

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



FOR INDIVIDUALS

HUGH | JAMES

Understanding law, understanding you

# 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 9% to £70,200, driven by lower milk prices and 4% for cattle & 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 those 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.



**£70,200**

Average Farm Business Income on dairy farms

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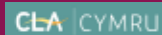
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**Rebecca Williams**  
Director – Wales, CLA  
rebecca.williams@cla.org.uk

Rebecca leads the CLA in Wales. The CLA is a membership organisation that represents the interests of landowners, farmers and rural businesses in England and Wales through lobbying 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 frequently acts for agricultural clients. Matthew also specialises in will and inheritance disputes, often in the agricultural sector.



**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, wayleaves and easements and education sector 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.

## Foreword

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.



**3,100**

Farm businesses in Wales engaged in producing output from diversified activities



# What is agricultural diversification?

Agriculture has always been and remains the cornerstone of Welsh rural communities and their economies. As such farming and land use is hugely important and will continue to be so.



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 no great surprise. Clearly the main driver is economic and the need to get additional income, to keep the family 'on the land'.

Commodity prices are low to the extent that, in some sectors and most notably milk, the sale price is lower than the cost of production; a position that is clearly unsustainable.

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

“ The CLA is seeing a whole host of new ways in which farmers have diversified their businesses ”

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 the same period and it seems highly likely that it will continue to decrease as the challenges facing the EU change (for example terrorism and migration).

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.

“ Farm business income from diversified enterprises increased to £15 million (5% of farm business income) in 2013-14, from £14 million in 2012-13. ”

“ Diversified enterprises contributed around £27 million (2%) to farm business output in 2013-14, having increased from around £22 million in 2012-13. ”

“ The average diversified output for farm businesses with diversified activities was £8,800 per farm in 2013-14, compared to £7,700 in 2012-13. Average enterprise income from diversified activities in 2013-14 was £4,900 per farm, with tourist accommodation and catering producing an average enterprise income of £6,800 per farm. ”

## 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' sites (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.

You should also talk to your neighbours because co-operation and collaboration are key to meeting policy drivers. Perhaps look for opportunities to work with others. Early research and advice could save a lot of trouble and expense later on.

## David Morgan Case Study

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

Following the death of his father when David was just six years old and the brave 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 dairy 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 renovated and let the farm's once-derelict, but historic and listed farm buildings.

His childhood passion for building things and a self-taught skill as a welder has also seen his family develop a local agricultural buildings business into Morgans of Usk - Wales's leading manufacturer of steel framed structures, with projects ranging from schools and universities to hospitals, supermarkets and cinemas.

Along the way, David was one of the first steel building fabricators to use autoCAD technology when in 1970 he invested the huge sum of £48,000 in a desktop computer. He also brought the first robotic milking machines to Wales in 2001, gained City funding for his wood-to-gas electricity power plant, and is about to launch a range of dried slurry fertiliser to the garden centre sector.

David is 74, still works every day with his wife, daughter and one of his sons, and was the president of the Royal Welsh Agricultural Society for 2015. He was awarded the MBE in the Queen's New Years Honours 2015 for services to agriculture and for voluntary service to the agricultural community in Monmouthshire.



£48,000

Invested in a desktop computer

# David Morgan Interview

## Have you always been a farmer?

I was born at my family farm near Little Mill in Glascoed and grew up around the cows, chickens, sheep and crops. My father bought Trostrey Court Farm in 1943, but sadly died three years later when I was just six. My mother kept the farm and rented it out, and built herself a new house on some adjacent land. I helped her work that farm until I took over Trostrey Court in 1961 when the tenants went out of business. I've worked the farm, amongst other things, ever since.

## But you're a builder as well?

When I was growing up, if you had nails, a saw and some wood, you could build anything. So I built all of the farm buildings on my mother's farm and, when I was running Trostrey Court, I built all of the modern buildings here too.

We had a lot of machinery that needed repairing and maintaining so I taught myself to weld, and then put up a couple of steel framed buildings too. A neighbour told me he was planning a new building and I asked to quote - he gave me the job and, by the time I had finished, I had two more lined up.

## And that is how Morgans of Usk came about?

Yes. Now we're building the steelwork for huge projects including supermarkets, cinemas and hospitals.

## Do you think of yourself as an innovator?

I like technology and things that help make life easier, I suppose. I remember talking to a friend in the 1970s about whether there was a computer program that could help

me with the drawings for the building business. There wasn't one that ran on a desktop computer, so we invented one. The computer and program cost me £48,000 - a huge amount. I remember thinking at the time that I could have bought two houses for that. It revolutionised the business though; we were streets ahead of the competitors.

## The farm itself is still quite traditional though, isn't it?

In so far as we have a pedigree dairy herd of about 220 cows with 250 followers, raise poultry and grow arable crops across our 500 acres, yes I suppose it is.

“  
In all this though you have got to be enthusiastic.  
If you can't give it 100%, don't bother starting

220

Pedigree dairy cows



300

Tonnes of chickens reared every six weeks



## Do you use technology in the milking shed?

Yes, we were the first people to bring robotic milking parlours to Wales. In around 2001 we visited a couple of the robotic systems working in England, and the Dutch one we eventually bought was amazing. In fact, it's still in use today and we've only recently needed to upgrade the software.

## 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 Farm, so it's important to keep standards high. We also added solar photovoltaic panels to the chicken sheds about five years ago. That's been a great help to keeping energy costs down.

## Was that your first experience with renewable energy?

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

I started with some converted diesel engine generators running on palm fatty acid distillate (PFAD). Unfortunately, quite early in that project the Government cut the energy subsidy, the price of PFAD doubled and the engines were not performing as I had been led to believe they would, so I knocked that on the head before I lost too much money.

Now we have partnered with a company and built a substantial biomass power plant. We burn waste wood chips at a very high temperature; so hot that it turns to gas. We then process that gas and burn it in very large gas-fired engines which in turn drive the alternators to generate the energy.

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 keep spreading it across our fields.

## So you have a diverse product list at Trostrey Court?

Yes, I suppose we do. There's the milk and some beef from the barren cows, around 300 tonnes of chicken every six weeks, plus we grow all our own feed for the cows, silage and maize mostly, but also wheat some of which we sell. We rotate our crops so there is always something useful growing.

We also sell the power we don't use and we sell the waste products from the biomass. The process produces a type of black powder called char. We mix that with sawdust, form it into bricks and sell it to a coal fired power station as fuel. We also want to enter the retail sector by working with garden centres to sell the dried slurry as garden fertilizer.

Then there's the accommodation.

# David Morgan Case Study

**I was going to ask about that. There are lots of buildings here that you've converted.**

Yes, we have renovated nearly all of them. Many were almost derelict when I took over in 1961, but some are listed. The court house dates back to 1667. We now have about 12 properties, all with assured shorthold tenancies.

**Not holiday lets?**

No, that would involve a lot of work at weekends on turn around.

**Would you venture in new build?**

I'd love to but planning is a real issue for land owners. It's all greenfield land we own, so they won't let you build anything. We are lucky we had enough existing buildings on the farm to renovate them for ourselves and our daughter.

**What advice would you give to someone who is thinking of similar diversifications?**

Well what we've done has been a progression. I didn't map out what we've got today in one go. I'm usually looking for the next thing to make us more profitable. In all this though you have got to be enthusiastic. If you can't give it 100%, don't bother starting.

Our single biggest issue with all we have done is getting planning permission. Everything takes so long to get through. I find that very disappointing and frustrating. Regulation is another issue. Everything we do at Trostrey Court is highly regulated - dairy, poultry and power. There seems to be a piece of red tape for everything the farming community does.

**Has it been worth it?**

The year we took over Trostrey Court was also when I got married to Nancy. We have lived and worked here every day for 54 years. I work alongside my daughter to look after the cows and Nancy works with my youngest son Andrew at Morgans of Usk. Our other son Peter has his own land, solar panels, building conversions and renovations nearby as well. The farm has been wonderful for us.



# Legal issues for consideration

All 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.

## Grants and subsidies

Grants and subsidies are of huge importance to the rural economy. Subsidies can also potentially be a significant driver for diversification.

In recent years this has been in the direction of 'green energy'. Government policies are often politically motivated and can be prone to trends, as has been the case with feed-in tariffs paid for renewable energy schemes.

Before considering diversification projects, it is important to seek advice on which grants and subsidies may be available for the schemes envisaged and also, importantly, on how the proposed diversification may affect any already being received.



# Thinking about the future

## Succession planning and business continuity

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 a professionally drafted will 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 measures 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 steps are 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.



“ On the whole, agricultural businesses are taxed quite favourably when compared with others ”

### 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 either:

- 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 that they must take steps to ensure that it is available to them and maximised at the time of their deaths. That is particularly pertinent if diversification is being considered. Here are a few pointers as to the issues to be borne in mind:

1 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.

2 APR is only given on agricultural assets. It isn't given on the value of the farm business itself. However, the business of farming is itself a business and it can qualify for another relief known as Business Property Relief (BPR). The conditions for that relief generally are that the business must be a sole trader or a partnership, or, if it is incorporated that it be the individual's family company. Investments made by an individual in a larger enterprise generally do not attract BPR.



3 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, is not used for an agricultural purpose 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 must, by definition, be attributable to the fact that solar panels are on it.

From a BPR perspective, the biggest challenge arises from the fact that the exploitation of land for rent is not 'business' in the BPR sense of the term. The clearest example of that would be the simple 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 receive the relief. A more complex situation comes with diversification for tourism purposes. For example, if a chalet or caravan is placed on part of the farmland and is let to holidaymakers, then that is a purely rental activity and does not qualify for BPR. However, there can be borderline cases.

For example, the running of a caravan park where a good deal of the income comes from the provision of services can qualify for BPR. The important point would be to ensure that the letting activity was not predominant and that the activity taken in the round is in fact a business rather than a letting.

It is perhaps obvious from those examples that any diversification activity has the potential to put both the APR and BPR status of assets that are used for such purposes at risk. Careful planning and consultation with accountants and lawyers before embarking on the exercise enables the business to be structured in a way that is more tax efficient, but also for the tax efficiency to be assessed up front. The death of the owner of a business is a particular time of risk and business continuity is paramount.



### 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 "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 towards the end of their lives) but wish to continue living in the farmhouse, it suddenly ceases to be the 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 question of planning permission is an integral element at the idea inception stage. It is never too early to consider planning implications in the context of a farm diversification project. Often we see complex planning disputes where a farmer is seeking to convince a planning authority to allow a project to proceed but the project has been conceived without the necessary concentration 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 ”

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 significant investment of time and energy is put into a diversification project.



## Family considerations

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 when 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 founded in the legal doctrine known as estoppel.

Most commonly the promise that it is alleged has been made is that somebody will eventually inherit the land in exchange in 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.

It is conceivable, however, that such issues could arise upon diversification. That is particularly 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 their expectation to their detriment.

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

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, preferably 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.

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





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