fact that direct payments will be at or above last year’s levels, the main variable determining whether or not farm incomes will improve in 2011 is likely to be input costs. Feed and fertiliser costs at the start of the year were high by historical standards. They are likely to stay high and remain above last year’s averages but not significantly above end-of-year levels. Soya prices may, however, exceed those levels as, for instance, soya meal prices in the US are currently above the 2007/2008 peak levels. Energy prices have spiked at present but are unlikely to come back significantly during the year. The overall outcome is, therefore, that much of the farmer benefit from strong prices will be absorbed by higher input costs. Nevertheless, there should be an increase in farm incomes this year sufficient to compensate for inflation but not very much more than that.


*Presenting the award at the National Dairy Show for the Confined Champion is Donal Whelton, AIB Agri Adviser to Anthony Kealy, Grangecon, Co. Wicklow with his cow Bawnaughra Bohene ET.*

# Price convergence

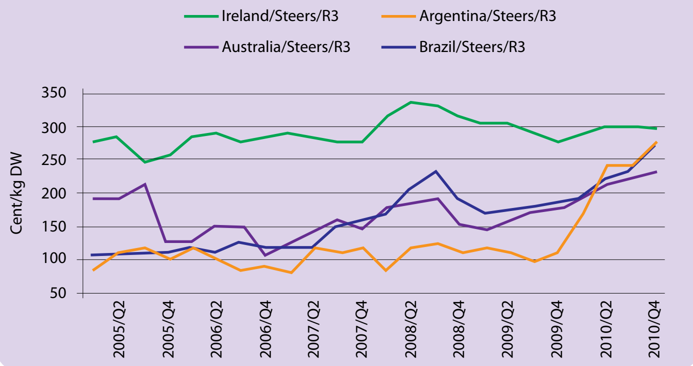
Traditionally, commodity prices in the EU have been very much higher than on the world market. Typically, beef, grain and dairy product prices on world markets have been no more than 50% of European prices. Export refunds have, in the past, made up the difference and allowed EU traders compete on those markets. As European policy has changed away from market support towards direct payments the importance of export refunds has greatly diminished.

Over the past 15 years, EU support prices have been substantially reduced and the level of export refunds needed has been reduced to an even greater degree. Indeed, in many cases, refunds have been able to be dispensed with completely for much of the past few years.

In theory, this would indicate that EU and world prices must have converged and, as is clear from the following two graphs relating to beef and milk, this is what has happened in practice.

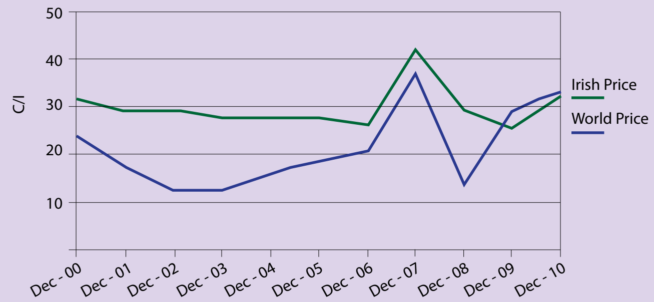
The beef figures show a remarkable convergence over the past five years. The milk figures paint a somewhat more volatile picture but the trend is, nevertheless, one of convergence. The interesting question relates to the extent to which convergence is due to world market prices strengthening in response to EU policy changes which facilitated cuts in export supports. There must be at least some element of that in the convergence but undoubtedly many other factors were at work also including the influence of exchange rate movements.

Figure 3: Cattle Prices




Source: Bord Bia

Figure 4: Irish and World Milk Prices




**Note:** Prices are gross figures (i.e before deduction of processing costs) and are AIB estimates based on CSO and USDA data.

*Pictured at the launch of the Green Dragon Innovation Challenge 2010/11 are Minister of State at the Department of Agriculture, Fisheries and Food, Sean Connick TD; Michael Dowling, Head of Agri Strategy, AIB; Teresa Brophy, Manager Ireland Market, Bord Bia and Bernard Donohue, Chairman Agri Aware. The Green Dragon Innovation Challenge is a secondary school initiative developed by Agri Aware in association with AIB and Bord Bia.*

# Economic outlook

Although the Irish economy still faces many headwinds, recent data confirm a clear easing in recessionary conditions. On a GDP basis, the economy contracted by 1.0% last year, much lower than the 7.6% decline in output seen in 2009. On a GNP basis, meanwhile, the economy expanded in each of the three quarters to Q4 of last year. Leading indicators so far for 2011 have been generally positive. The closely watched Markit PMI survey of manufacturing activity is currently at its best level since January 2000, while the services index was at a seven-month high in February. Consumer confidence is still subdued but has picked up in recent months. The unemployment rate remains close to its cyclical high but the Live Register has fallen in four of the past five months. Meanwhile, the Exchequer Deficit declined in January and February, with the tax take up in year-on-year terms in both months.

The GDP data 2010 do, however, confirm that a two-tier economy has emerged in Ireland. The export sector is booming while the domestic sector remains weak. What marks Ireland out from other economies is the sheer size of its export base, which is now approaching 100% of GDP. In most other countries, exports amount to 20-30% of GDP. Thus, when this sector is growing strongly in Ireland, it has the capacity to add greatly to economic growth. And the export sector here is certainly powering ahead at the moment.

Exports rose by 9.4% over the course of last year, with imports up 6.0%. Encouragingly, the growth in exports was broad based, with services as well as goods performing strongly. After a drop of 3% in 2009, service exports rose by 11.5% in year-on-year terms last year, with goods exports up 7.7%. This robust performance by the traded sector is reflected in an 8.3% rise in manufacturing output last year. While the upturn in manufacturing has been led by the multi-national sector, it is encouraging to see evidence of a recovery in output from both indigenous owned firms also. Output from the "modern" sector rose by 10.7% in year-on-year terms last year, while output from more traditional industries rose by 1.9% after a decline of 14.1% in 2009.

Domestic spending contracted for the third consecutive year in 2010, with investment activity again remaining very weak. Total fixed investment fell by 27.8% last year, compared to declines of 31.0% and 14.0% in the two previous years. This continued weakness reflects further steep falls in both residential and other construction activity, as well as lower spending on machinery and equipment.

Government spending also continues to fall, declining by 2.2% in 2010, a continuation of a pattern evident since early 2009 when the Government started to tighten fiscal policy aggressively. The Irish Government has implemented severe corrective fiscal measures to curtail the deterioration in the budget deficit. Fiscal tightening amounted to 6% of GDP in 2009 and 2.5% of GDP in 2010, and the underlying budget deficit has been stabilised at below 12% of GDP. Fiscal cutbacks of €6 billion are in train for 2011 (3.7% of GDP) to get the budget deficit down to 9.4% of GDP this year and cuts of €9 billion are planned for the period 2012-2014 under the proposals as set out in the four-year recovery plan.

Consumer spending also contracted again last year, falling by 1.2% in year-on-year terms, although the pace of decline slowed considerably from the 7% fall recorded in 2009. Although the decline in high-street spending appears to be bottoming out, households are likely to remain constrained in terms of spending decisions given widespread evidence of declines in wages, as well as tight credit conditions. Incomes also continue to be squeezed by contractionary budget measures, including higher personal taxes. Furthermore, the personal savings ratio has risen markedly, though this should be a positive for spending once economic conditions improve. Meanwhile, the ongoing difficulties in the housing market are adding to the negative backdrop for consumer spending.

Nonetheless, driven by a continued strong performance from the traded sector GDP is expected to rise by around 0.5% in 2011. Exports are expected to continue growing strongly, while both consumer and Government spending should see similar falls to 2010. However, the rate of decline in fixed investment should slow appreciably and, thus, the drag on GDP growth from declining investment activity is set to ease markedly from this year onwards. Recent prices data suggest that the period of deflation has ended as the headline CPI is driven upwards by higher mortgage costs, as well as rising commodity prices. However, underlying inflation is still subdued as reflected in the harmonised index of inflation.

**Table 2: Economic Forecast – Ireland**

**Annual % Change Unless Otherwise Stated**

| | 2008 | 2009 | 2010 (e) | 2011 (f) | 2012 (f) |
|---|---|---|---|---|---|
| Real GDP | -3.5 | -7.6 | -1.0 | 0.5 | 2.0 |
| Real GNP | -3.5 | -10.7 | -2.1 | -1.5 | 1.0 |
| Consumer Spending | -1.5 | -7.0 | -1.2 | -1.0 | 0.0 |
| Government Spending | 2.2 | -4.4 | -2.2 | -3.0 | -2.0 |
| Fixed Investment | -14.3 | -31.0 | -27.8 | -14.0 | 0.0 |
| Exports | -0.8 | -4.1 | 9.4 | 7.0 | 5.5 |
| Imports | -2.9 | -9.7 | 6.6 | 5.0 | 4.0 |
| CPI (%) | 4.1 | -4.5 | -1.0 | 3.0 | 2.5 |
| HICP (%) | 3.1 | -1.7 | -1.6 | 1.5 | 1.2 |
| Unemployment (%) | 6.3 | 11.8 | 13.6 | 14.2 | 14.1 |
| General Govt Balance (as % of GDP) | -7.3 | -14.4 | -31.9* | -9.4 | -7.3 |

**Source: AIB Economic Research Unit**

***Includes full upfront support to banking sector***

# Emerald Expo

A new All Ireland dairy event, Emerald Expo 2011 supported by the Irish Holstein Friesian Association (IHFA) in association with Alltech Ireland and sponsored by AIB will take place in Cillin Hill Mart complex, Kilkenny, on April 29 and 30.

There will be a wide range of interesting activities for farm families over the course of the two days.

Key features of Emerald Expo will include:

- Greenfield Dairy Farm site visit
- Technical Seminars
- National Shows with 20 classes, six Championships and a prize fund of €25,000
- Sale of both commercial and pedigree cattle

Further information regarding the event can be obtained at www.emeraldexpo.ie or by contacting Richard Whelan, the Show Coordinator on tel: 044-9375734/087-9152792 or by Email lumville@eircom.net

# Tax planning for farmers - assessing the Limited Company option

Declan McEvoy
IFAC Accountants
Senior Tax Consultant

The option to farm through a Limited Company has been available to all sectors of farming since 2008 through the de-regulation of milk quota rules allowing the leasing of milk quota and land to a company structure.

There are income and capital taxes, legal, commercial and personal tax consequences to be considered and sound professional advice is essential.

With a 12.5% company tax rate compared with a possible 55% income tax (including PRSI and Universal Social Charge) it may seem an ideal way to reduce one's tax liabilities but prior to entry into a limited company one must be aware of the possible disadvantages also.

## Preliminary Assessment

The answers to the following preliminary questions will give an initial indication as to whether the company structure should be pursued:

1. Will the individual be liable to the top rate of tax on an ongoing basis?
2. Is expansion being considered?
3. Will projected personal and non-farm expenses be substantially lower than the profits being generated by the farm AND likely to remain lower in the future?
4. Are any major immediate farm management or ownership changes envisaged?

The answer to these questions will give an indication as to whether the company option should be examined further.

## Exploring avenues other than the Limited Company Structure

The limited company structure should not be the first avenue to be explored because 'personal money is preferable to corporate money'.

Prior to opting for a limited company structure one should explore all tax saving mechanisms available including the following:-

- **Tax planning within the farm gate to include:**

Maximising
  - Family wages
  - All tax allowances
  - Claimable deductions

- **Structure of the business**
  - Partnership Option

- **Off-farm Tax Shelters**

Availability/Advisability of off-farm tax efficient investments:
  - Pensions
  - Business Expansion Schemes etc.
  - Film Relief

Only having considered these options should the limited company structure be seriously considered.

## Advantages of a Limited Company Structure

### 1. Tax Rate

The company tax rate on trading profits is 12.5% compared with a tax rate of up to 55% (Income Tax, PRSI and Universal Social Charge) for an individual. The rate of tax applies to retained profits, i.e. profits left in the company after living expenses are withdrawn usually by way of salary, rent etc.

### 2. Enhanced ability to repay borrowings

The company tax rate of 12.5% enables the retention of 87.5 cent from every euro trading profit in the company for development/loan repayments compared with as little as 45 cent when trading as an individual sole trader.

Table 3 below shows the pre-tax gross income that is required to produce net after tax income of €1,000 taking into account the various rates of personal and corporation tax. This shows that with tax, PRSI and Universal Social Charge amounting to 55% the business would have to earn €2,222 in order to repay €1,000 to the bank if one were a sole trader, while the direct comparison with a company is that it would only have to earn €1,143 in order to repay €1,000. This represents a significant saving.

**Table 3: Company Tax**

| | Personal | Limited Company |
|---|---|---|
| Gross | €2,222 | €1,143 |
| Less 55% Tax | €1,222 | |
| Less 12.5% Tax | | €143 |
| Available after tax to repay loans | €1,000 | €1,000 |

### 3. Pensions

A benefit to be derived from using a limited company is the more generous tax treatment afforded to company pension plans compared with pensions for individuals. Pensions are a common tax efficient tool for the extraction of value from a company.

### 4. Directors loan

The transfer of stock and machinery and other farming assets into the company can be used to accumulate a tax-free source of funds available to be withdrawn tax free over time.

### 5. Limited liability

In practice we find in many cases limited liability is diluted due to financial institutions' insistence on securing personal guarantees for bank borrowings.

## Material Disadvantages of a Limited Company

### 1. Higher tax rate on investment income

Investment income - e.g. deposit interest, rental income etc. - earned by the company attracts a higher rate of 25% compared with 12.5% on trading income. Where this investment income is not distributed to shareholders within 18 months an additional surcharge of 15% applies.

### 2. Withdrawing money from the company

The most common mechanisms used by company Directors to withdraw money from a company is by way of salary and/or rent which are subject to income tax in the hands of the Director.

'Surely I can get a loan from my own company!'
Legally, a company is a separate person from its owner/s and even a 100% shareholder is not entitled to treat the company as his private bank. There are legal restrictions on a Director taking money out of the company, which would not apply to a sole trader farmer taking money out of his own business. Directors cannot legally borrow from the company more than 10% of the value of the company and to do so is an indictable offence. Allowable loans up to 10% of the value of the company are not tax efficient because there are income tax consequences for the company and benefit-in-kind issues for the Directors.

From my experience of seeing farmers transfer from sole trader to limited company the issue of restricted access to company monies represents the greatest challenge.

### 3. Revision of sole trader tax bills

The Tax Authorities have the right to re-examine the tax liabilities of a number of years immediately prior to a sole trader farmer ceasing to farm. This must be examined on a 'case by case' basis.

### 4. Capital gains tax - double chop

The rate of capital gains tax payable on the disposal of shares in a company is 25%. However, a double capital gains tax charge could arise if the company first sells its assets i.e. the tax is paid within the company, and subsequently the company is sold, transferred or liquidated.

### 5. Additional administration costs

There is an extra layer of bureaucracy and administration required with limited companies including the dual annual filing requirements with both the Companies Office and Revenue.

### 6. Succession planning

The existence of a limited company can make succession planning and future transfers more complex necessitating proper structuring and planning.

### 7. Loss of confidentiality

A small Irish registered company is obliged to file its balance sheet with the Companies Registration Office and this balance sheet is open for inspection by the public.

## Farming Companies More Complex

Farming companies are more complex than most companies engaged in other businesses because of the existence of specific legislation and practices relating to the trade of farming. These include:

- Specific farm tax reliefs;
- Milk quotas;
- Single farm payment entitlement; and,
- Current/potential impact on existing or future qualification for national and European aids.

The existence of the above makes it imperative that any farmer considering the use of a limited company structure should have clear, reliable and concise advice.

## Benefit for Higher Rate Tax Paying Farmers

The use of a limited company structure can yield significant tax savings to certain farmers paying income tax at the higher rate. In assessing the advisability of opting for the company structure, it is not as simple as comparing the 12.5% company rate to the higher personal income tax rates of up to 55%. The decision to opt for the limited company structure should be approached with caution.


*Pictured at the final of the AIB/Macra na Feirme Club of the Year Competition are members of Portlaoise Macra, AIB/Macra na Feirme Club of the Year 2010 with Patrick Butterly, AIB Agri Adviser and Michael Gowing, Macra na Feirme National President.*

Laurence Shalloo

# Milk quota management 2011 to 2015

**Laurence Shalloo and Brendan Horan**
**Livestock Systems Research Department, Animal & Grassland Research and Innovation Centre, Teagasc, Moorepark, Fermoy, Co. Cork**

Milk quota has been in place in Ireland and the EU since 1984. Milk quotas will be abolished on the April 1, 2015. Since 2008, European dairy farmers have been given the signal that expansion will be possible, with the Irish national quota to be increased by the equivalent of 9.3% between 2008 and 2013 when all components are included. Between now and 2015, while preparing the business for a no quota dairy industry, farmers must manage their milk quota position to ensure that they will not expose their dairy business to financial difficulties in the event of a super levy. This transition period will be a challenge for many farmers who have reacted to expansion signals by putting more animals in calf to dairy sires, which has increased the availability of dairy heifers and ultimately is resulting in a larger dairy herd nationally. The availability of additional dairy heifers has the potential to increase the national dairy herd by between 3% and 4% in 2011 and 2012. However, unlimited expansion will not be possible until milk quotas are removed in 2015. The current rate of the super levy fine is €0.287/litre. If confronted with such a penalty, there could be negative effects on a dairy business.

Table 4 shows the costs of production and net margin per litre for the average dairy farmer, the top one-third (lowest cost) and the bottom one-third (highest cost) producers in 2010. The figures shown in each column represent the average across the 6,000 or so farmers in each cost grouping.

**Table 4: Costs of Production and Net Margin (Cent per litre) 2010**

| Farm Group | Low Cost | Average | High Cost |
|---|---|---|---|
| Gross Output | 30.2 | 30.2 | 30.1 |
| Production Costs | 16.6 | 20.8 | 27.4 |
| Net Margin | 13.6 | 9.4 | 2.7 |

Source: Donnellan and Hennessy (2011)

The top one-third of dairy farmers earned a net margin of almost 14 cent per litre in 2010. Taking an example of an owned quota of 400,000 litres, in 2010 the net profit from milk production was approximately €54,400, €37,600 and €10,800 for the low, average and high cost producers, respectively. If this farm had only had milk quota for 350,000 litres, but produced 400,000 litres, and a super levy was applied then the profit would have been €40,070, €23,270 and -€3,530 for the low cost, average cost and high cost producers, respectively. Clearly, the penalty is applied at the same rate for all of the producers but the effect on profitability is much larger for high cost producers as it reduces their overall profitability to less than zero.

Individual farmers breaching their milk quota should develop a plan around milk quota management. Depending on the level of exposure the plan will incorporate one or more strategies. One plan will not fit all and plans should be developed with a number of components in mind. These include level of milk produced above milk quota, cost of milk production, level of borrowings and requirement for drawings. There are a number of mitigation strategies that can be put in place on farms that will both reduce the likelihood and effect of a super levy fine:

- Reducing supplementary feed;
- Feeding more milk to calves;
- Purchasing milk quota;
- Reducing the milking frequency for part or all of the year;
- Reducing lactation length; and,
- Reducing livestock numbers - mature cows or heifers

Three different scenarios, where the producer is 11%, 30% and 50% over their respective milk quotas, will be analysed and a management plan developed for each. The projected 2010 costs and price data from the National Farm Survey (Donnellan and Hennessey 2011) were used as a baseline for the analysis.

## Over milk quota (11%)

In this first scenario, a producer has the potential to produce 11% over their actual milk quota in the 2011/2012 milk quota year. This producer has to decide whether they should continue to milk on, similar to the 2010/2011 milk quota year, or whether they should take action on their farm to reduce the exposure. As highlighted earlier, their actual cost of milk production and expected level of profitability should indicate the urgency with which the issue needs to be addressed on farm. Table 5 presents two scenarios. In one scenario the producer does not amend his/her management decisions and, ultimately, incurs the super levy fine while in the second scenario the producer takes action to reduce the exposure. In this analysis the farm has the potential to produce 400,000 litres with an actual milk quota of 360,000

**Table 5: Mitigation strategies for a potential exposure of 11% of total quota**

| Milk Quota (l) | 360,000 | |
|---|---|---|
| | No change: Super Levy | Reduce Exposure to Super Levy |
| Concentrate fed per cow kg | 990 | 350 |
| Concentrate costs €/tonne | 260 | 260 |
| Concentrate response l/kg | 0.70 | 0.70 |
| Milk price c/l | 32.0 | 32.0 |
| Milk deliveries per cow l | 4,651 | 4,203 |
| Cow numbers | 86 | 86 |
| Milk deliveries | 400,000 | 361,458 |
| Concentrate costs c/l | 5.20 | 2.02 |
| Gross Output farm | 129,200 | 116,867 |
| Direct Costs farm € | 50,320 | 36,821 |
| Fixed Costs farm € | 36,640 | 36,640 |
| Super levy fine € | 11,480 | 418 |
| Net Profit Farm € | 30,776 | 42,988 |

litres. Reducing concentrate supplementation from 990kg of concentrate per cow to 350kg (still allowing for spring supplementation of up to 3kg/day) of concentrate per cow results in a milk sales reduction of 9.6%. This results in a small super levy fine of €418. Without action on the farm a super levy fine of €11,480 would have been incurred. So, overall profitability is increased by 40% through reduced concentrate feeding while avoiding any significant super levy fine. In the event where there was no super levy with a milk price 32c/l, concentrate cost of €260/tonne and response to concentrate of 0.7l of milk/kg of concentrate there would still be a small reduction in profitability from the higher level of concentrate feeding.

### Over milk quota (30%)

In the second scenario the farm has the potential to produce 30% over their actual milk quota in the 2011/2012 milk quota year. As in the first scenario, the supplementary feed levels should be reduced at first, which will reduce milk output by approximately 10%. The next option available is to milk cows once a day for part or all of the lactation. Table 6 presents a comparison of once-a-day with twice-a-day milking, which was modelled on research carried out in Moorepark over a two-year period. In this study, cows were milked once and twice daily and compared for the entire lactation. In this analysis, the reference milk concentration for the fat adjusted milk deliveries is 3.80%. Full labour costs are included in the analysis with 25% less labour in the once-a-day system (at a rate of €12.44 per hour). The results presented show that if the herd were milked for the entire lactation twice a day they would have incurred a super levy fine of €39,938. Milking once a day reduced this fine to €6,011. The profitability was €16,173 higher when the cows were milked once a day. There may be a requirement to sell cows with cell counts greater than 250,000 before embarking on once-a-day milking.

### Over milk quota (50%)

In the third scenario the farm has the potential to produce 50% over their actual milk quota in the 2011/2012 milk quota year. It is not possible to reduce milk output enough in this scenario to fully insulate against a super levy fine without selling some stock from the farm. Reducing concentrate feed and milking cows once a day will only reduce milk output by at most 35%. A producer with this level of exposure is likely to also have to reduce stock numbers. Mature cows produce 25% more milk than heifers, have the lowest EBI, have a higher probability of being lame and potentially have the highest somatic cell counts in the herd. A 10% reduction in mature cows will reduce milk output by 11.5% which, when coupled with a reduction in concentrate feed and a reduction in milking frequency, has the potential to reduce milk output by close to 50%.

**Table 6: Effect of milking frequency (MF) on biological and economic performance.**

| Milk Quota (l) | 360,000 | |
|---|---|---|
| | No reduction in milk output | Reduction in milk output |
| | TAD | OAD |
| Milk yield (kg/cow) | 6013 | 4437 |
| Milk solids yield (kg/cow) | 437.0 | 351.1 |
| Fat (g/100g) | 3.99 | 4.40 |
| Protein (g/100g) | 3.29 | 3.53 |
| Milk sales (l) | 490,766 | 364,643 |
| Fat sales (kg) | 20,129 | 16,375 |
| Protein sales (kg) | 16,642 | 13,176 |
| Cow numbers | 90.0 | 90.0 |
| Labour costs € | 30,891 | 23,259 |
| Total costs € | 144,266 | 128,655 |
| Milk returns € | 167,938 | 136,193 |
| Super levy fine € | 39,938 | 6,011 |
| Profitability € | 13,057 | 29,230 |

### Summary

Nationally, since milk quotas were introduced there have been super levies paid on 14 occasions, with €117 million paid in total. Based on current projections around heifer numbers and the current EU milk quota policy, there will be further super levy fines in the future. No farmer who will supply more milk than his/her quota allows can afford to ignore the super levy threat between now and 2015. The costs of production and level of exposure are key components of any plan to deal with this threat. There are options as discussed above, as well as options around milk quota purchase (while exchanges are closed for the 2011/2012 milk quota year, they remain an option for future years), feeding milk to calves and reducing lactation length. All options need to be evaluated at farm level in light of the national, milk processor and finally one's own position relative to quota.

# Recent Appointments

## Simon Coveney, Minister for Agriculture, Marine and Food

Simon Coveney T.D. was appointed as Minister for Agriculture, Marine and Food on March 9, 2011. With a B.Sc. in Agriculture and Land Management from The Royal Agriculture College, Gloucestershire, Minister Coveney was first elected to the Dáil in 1998 as one of Fine Gael's youngest TDs. Since then, he has held Shadow Ministries in the following areas: Drugs and Youth Affairs; Communications, Marine and Natural Resources; Transport and the Marine. He was elected to the European Parliament in 2004 and was a member of the EPP-ED group. Minister Coveney chaired the Fine Gael Policy Development Committee, prior to the 2011 General Election.

## Vanessa Woods, Executive Director, Agri Aware

Dr. Vanessa Woods has recently been appointed as Executive Director of Agri Aware. Vanessa is a native of Athboy, Co. Meath and hails from a beef farm. She holds an honours degree in Microbiology from University College Galway and a PhD in animal nutrition from University College Dublin. Vanessa worked as a senior researcher with the Agri-Food and Biosciences Institute Hillsborough for the past 11 years in areas covering the broad-spectrum of the agri-food industry. She also delivered lectures to students attending the School of Agriculture and Food Science at the Queen's University of Belfast.

# Banking - the agri sector

**Patrick Butterly, Agri Adviser AIB, discusses the recent volatility in the agri sector and the importance of financial planning.**

With the Irish economy suffering one of its steepest ever contractions in economic activity over the past couple of years, Irish policy makers are now more focused than ever on identifying and nurturing sectors that can contribute to Ireland's economic future. One such sector is the agri food sector, the output of which accounts for 10% of total Irish exports, but which contributes significantly more to the Irish economy given that practically all of its output and profitability is generated and retained within the Irish economy. The recently published Food Harvest 2020 report from the Department of Agriculture, Fisheries and Food is clear evidence of this renewed focus on agri food and the potential of the sector. This report targets an ambitious increase of approximately 42% in food exports by 2020, which is underpinned by ambitious and clear targets for each of the agri sectors, thus giving clear direction for the future.

In AIB we are committed to playing our part in supporting this expansion. The bank is committed to supporting and assisting viable farmers develop and expand their farms and, in so doing, helping to exploit the potential of the agri industry. Agriculture has always been a key business sector for AIB. Market research shows that approximately four out of every 10 farmers have their main account with AIB. There is a depth of knowledge of, and experience in, dealing with farmers throughout the bank and this is strongly supported by a team of six specialist Agri Advisers.

Previous editions of Agri Matters highlighted the key information required by the bank to assess funding proposals, including: up-to-date farm accounts; management accounts such as profit monitors where applicable; asset/liability profiles; cash flow and income/expenditure projections, particularly in regard to farm development plans. Customers are now experiencing a more structured and formal lending process that requires more management information than in the past However, a well prepared proposal, supported by a good business plan, is key to ensuring that a farmer's lending proposal receives the most favourable and speedy consideration by the bank.

Our expectation is that farm investment will increase from current levels over the medium-term, driven by the combination of targets set out in the Food Harvest 2020 Report and the broader, more positive outlook for agriculture as depicted by FAO and OECD projections. We are already seeing evidence of increasing numbers of farmers buying land, with land prices now down to more realistic levels compared to the highs of 2007 and 2008. The ending of milk quotas in 2015, the continued allocation of milk quota to new entrants, the launch of the Dairy Equipment and Rainwater Harvesting Schemes and ongoing investment in on-farm efficiency and improvements will maintain high levels of investment in agriculture.

### Volatility

The recovery in the dairy and cereal markets in 2010 is evidence of how quickly markets can change and exemplifies the volatility that comes with world market trade. The trend towards the market orientation of agricultural policies at EU and WTO level is reducing the influence of market management instruments. Volatility will be a greater feature of the EU market in the future than it was in the past. It is critical that we learn from the experience of the past few years. Milk, cereal and other agricultural product prices are likely on average to be higher than in the past but very unlikely to be stable. The latter is more or less inevitable in a mainly market led environment. It is important for producers to bear this in mind during good years. Our advice to farmers is not to over react to the high or low prices: to view the farm performance over a five-year period and to build up a buffer fund 'in good years' in the expectation that markets can change. Farm expansion plans need to take account of these cycles and should not be too heavily based on high prices at the top of the cycle. Putting something away for a rainy day was an old maxim that was forgotten by all of us in recent times. Many pig farmers who are now experiencing cash flow difficulties are accustomed to the need to have built up cash reserves in preparation for the low profit phase in the pig cycle.

### Managing your bank account/financial planning

The increasing level of volatility has now highlighted the need for greater financial planning at farm level. Managing your farm finances and your bank account performance is now equally as important as managing your farm to as high a standard as you can. Undoubtedly there is increased rigour in the assessment of credit requests and increased control by all banks of working capital facilities. Bank account performance is a key indicator of how businesses are managing their cash flow. Therefore, we encourage farmers to take more control of their current account management and adhere to their bank account limit more closely than previously.

It is important to talk to your bank on a regular basis to ensure they are fully up-to-date on your business and can plan in advance for your financial requirements. Our advice to farmers is to plan their cash flow requirements at the beginning of each season and stress test these against changes in input and output prices. Farmers who follow that advice will be best placed to approach their bank at an early date if significant changes in output prices (as with milk prices in 2009) or input prices (as with pig feed prices in 2011) occur. Where short-term cash flow problems arise, it is important to approach your bank at an early stage. In addition, a timely and well prepared cash flow plan also gives comfort to the bank that this client is an effective manager of their farm finances.

### In conclusion

2010 was a substantially better year for agriculture and was much needed to repair the cash flow damage of 2009. Agriculture, which has proven its resilience over the years, is one of the few properly functioning sectors in the economy and it provides one of our main planks for economic recovery. The medium-term outlook is positive and growth targets for Irish agriculture will require significant investment and bank support. Managing volatility will be a key component in future farm expansion strategies. AIB has had a long association with the agricultural sector. We remain strongly committed to partnering with farmers and the agri industry in striving to achieve the potential of the sector.