NESC REPORT NO. 15

THE TAXATION OF FARMING PROFITS

Price: £3.50

NATIONAL ECONOMIC AND SOCIAL COUNCIL

The Taxation of Farming Profits

No. 15

NATIONAL ECONOMIC AND SOCIAL COUNCIL

CONSTITUTION AND TERMS OF REFERENCE

1. The main task of the National Economic and Social Council shall be to provide a forum for discussion of the principles relating to the efficient development of the national economy and the achievement of social justice, and to advise the Government through the Minister for Finance on their application. The Council shall have regard, *inter alia*, to:

(i) the realisation of the highest possible levels of employment at adequate reward,
(ii) the attainment of the highest sustainable rate of economic growth,
(iii) the fair and equitable distribution of the income and wealth of the nation,
(iv) reasonable price stability and long-term equilibrium in the balance of payments,
(v) the balanced development of all regions in the country, and
(vi) the social implications of economic growth, including the need to protect the environment.

2. The Council may consider such matters either on its own initiative or at the request of the Government.

3. Members of the Government shall be entitled to attend the Council's meetings. The Council may at any time present its views to the Government, on matters within its terms of reference. Any reports which the Council may produce shall be submitted to the Government and, together with any comments which the Government may then make thereon, shall be laid before each House of the Oireachtas and published.

4. The membership of the Council shall comprise a Chairman appointed by the Government in consultation with the interests represented on the Council

Ten persons nominated by agricultural organisations,
Ten persons nominated by the Confederation of Irish Industry and the Irish Employers' Confederation,
Ten persons nominated by the Irish Congress of Trade Unions,
Ten other persons appointed by the Government, and
Six persons representing Government Departments comprising one representative each from the Departments of Finance, Agriculture and Fisheries, Industry and Commerce, Labour and Local Government and one person representing the Departments of Health and Social Welfare.

Any other Government Department shall have the right of audience at Council meetings if warranted by the Council's agenda, subject to the right of the Chairman to regulate the numbers attending.

5. The term of office of members shall be for three years renewable. Casual vacancies shall be filled by the Government or by the nominating body as appropriate. Members filling casual vacancies may hold office until the expiry of the other members' current term of office and their membership shall then be renewable on the same basis as that of other members.

6. The Council shall have its own Secretariat, subject to the approval of the Minister for Finance in regard to numbers, remuneration and conditions of service.

7. The Council shall regulate its own procedure.

NATIONAL ECONOMIC AND SOCIAL COUNCIL

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BY A. T. C. McARTHUR AND IAN G. REID

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PART I

THE COUNCIL'S CONCLUSIONS AND RECOMMENDATIONS

I. Introduction*

1. In his Financial Statement of 3 April 1974, the Minister for Finance stated that consultations would be held with the National Economic and Social Council on considerations to be borne in mind in the taxation of farm profits. The Council's comments as agreed at its meeting on 16 May 1974, and as published in Part II of NESC Report No. 2, were as follows:

(*a*) In principle, all sections of the community (including farmers) should make their fair contribution to tax revenue. There was, however, no agreement on whether £100 or a lower poor-law valuation should be the starting point for the detailed application of the Minister's proposals.

(*b*) As regards the proposed notional basis of assessment, there was general agreement that rateable valuation of farm land was not necessarily correlated with farm income. The argument in favour of using rateable valuation was that all land had a rateable valuation, and that at present it was the only basis for a rough and ready measure of income. Actual farm accounts would be more equitable and relevant. If actual accounts were to be used, some time could elapse before they were generally available. In essence, income tax is a tax based on capacity to pay as measured by income.

(*c*) Where actual accounts were used as the basis for assessment, there might be a case for some relief from income tax in respect of rates on agricultural land. This is based on the assumption

* Following discussions in the Economic Policy Committee and the Council, the successive drafts of the Council's conclusions and recommendations were prepared by Tom Ferris in the Council's secretariat.

that for larger farmers rates constitute a significantly larger proportion of income than is the case in other business enterprises.

(*d*) If actual farm accounts were used as the basis for assessment, some adaptation of the present system of tax reliefs, which were primarily geared towards non-agricultural activities, would be required. Allowances could be determined or adjusted to encourage investment in sound agricultural development.

(*e*) There was disagreement on the "multiplier" of 40 mentioned in the Minister for Finance's proposals. If this notional basis is to be maintained for other than a transitional period, the Council would welcome the opportunity of examining the basis on which a more equitable notional assessment might best be made.

(*f*) There was general agreement that, where farmers were assessed on the basis of actual accounts, some provision would be desirable whereby the average income over a number of years could be taken for assessment rather than the income in a single tax year.

(*g*) There was general agreement that, where income from agriculture was not assessable for tax, it should not be permissible to offset losses arising from agriculture for tax purposes against income arising from outside agriculture.

2. In a letter dated 24 February 1975, the Secretary of the Department of Finance wrote to the Council as follows:

"I am directed by the Minister for Finance to refer to the consultation which the Government held in April last year with the National Economic and Social Council regarding the considerations to be borne in mind in the scheme for the taxation of farming profits announced in the Minister's Financial Statement of 3 April, 1974.

The scheme of taxation of farming profits enacted in the Finance Act, 1974, which was designed for the special circumstances of farmers, took account of the Council's comments on the matter. A number of modifications to the scheme were announced in the

Minister's Financial Statement of 15 January last and are being provided for in the Finance Bill, 1975.*

You will no doubt have seen recent press references to an agreement between the Government and the Irish Farmers' Association regarding a review of farmer taxation to be carried out under the auspices of a body such as the National Economic and Social Council. I am to confirm that the Government has decided, with the agreement of the Irish Farmers' Association, to ask your Council to carry out this examination.

The Government would, accordingly, be glad of the views of the Council at an early date (if possible within six months) on the taxation of farming profits, taking account of the special circumstances of farming and, in particular, the need to promote investment, efficiency and production and having due regard to the interests of the general body of taxpayers."

3. The Council considered the Government's request to undertake a study on the taxation of farming profits at its meeting on 20 March 1975. The Council decided that the Economic Policy Committee should make the necessary arrangements to have the study of the taxation of farming profits undertaken. To help the Council with its task, expert advice was sought from Mr. A. T. G. McArthur of Lincoln College, New Zealand, and the University of Botswana, Lesotho and Swaziland, and Mr. Ian G. Reid, Director of the Centre for European Agricultural Studies, Wye College, University of London. The consultants submitted their report in October 1975 and it was discussed by the Economic Policy Committee on 29 October and 6 November 1975 and by the Council on 27 November 1975 and 15 and 22 January 1976. The consultants' report is reproduced in full in Part II of this document.

4. In order to respond at an early date to the Government's request for the Council's views on the taxation of farming profits, the Council had no alternative but to take the existing overall tax system as a datum. The equity and efficiency of the present overall system of central and local taxation (including capital taxation) have not, therefore, been examined.

*The relevant part of the Minister's Financial Statement of 15 January 1975 is reproduced in Appendix A at the end of Part I.

The Council has attempted to fit farmers into the taxation system as it now exists, taking into account the special problems of farming and the contribution which it makes to the economy. The Council has noted, however, the recent statement by the Minister for Local Government, namely:

> "Apart from removing the burden of the health and housing services and easing the burden of malicious injuries, the Government is also committed to reforming the system of local taxation, with the primary aim of relating rates more closely to the ability of persons to pay."*

This statement is relevant when assessing the implications for farmers of the Council's recommendations relating to the treatment of rates in determining taxable income.

II. Farmers' Profits and Income Tax: The Present Position

5. The Finance Act, 1974 imposed a tax charge on certain farming profits, provided for a restriction of personal reliefs in certain cases,† and introduced restrictions in relation to relief for certain farm losses. Under the Finance Acts, 1974 and 1975, farmers with an annual land valuation of £100 or more are now chargeable to income tax on their farming profits. While those with an annual land valuation below £100 are *generally* excluded from income tax, there are *specific* cases where such people have their farming profits chargeable to income tax or have their personal reliefs affected—for instance, where the farming is carried on by a farmer or his wife either of whom is engaged in another trade or profession or holds a directorship of a company carrying on a trade or profession in which either of them controls more than 25% of the ordinary share capital. In such a case,‡ the farming profits are chargeable to tax when the rateable valuation exceeds £50.

* Address by Mr. James Tully, T.D., Minister for Local Government, to the Consultative Council of the Labour Party on 18 October 1975.

†Where a farmer has farming profits, which are not chargeable to tax, but has (or his spouse has) non-farming income.

‡ All trades are covered by this provision except where the trade consists of the provision of farm holidays by the farmer's spouse and is ancillary to the farming.

(In addition, the Revenue Commissioners have agreed that where agricultural contracting business is shown to be on a part-time basis and ancillary to the farming business, the contracting service would not be treated as a separate trade for the purposes of the 1974 legislation.)

6. The restriction of personal reliefs can affect farmers with rateable valuations of between £20 and £100. Such a restriction is imposed where a farmer has farming profits which are not chargeable to tax but has, or his spouse has, non-farming income. In such a case the personal reliefs, to which the farmer would ordinarily be entitled and which he would set off against the non-farming income, are restricted. This could reduce his allowances by as much as a half.* However, where the farmer, or the farmer's spouse, is also carrying on another trade or profession (other than the provision of farmhouse holidays), the provision applies only if the valuation of the farm is over £20 but not over £50. In the case of such farmers with rateable valuations over £50, the farming profits are chargeable to tax and the personal reliefs are available in full.

7. Three options were provided under the 1974 Finance Act for assessing farmers' tax liability. The *first* option is the normal basis of assessment—that is, by reference to the actual profits† in the preceding year; for example, the charge for the year 1974/75 is by reference to the profits of 1973/74. The *second* option allows farmers‡ to elect to be charged for 1974/75 on the actual profits of the year of assessment. The *third* option, available for 1974/75 and 1975/76, but which is only available to farmers with no trading income other than from farming, is to have the assessment made on a notional basis. Notional income is computed as 40 times the rateable valuation of the farm land less deductions** for rates, labour costs, contractors' charges and depreciation of machinery or plant used on the farm. It should be noted that the notional income option is only provided for a transitional period.

*The personal allowances in this case are reduced by the lowest of the following amounts:

(*a*) one-half of the personal reliefs,
(*b*) 80 times the excess of the rateable valuation over £20,
(*c*) the amount of the farming profits.

† *Actual profits* is the term used to denote profits calculated by conventional accounting procedures for tax purposes. *Notional profits*, on the other hand, is the term used for profits calculated on the basis of an income presumed to have been made from farming activities.

‡That is, farmers, whether individuals or companies.

** While interest payments are not allowed as a deduction in computing the notional income, a farmer using this basis can claim relief on interest up to £2,000 in the same way as any other taxpayer. In addition, he is entitled to set his personal reliefs against the notional income.

8. As regards farming profits charged to tax on an accounts basis, all the deductions and allowances available in the case of a business charged under Case 1 of Schedule D may be claimed where appropriate. These include all trading expenses and interest on money borrowed for the purpose of farming. Farm losses can be claimed for income tax purposes when farming profits are chargeable to tax on an accounts basis. In such a case, losses can be set against other income of the year, or deducted in arriving at the profits of another trade for that year, or carried forward to later years and allowed against subsequent income from the farm.

9. As the legislation stands at present it is possible for a farmer to alternate between assessments on an actual or a notional basis in different years. This decision will naturally depend on a farmer's individual circumstances in different years. It must be recognised, however, that in electing for assessment on a notional basis a farmer is not entitled to the same deductions and allowances as under assessment on an actual basis. Table 1 shows the deductions and allowances that are available to a farmer who has land valuation over £100 under the two systems of assessment.

TABLE 1

Allowances and Deductions under Notional and Actual Systems of Income Tax Assessment

(Illustration of Hypothetical Farmer with rateable valuation over £100)

Farmer's Allowances and Deductions	Notional Basis of Assessment	Actual Basis of Assessment
Personal Reliefs	Yes	Yes
Rates	Yes	Yes
Labour costs	Yes	Yes
Contractors' Charges	Yes	Yes
Machinery/Plant Depreciation	Yes	Yes
Farm Buildings Allowance	No	Yes
Interest payments	No*	Yes
Relief in respect of increases in trading stock values	No	Yes
Farm losses	No	Yes

* A farmer using this basis of assessment may claim relief on interest up to £2,000 in the same way as any other taxpayer.

10. A summary of the position relating to the taxation of farming profits following the Finance Acts of 1974 and 1975 is set out in Table 2.

TABLE 2

Summary: Liability to Income Tax of an Individual with Farming Profits

Rateable valuation of farm land	£ 0–20	£ 21–50	£ 51–99	£ 100 +
Farming profits only	Not liable	Not liable	Not liable	Liable
Farming profits, where there is other income (from employment or investment and whether arising to farmer or spouse)	Not liable	Not liable*	Not liable*	Liable
Farming profits, where the farmer or spouse is carrying on a trade or profession, etc.‡	Not liable	Not liable*	Liable†	Liable†

*Farming profits are not liable but the personal reliefs to be set against non-farming income are restricted.

† The notional basis of assessment is not available, and the marginal relief provisions are not applicable.

‡ All trades except where the trade consists of the provision of farm holidays by the farmer's spouse and is ancillary to the farming.

Source: *Farming Profits and Income Tax*, The Revenue Commissioners, Dublin Castle (F.P. (EX)–1975).

III. Recommendations

11. Having considered the consultants' report, and submissions from the IAOS, the ICMSA and the IFA, the Council recommends as follows:

(i) Tax Base

(*a*) The objective should be to determine the income tax liability of farmers on the basis of actual accounts. Since farmers must be given reasonable time in which to develop accounts for income tax purposes, this objective cannot be attained immediately.

(*b*) The notional income option for farmers with a rateable valuation of £100 or more should be allowed for 4 years. Since the option is already available for the 1974/75 and 1975/76 years of assessment, this recommendation means that it should be made available for the 1976/77 and 1977/78 years of assessment.

(*c*) The notional income option should be allowed for a 4-year period to each group of farmers who become subject to income tax as the valuation threshold is lowered.

These recommendations are not supported by the representatives of the IAOS, the ICMSA and the IFA. In their view, the notional income option should be allowed for at least 10 *years, after which there should be a review to assess its effectiveness in promoting agricultural expansion and development. If it were allowed only for a shorter period, its effectiveness in encouraging agricultural expansion and development would be seriously reduced because of the length of the productive cycle in agriculture.*

(ii) Tax Threshold

(*a*) The valuation threshold for assessing income tax should be lowered to £75 for the 1978/79 year of assessment and to £50 for the 1980/81 year of assessment. The desirability and practicability of further reductions in the valuation threshold for assessing income tax below £50 should be reviewed during 1979.*

The representatives of the three farming organisations do not accept that the threshold should be reduced below £100 *rateable valuation. It is their considered view that any such reduction in the threshold would seriously inhibit agricultural development and expansion.*

*The pace at which the valuation threshold for liability to income tax will be lowered will doubtless be decided by reference to general budgetary policy from year to year—thus, if budgetary policy in a particular year requires an increase in tax revenues, the Minister for Finance may consider raising some of the additional revenues by accelerating the process of lowering the threshold.

(*b*) In future, a farmer who has once opted to use his actual accounts for the assessment of his taxable income must remain with that system. (Under the present arrangements, a farmer may opt for actual income (or notional income) and change to notional income (or actual income) between one year of assessment and the next.)

It is the view of the representatives of the three farming organisations that farmers who had exercised an option (e.g. for actual or notional income) should be required to remain with that option for at least three years, after which they should be allowed to change their option.

(iii) Calculation of Notional Income

(*a*) The multiplier (which is applied to the valuation of land in order to determine notional income) should be adjusted over three years to reach its "full value" in the 1978/79 year of assessment. The multiplier should be modified annually thereafter to reflect the fortunes of agriculture.

(*b*) The "full value" of the multiplier should be calculated by dividing Adjusted Family Farm Income by Total Land Valuation.* There should be consultations between farming organisations and the relevant Government Departments to determine the precise method of calculation.

(*c*) Once the multiplier has reached its "full value" (for example, as calculated in the footnote), farmers who have opted for assessment on the basis of notional income should be allowed deductions in respect of those farm expenses, that had been added back in

*For example, it was the view of the consultants that the adjustments to Family Farm Income should consist of additions for the total of rates paid on land, depreciation of machinery and remuneration of employees. The multiplier computed in this way for 1973 would be 62, derived as follows:—

(i)	Family Farm Income	£365·0 million
(ii)	Adjustments (as listed above)	£71·9 million
(iii) = (i) + (ii)	Adjusted Family Farm Income	£436·9 million
(iv)	Total Land Valuation	£7·0 million
(v) = (iii) ÷ (iv)	Multiplier	62

B

arriving at adjusted family farm income, on the same basis as farmers who are being taxed on actual income.

(*d*) There should be discussions each year between Government Departments responsible for adjusting the multiplier towards its "full value" (over the 1976/77 to 1978/79 years of assessment) and modifying it annually thereafter, and farmers' organisations. No adjustment or modification in the multiplier should be determined until these consultations have taken place.

(iv) Rates on Agricultural Land

(*a*) Farmers (who are being taxed on the basis of actual or of notional income calculated on the basis of a "full value" multiplier) should be allowed to deduct some appropriate percentage of the rates actually paid in determining taxable profits. The consultants' report* suggests that this percentage might be of the order of 150%. However, more detailed figures and further analysis are required to establish the correct order of magnitude.

(*b*) Farmers who pay income tax on their actual income, and who pay rates on their land which exceed 10%† of their farm profit for tax purposes (before deduction of capital allowances), should be allowed to deduct the amount by which the rates actually paid on land exceed 10% of farm profit for tax purposes (before deduction of capital allowances) from their income tax liability. In administering this recommendation, any consequential element of double allowance in respect of rates should be eliminated.

It is the view of the representatives of the three farming organisations that, since rates bear more heavily on the farmers who pay them than on business and professional ratepayers in general, the rates paid by farmers on agricultural land should be allowed as a tax credit—i.e. should be deducted from the income tax liability until such time as rates on agricultural land are phased out.

*See paragraph 137 of Part II of this document.

†This figure of 10% would be subject to change in the light of the further analysis suggested at the end of (iv) (*a*) above.

(v) Part-time Farmers

(*a*) The earnings of part-time farmers for tax purposes should continue to be treated as set out in the Finance Act, 1974. This means that there would be no change in the treatment of part-time farmers with valuations between £20 and £50. As the threshold valuation is reduced (see (ii) (*a*) above), part-time farmers* with valuations above the threshold would be assessable on their earnings outside agriculture plus their actual or notional farming profits.

(*b*) The reduction of the present land valuation threshold of £50 (applicable to persons with land who also carry on another trade or profession) according as the general valuation threshold is reduced (see recommendation (ii) (*a*) above), should also be considered.

It is the view of the representatives of the three farming organisations that part-time farmers (under (v) (a) *above) who are eligible to participate in the Farm Modernisation Scheme should be treated for tax purposes as if they were whole-time farmers—i.e. as if they had no earned income from outside agriculture.*

(vi) Allowances and Deductions

(*a*) Free depreciation should be allowed for the developmental capital costs of fences, roadways, holding yards, drainage and land reclamation.

(*b*) In valuing breeding livestock for tax purposes, farmers should be given the option of using the UK "Herd Basis" scheme or the New Zealand "Nil Standard value" scheme. The choice of which of these schemes should be made available as an option, and to what extent it should be modified to suit Irish circumstances, should be made after consultation with farming organisations. In making the choice, importance should be given to administrative simplicity and the strength of the incentive given for the development of farming.

*Part-time farmers in this paragraph refer to farmers with other income (from employment or investment arising to the farmer or his spouse). It does not include persons (or their spouses) carrying on another trade or profession.

(*c*) Farmers should have the option of basing their tax for the current year of assessment on the average income actually earned from the farm over the previous three years. This option would improve the cash flow of farmers who are expanding their incomes by the development of their farms and improvements in efficiency.

It is the view of the representatives of the three farming organisations that:

—*in order to encourage agricultural expansion and development, farmers should be permitted to deduct* 150% *of their actual capital and depreciation allowances;*

—*full-time farmers who borrow to maintain or acquire viable holdings should be given some tax remission while they are repaying their borrowings;*

—*special consideration should be given to farmers who entered into capital commitments before* 6 *April* 1974 *in order to develop their farms but who find their cash flow reduced after payment of income tax;*

—*farmers should have the option of basing their tax for the current year of assessment on the average income actually earned over the previous five years, and not merely over the previous three as recommended above.*

12. The recommendations set out in paragraph 11 are interdependent and must be treated as a package. It is the view of the Council, with the exception of the representatives of the three farming organisations, that this package of recommendations takes account of equity (both within the farming community and as between farmers and other productive sectors) and of the vital importance of accelerating the pace of agricultural development.

13. In any consideration of the situation that would result from the acceptance of the package of inter-related recommendations set out in paragraph 11 above, the relevant comparison must be with the situation that exists now under the 1974 and 1975 Finance Acts with respect to the taxation of farming profits, and not with the situation that existed before the 1974 Finance Act.

APPENDIX A

FINANCIAL STATEMENT, 15 JANUARY 1975*

Taxation of farming profits

I would now like to refer to a number of matters in relation to the taxation of farm income for which I shall be providing in the Finance Bill. The first of these relates to the option provided for farmers of electing for assessment in the present income tax year on a notional basis. The intention is that this concession will be available to farmers, as an alternative to assessment on an actual profits basis, for a transitional period and accordingly I propose that it will continue to be available for the income tax year 1975/76 on the same basis as in the current income tax year.

When a new capital allowance is introduced the normal practice is that the new allowance relates only to expenditure incurred from a current date. In the case of the farm buildings allowance which was introduced in the Finance Act, 1974, the operative date is 6 April 1974. Many farmers invested a substantial amount of borrowed capital on farm buildings in the years immediately prior to 1974 in wise anticipation of the opportunities presented by Common Market membership. This investment was originally undertaken and loans raised when the repayment of these loans could be met out of tax-free profits. Since this is not the case as far as those farmers now liable to tax are concerned, the Government, having regard also to the difficult year experienced by farmers generally, have decided exceptionally to make the existing annual farm buildings allowance retrospective. Instead of applying from 6 April 1974, the allowance will now apply from 6 April 1971.

In addition to this concession, the Government have also decided to introduce an initial allowance of 20% in the case of farm buildings, with

*Section of Financial Statement relating to the taxation of farming profits presented to Dáil Éireann by Mr. Richie Ryan, T.D. Minister for Finance on 15 January 1975.

effect from April 1974. This allowance will enable capital expenditure to be written off more quickly and should provide a valuable incentive to farmers. So as to ensure that market gardeners will not now be at a comparative disadvantage in this regard, it has also been decided to increase to the same level and from the same date their initial building allowance which at present is at the rate of 10%.

The cost to the Exchequer of these changes will be £100,000 in 1975 and £150,000 in a full year.

The next matter relates to land taken for grazing which, under existing law, is not included in determining land occupied for the purpose of the taxation of farming profits. On the other hand grazing profits have always been chargeable to tax. I propose to remove the anomalies by treating land taken for grazing as occupied by the person taking it and by treating a grazier as carrying on farming. The change will have effect as from 6 April 1975.

The final provision is designed to remove a doubt relating to the application of sections 15 and 16 of the Finance Act, 1974. It has been contended that farmers with land of rateable valuation of £100 or more who are also carrying on another trade or profession are not within the scope of section 16 and are, therefore entitled to marginal relief and to the option of being assessed on the notional basis. This was not intended, and I propose making a suitable amendment, effective from April 1974, in the Finance Bill.

PART II

THE TAXATION OF FARMING PROFITS

by

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and

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October 1975.

Chapter 1: SYNOPSIS AND RECOMMENDATIONS

1.1. Introduction

1. We were asked by the National Economic and Social Council to prepare a report on the present system of taxing farm profits to assist the Council in forming views on the subject. The Council's view had been requested by the Government. We were asked to take account of the special circumstances of farming and, in particular, the need to promote investment, efficiency, and production as well as bearing in mind the interests of the general body of taxpayers.

1.2. Criteria of a Good Farm Taxation System

2. A good taxation system must meet four criteria. First it must seem fair and equitable to all taxpayers to be accepted politically. Each sector of the community wants to be treated fairly and equally. Within a sector such as farming, taxpayers want those of the same degree of "well-offness" to be charged the same amount of tax.

3. Because a farm tax system can influence the farmers' decisions on how much they produce, a second criterion should be that the tax system ought to provide farmers with an incentive to develop and improve their farms. Taxation concessions and incentives should act as a carrot to encourage keen farmers. The system should also encourage those who have neither the motivation nor the resources to develop their farms, to give way to those who have. Taxation should act as a stick as well as a carrot. We realise in saying this that certain assumptions have been made concerning the rightness of economic development as a social and political objective. This also implies changes in social and personal values.

4. Unfortunately, it is difficult to design a taxation system which on the one hand stimulates production and on the other is fair and equitable

to all taxpayers in the short run. However, we feel that the potential for Irish farming to contribute to the growth of the economy is now much greater than before Ireland joined the European Community. Irish farmers could decide to adopt safe and easy methods of "status quo" farming if the tax system provides no incentives for the farmer who risks his capital and works hard to develop his property. By modifying the farmer's cash position through taxation or through grants so as to encourage farm development, taxpayers in other sectors can look forward, in the long run, to a greater contribution from the farming sector to the economy and to tax revenue.

5. A third criterion concerns the cost of collecting tax from farmers. This should represent only a small fraction of the revenue extracted. Because Irish farmers have no tradition of book-keeping, it has been suggested that the cost of tax collection both to the Government and the farmer are not worth the extra revenue. This argument has not deterred other European governments from imposing income tax systems based on farmers' accounts.

6. We also considered a fourth criterion—that any change in the present income tax scheme should bring in at least the same tax revenue as at present. Income tax for farmers will bring in about £10 million annually, and rates a further £13 million. Hence when suggesting tax concessions for encouraging farm development we also pointed to alternative sources of revenue from the farming sector. In addition to the four criteria mentioned above, we also bore in mind the eventual aim of harmonising the Irish tax system with the systems used by other EEC countries.

1.3. Rigorous Notional Tax System

7. We were asked to search for a tax system which would have the maximum impact on farm efficiency. We examined carefully the implications of a rigorous notional tax system as an alternative to tax based on the farmer's actual income. Under such a tax system the average income for each class of land in each year would be estimated. The farmer would be informed of his imputed income from his farm and hence the tax he would have to pay that year. Theoretically, this is an

excellent scheme because it provides a carrot for eager farmers who retain the net returns from all the additional income they produce. As this is a fixed tax, additional income is tax free. On the other hand, the below average farmer would have a greater tax burden than his actual income would imply. This could encourage him to pass his farm on to someone keen to farm well or encourage him to farm better himself. This is the stick effect within a rigorous notional income tax system and comes from not allowing such farmers to use their actual income as the basis for their tax assessment.

8. Such a system would be cheap to run. Farmers would not have to keep books and the Revenue Commissioners would have a simple task of assessing taxable income. Moreover, the Government would collect the same amount of tax from farmers, taking proportionately less from the good farmers and more from the poor ones. However, farmers suffering from this stick effect would object to such treatment and might gain limited support in their objection. On the other hand the privileged tax position of the more efficient farmer would be seen as unfair by the general body of taxpayers. The Irish Government would find it difficult to retain such a system in the long run. Rather reluctantly we abandoned the idea of this tax system and we recommend: **"That the system of income tax for farmers, introduced in 1974, whereby they are taxed on actual income, be continued"** because of the greater acceptability of this system on the grounds of equity to both farmers and non-farmers alike.

1.4. Tax Based on Actual Profits

9. With a view to extracting more tax with one hand from the farming community which could be given back in the form of carefully selective incentives with the other, we searched for ways of bringing more farmers Into the income tax net. We hold the view in principle that all farming profits should be taxed. At the moment only those with an annual land valuation of £100 or more are chargeable to income tax. We appreciate that farmers, the Revenue Commissioners, and the accountancy profession will need time to adjust to and plan for changes in the taxation system. Hence we recommend: **"That the threshold valuation for assessing income tax be lowered to £50 for the 1977/78 year of assessment and to £20 for the 1980/81 year of assessment".**

10. The Government should announce this transition now so that farmers can plan ahead and keep the necessary accounts. At the moment farmers have the option of calculating their taxable income by multiplying their rateable valuation by 40 rather than using actual profits from their accounts. This concession is for those who do not have the necessary accounts to calculate actual income. We recommend: **"That the notional income option be allowed for farmers with a £100 valuation or more for one additional year and that the notional income option be allowed for a three year period for each group of farmers who become subject to tax as the threshold is lowered".**

11. However, we think that farmers should be encouraged to use actual income rather than notional income and this can be promoted in two ways. Firstly, we recommend: **"That in future a farmer who has once opted to use his accounts to assess his taxable income must remain with that system".** It is inequitable that a farmer should have an advantageous option not open to other taxpayers. Secondly, we believe that a multiplier of 40 underestimates the average income of farmers so that most will prefer to be assessed on notional income rather than actual income. This would delay full adjustment to the proposed new taxation system, and would also discourage the development of farm records for management purposes. We therefore recommend: **"That the multiplier be adjusted systematically over 3 years to the full objective value but that it should be modified year by year thereafter to reflect the fortunes of agriculture".** This means that notional income levels would be reduced in years of low farming profits and vice versa.

1.5. Income Tax for Farmers with Other Income

12. Since a number of submissions were made to us concerning the treatment of part-time farmers under the income tax provisions, a further recommendation is required. As we have suggested that the threshold for paying income tax should be reduced and that all farms over £20 valuation should eventually pay tax on their actual income, it follows that part-time farmers will be treated like every other income earner. This is a transitional problem, hence, we recommend: **"That there is**

no need to change the treatment for tax purposes of the earnings of part-time farmers".

1.6. Rates and Income Tax

13. Rates are levied to finance the services of local authorities and are based on the occupation of property. Farmers' organisations told us that rates bear more heavily on farmers than other ratepayers because they use more rateable property in their business operations than their business and professional counterparts. In their view this inequity was tolerable when farmers did not pay income tax but now that income tax has been imposed, all farming land should be derated, otherwise they would be doubly taxed.

14. On examining the evidence it appears that those farmers who pay rates, pay very roughly one half as much again per unit of income than do business and professional ratepayers in toto, though this degree of inequity has been declining because of the creeping revaluation of urban property. It was also suggested to us that there is some evidence to show that some businesses, such as hotels, bear an even higher rates burden than farming. Moreover, new farm buildings have been exempted from rates since 1959 and most importantly the Agricultural Grant of £30 million annually now meets 67% of all rates levied on land. In the period 1969 to 1973 farmers paid no income tax. Farmers considered the extra rate burden a substitute for income tax but this was much less than they would have been paying if their tax had been based on actual income. Hence the term "double taxation" exaggerates the situation. Our conclusion is that levying rates on agricultural land is not inequitable between farmers and non-farmers given that adjustment through the Agricultural Grant is adequate. Thus we recommend: **"That the level of the Agricultural Grant be raised so that the proportion of income absorbed by rates is equalised between farming and non-farming businesses and that this level be reviewed regularly".***

1.7. The Land Valuation System

15. If rates for farmers are to continue, the system of land valuation

*We feel that in future the Agricultural Grant might more appropriately be referred to as the Agricultural Rates Adjustment Fund.

must be improved. The Poor Law Valuation based on the Griffith assessment in the middle of the last century no longer reflects a valuation of land productivity and hence the income level from the farms. This is a well documented fact and results in inequity between farming ratepayers.

16. Some developed countries have a continuous system of updating farm valuations. This can be an expensive operation. However, a simpler basis would be to use the soil classification of the Agricultural Institute. The value of each soil type could be based on its grass growing potential or some other method of measuring productivity. The total rate burden of farmers within a county would be allocated between them on the basis of soil type. Such a system would reduce inequity between farmers and would be cheap to implement. We recommend: **"That resources be allocated to the Agricultural Institute to complete their detailed soil classification for the 26 counties, on a farm by farm basis, and that the resulting soil maps be used as the basis for allocating the farmers' rates burden within each county".**

17. Because the new system is likely to take at least nine years to implement, we recommend: **"That farmers who pay income tax on their actual income, and whose land valuations are greater than £1 per acre, and whose rates payable on land and farm buildings exceed 10% of farm profit for tax purposes (before deduction of capital allowances) should have the option of appealing to the Valuation Office for a revision of valuation. These thresholds of eligibility should be altered if necessary in the light of experience".**

1.8. Income Tax Incentives

18. It has been suggested that income tax is actually a positive incentive to work harder because farmers need to work harder to reach their aspired level of post-tax income. We think that this will have the opposite effect upon a number of farmers who decide that the risk, worry, and effort of farm development is not counterbalanced by the additional gains when these are reduced by income tax. Moreover, taxes leak away cash from the farm which could be invested in it.

19. Consequently, the general income tax code needs to be arranged so that it does not discourage those farmers who plan to develop their farms. We recommend three income tax incentives.

20. Firstly, we recommend: **"That free depreciation be allowed for development capital costs of fences, roadways, holding yards, drainage and land reclamation".** The recommendation makes 100% depreciation possible for non-machinery and non-building capital expenses in the year that these farm improvements are made. There are several reasons for the recommendation. From a record keeping point of view depreciating annually small farm improvements is complicated. Moreover, it is very difficult for the Revenue Commissioners to distinguish between the repair of an existing fence and the construction of a new one. Finally, this incentive has a useful economic and psychological effect on farmers who usually reason that surplus cash is better invested in farm improvement than spent on consumption in which case a share will leak away as tax.

21. Secondly, we recommend: **"That the 'Herd Basis' for valuing breeding livestock, as used in the UK, be introduced as an option".** Using conventional Trading Account procedures, an increase in the herd could result in a larger inventory of stock with a higher value which increases profit. The resulting increased tax burden from herd expansion is a positive disincentive to an action which is in the national interest. Under the "Herd Basis" system, any profit on the sale of the whole herd or flock (or a substantial part of it) without replacement when the farmer retires or sells up, would not be included in profits for tax purposes. Nor would relief of tax on any loss from such a sale be given.

22. Thirdly, we recommend: **"That farmers have the option of basing their tax for the current year on the average income from the farm over the previous three years. Upon the termination of this option, the tax liability will be calculated on the last three years treated on a single year basis".** The advantage of this tax incentive is that a farmer who is on a rising income tends to leave his tax bill astern. If he stops raising his income through better farming his tax bill catches up with him. It is an incentive which has elements of both

stick and carrot. Income averaging as the basis for tax can also be justified on the ground of equity in that farmers tend to have an income which fluctuates more than other taxpayers and hence pay more tax on average than a taxpayer on the same average income which does not fluctuate. However, the income averaging would not suit farmers who anticipate a decline in income but we are suggesting this as an option for the farmer who is developing his business.

23. This package of incentives will not restore completely the economic attractiveness of farm development which existed in the era of no income tax, but we think they will go a long way towards it. Moreover, we believe the package has a useful psychological value in that the high tax burden associated with farm improvement and development does not catch the farmer at the time he makes the improvements but catches up with him later—rather earlier if he reduced his efforts. The only way to avoid the tax net is to swim harder.

1.9. Capital Taxation

24. While capital taxation is outside our terms of reference, we recognise that it is the burden of all taxes which leaks away cash from the business and hence reduces the ability to finance development. In this total tax burden capital taxation is likely to become increasingly important because the size of farms is growing. Capital taxation is a special problem for farmers because land is overvalued in terms of its current-use profitability and because of the financial structure of the ownership of farms.

25. Wealth and capital acquisitions tax legislation recognises these special circumstances of farming by giving concessions of land valued under £200,000. These are a deduction of the lesser of 50% or £100,000 from the market value of farms. In wealth tax, where the value of the farm exceeds £500,000, this relief is replaced by a 20% reduction. These reliefs are confined to individuals who are domiciled and ordinarily resident in the State and 75% of whose property consists of what might broadly be termed agricultural property. There are, however, aspects of this legislation which could nullify these concessions as an incentive to structural development. For instance, the formation of small private

family companies which might help the inter-generation turnover, disallows the concessions for the valuation of agricultural property. Likewise, this provision may well preclude the entrance into farming of a person with considerable non-farming funds, who could make a contribution not only in terms of capital but also in terms of innovation. This provision could also deter a farmer from investing in co-operative ventures in the processing and other ancillary industries.

26. We suggest that capital taxation legislation needs further concessions so that it does not penalise the farmer who has increased his capital value by farm improvement. This might be effected by using standard values for land based upon the soil type classification recommended earlier for rating purposes. We also suggest that in order to keep the farm assets together in a large enough unit to be economic, the exemption threshold for the capital acquisitions tax should be continually reviewed in the light of inflation and other variables. We recognise that senescense reduces the attractiveness of development for the owner-manager of any business. This is particularly important in farming where the owner-manager supplies a major part of the physical effort. We would, therefore, suggest that methods be explored for using the capital acquisitions tax to encourage the transfer of ownership and control of farm businesses to the younger generation at an earlier age. For instance the exemption levels in the capital acquisitions tax might be made less favourable with the increasing age of the donor. Likewise, eligibility for a State retirement pension might be linked to the transfer of control of the farm business by means, for instance, of granting a tenancy to a younger person.

1.10. Conclusion

27. In making these recommendations we have attempted to be fair to other taxpayers and at the same time make recommendations that will stimulate the growth and development of Irish Agriculture, which can make a great contribution to the economy. The cost of the incentives and concessions we have suggested should be more than balanced by our recommendations for spreading the taxation net wider amongst the farming community, and by the increased farm income which should be generated. It is also hoped that our recommendations concerning the

announcement of the details of the transition will stop the uncertainty which is so detrimental to making positive decisions about investment in farming.

28. Finally, we wish to emphasise the danger of falling between two stools by the one-sided acceptance of some of the recommendations contained in this report. If only those recommendations concerned with equity are accepted, the incentives for Irish farmers to press forward will be lost. If only the tax incentives are selected the patent inequity will remain and Irish agriculture will continue to be a target for criticism instead of being seen as an essential component of a growth economy.

Chapter 2: BACKGROUND TO THE REPORT

2.1. Terms of Reference

29. We were asked by the National Economic and Social Council to prepare a report on the present system of taxing farm profits* in order to assist the Council in forming its views on the subject. The views of the Council had been requested by the Government, and its comments were to take account of the special circumstances of farming, and, in particular, the need to promote investment, efficiency and production, and to have due regard to the interests of the general body of taxpayers.

2.2. Historical Note

30. The present system of taxing farm profits was introduced in the Finance Act, 1974. Its introduction coincided with discussions on changes in the system of capital taxation proposed in the Government's White Paper on Capital Taxation published in February 1974. In our view, it was unfortunate that the implementation of both these fiscal policy changes of great importance to farmers coincided with severe difficulties in some sectors of the agricultural industry.

31. In our discussions with farmers and their representatives, we were impressed by the general feeling of uncertainty which pervades the

*Throughout this report we shall follow our terms of reference in referring to the taxation of farming profits. This is technically more precise than talking of the taxation of farm incomes. Income from a farm can arise in a number of ways, for example, by letting of the land, through the receipt of wages, by standing stallions on it or by occupying it for the purposes of husbandry. Only the latter gives rise to a farm profit which is taxable under Case 1 of Schedule D. It is important also to distinguish between the income or profit from farming and family farm income. The latter is a farm management term and because of the different way in which it treats some items, for example, family labour, valuation of stock, depreciation of machinery or buildings, it can be quite a different figure from the taxable profit from farming.

industry at present. Much of this, in our discussions, was blamed on the timing of the taxation decisions. Farmers were unsure of the implications of the new legislation, in part because of a vagueness about how it would work in practice, and were correspondingly hesitant about undertaking farm development programmes. Few farmers had fully understood how they personally would be affected, and all feared the worst. However, it must be remembered that the expansionist climate which existed in farming in the early seventies has been severely eroded. There have been marketing difficulties in the last two years particularly for cattle. Costs have risen at an unprecedented rate during this period. There have been difficulties in ensuring the effectiveness of the price guarantees agreed at the Brussels price reviews. Thus farmers have directed their frustration and disappointment against the taxation proposals because these lie within the control of the Government itself.

32. In a wider context, taxation policies have loomed larger in political debate in many European countries over the last two years. This is largely due to the effects of inflation. It is sufficient to say here that we found it necessary to assume that thresholds, methods of valuation and other conventional accounting procedures will have to be kept under review if taxation systems are not to create gross disincentives to economic development.

33. In our discussions, we have had the benefit of advice and assistance from many quarters and individuals. We should like to thank the following who made submissions to us: The Confederation of Irish Industry, Irish Congress of Trade Unions, Irish Creamery Milk Suppliers' Association, Irish Farmers' Association, Irish Agricultural Organisation Society, National Income Tax Reform Organisation, the Institute of Chartered Accountants in Ireland, Retail Grocers' Association, the Federation of Trade Associations and the Society of the Irish Motor Industry. We would also like to thank the officials of Government Departments, particularly those in the Revenue Commissioners, the Department of Finance, and the Department of Agriculture and Fisheries, who provided us with necessary information. Not least we would like to pay tribute to the help given by Mr Alan Matthews, and by Mr Tom Ferris of the National Economic and Social Council. Their efficiency, impartiality and unfailing courtesy are acknowledged with gratitude.

34. It is perhaps useful to summarise here the conclusions of previous reports on farmer taxation. The Commission on Income Taxation, in its Fourth Report published in 1961, gave its views on the taxation of income from land. It recommended that the income of those engaged in agricultural and non-agricultural activities should be taxed equally and that tax should be assessed on actual rather than notional incomes so that those in similar financial and personal circumstances would bear the same tax burden. It suggested that for practical reasons a change to assessment based on actual profits should be introduced gradually rather than all at once. Initially the revised basis should be applied to the larger holdings only. Smaller holdings not subject to income tax on actual profits should be assessed on a notional basis meanwhile. Because the rates on large holdings were apparently heavier in proportion to income than rates on other business properties, the Commission recommended that a credit for part of the rates (not more than one-third) should be subtracted from income tax when the tax was based on actual profits. The Commission decided against the averaging of profits from land over a number of years for the purpose of assessing tax. However, they left open the possibility of introducing this as a limited option if there was a strong demand for it.

35. In 1970 the Committee on State Expenditure in Relation to Agriculture also reported* on the question of rates and income tax. They too favoured making farmers liable to income tax based on actual profits, but suggested a transitional period of up to five years during which a notional basis might be used. The Committee also favoured replacing rates on land by a flat land tax at a lower rate. All fulltime farmers would receive an allowance for the tax on the first £20 valuation of their holdings, thus effectively exempting all full-time farmers occuping land under a valuation of £20. The Committee suggested that this land tax should be credited against income tax as assessed. Farmers would pay rates on their houses and buildings in the normal way.

36. The 1972 White Paper on Local Finance and Taxation† also recognised that rates on land had been a controversial subject for many

*Report of the Committee on the Review of State Expenditure in Relation to Agriculture (Prl. 1231, 1970).

†Local Finance and Taxation (Prl. 2745, December 1972).

years. It observed that the Interdepartmental Committee on Local Finance and Taxation would be issuing a further report on the question of grants to local authorities which would include a discussion of rates on land. So far nothing has been published. In an earlier report, the Interdepartmental Committee had recommended against a new valuation of land and argued that the Agricultural Grant provided a convenient method of adjusting the incidence of local rates on farmers.*

2.3. Structure of the Report

37. As the Council has already commented at length on the capital taxation proposals,† we have not gone over this ground again. However, as it is not really possible to consider income tax in complete isolation from other fiscal proposals, we have borne in mind the likely effects of the capital taxation package when making our recommendations regarding farm profits taxation.

38. The structure of this report can be outlined briefly. In Chapter 3, we first outline the principal features of the present fiscal situation for Irish farming. In Chapter 4, we discuss the farm taxation systems of other European countries. Chapter 5 discusses the criteria for a good tax system, and outlines the major alternatives of a notional system and a system based on actual profits. In Chapter 6, we examine the present system in the light of the criteria proposed in Chapter 5. Chapter 7 examines the taxation and incentives for agricultural development. Finally, in Chapter 8 we include an addendum on Capital Taxation.

*Report on Valuation for Rating Purposes (Prl. 8536).

†*Comments on Capital Taxation Proposals* (NESC, Report No. 2, July 1974)—see also Part 2 of the Report for the Council's comments on the taxation of farm income.

Chapter 3: FISCAL SITUATION OF IRISH FARMERS*

3.1. General Review

39. Of all EEC countries the Irish taxation structure has the highest dependence on indirect taxes linked to production and imports (see Table A.6.1. in Appendix 6) However, income tax is growing in importance in total Exchequer revenue as shown in the following table:

Financial Year	Exchequer Revenue Receipts	Income Tax, Surtax	Income Tax, Surtax as Proportion of Total
	£m	£m	%
1960–61	138·8	28·0	20·2
1965–66	240·8	54·9	22·8
1970–71	481·5	116·6	24·2
1971–72	569·4	152·9	26·9
1972–73	659·1	173·7	26·4
1973–74	792·9	221·6	27·9
1974(a)	651·4	170·5	26·2

(a) 9 months.

40. Income tax is paid by both individuals, whether employees or self-employed, and companies. For individuals, taxable income for the 1975/76 year of assessment† was chargeable on a sliding scale as follows:

*This review does not concern itself with indirect taxes such as VAT or excise duties on mineral oils.

†In June 1975, a 10% surcharge was imposed on income tax paid by individuals which was charged at rates of 35% and upwards. This measure increased the rate of tax on the £1,551—£4,350 band of taxable income to 38·5% and to 49·5%, 60·5%, 71·5% and 77% respectively for subsequent bands of taxable income.

First £1,550	26%
£1,551—£4,350	35%
£4,351—£6,350	45%
£6,351—£8,350	55%
£8,351—£10,350	65%
£10,351 and over	70%

The increase in income tax revenue reflects both the rise in non-agricultural income and the increasing number of people being brought within the income tax net. Since 1960/61 when PAYE was introduced, the number of individual income tax payers has risen from 220,000 to 740,000.

3.2. History of Income Tax in Agriculture until 1974*

41. Until 1969, income from land for the purpose of income taxation was measured on a notional basis. Land was regarded as yielding income from ownership, assessed under Schedule A, and income from occupation, assessed under Schedule B. Where the owner was also the occupier his income for income tax purposes was the total of the amounts assessed under both Schedules A and B; where the owner was not the occupier, the owner's income from the land was measured by the amount of the Schedule A assessment and the occupier's income was measured by the amount of the Schedule B assessment.

42. The amount of the notional income assessed under Schedule A was the land valuation, under the Valuation Acts, less an allowance of one-eighth usually described as a repairs allowance. If appropriate, the interest on the land purchase annuity was also subtracted. The amount of the Schedule B assessment was either the valuation under the Valuation Acts or the annuity originally paid under the Land Acts, if any.

43. On the average, it could be said that the notional measure of income from land under both Schedules A and B (after taking into account land purchase annuities) amounted to about one and a half times the land valuation. However, there was a statutory provision for reducing the notional assessment under Schedule B if a farmer established that his profit from occupation for any year, as measured for income tax, was less than the Schedule B assessment.*

*This section draws heavily on the discussion in Chapter 1 of the Fourth Report of the Commission on Income Taxation, (Pr. 5731, 1961).

44. The occupier of agricultural land also had the option for any year to be assessed under Schedule D instead of under Schedule B. This meant he could have his income from land based on his actual profits for the preceding year instead of either his notional or actual profits in the current year. This allowed an occupier who had a low or nil income from land in any year to return that income for two successive years regardless of his income in the second year.

45. In 1969, assessments under Schedules A and B were abolished. Thus between 1969 and 1974 the situation was that there was no tax on profits from farming. However, a taxpayer occupying land for husbandry still had the right to claim a farming loss in those years in which he made a loss and to set this against any other income. Any corresponding profit was not taxed.

46. There were a number of uses of land which were not considered husbandry and were treated separately from farming. Commercial turf production and cattle dealing always remained assessable under Schedule D. Market gardening, nurseries and intensive livestock production when carried on by a non-farmer (that is by someone who owned only the land on which his buildings stood) were considered separate trades for tax purposes. The income from taking land for grazing was also taxed separately though few were taxed on this basis. However, profits from commercial woodlands and from the sale of stallion services on the owner's land were originally assessable under Schedule B. They too were exempted in 1969 though the right to claim relief in respect of a loss remained.

*We would like to make a distinction at this stage between actual profits and notional profits. *Actual profits* is the term used to denote profits calculated by conventional accounting procedures for the purposes of taxation computation. *Notional profits* is the term used for profits calculated on the basis of an income presumed to have been made from farming activities. This is calculated on the basis of an accepted formula, which for Irish Agriculture is land valuation multiplied by a factor decided by the Government.

3.3. Finance Acts, 1974 and 1975

47. The 1974 Finance Act changed the approach to farming profits for income tax. Farming was then taxed like any other trade. The Act taxes the profit from farming of all individuals occupying farm land whose rateable valuation is £100 or over at any time during the year of assessment. Individuals with a valuation of over £50 and another source of non-farming business income were also brought into the net. This includes cases where either a spouse is carrying on a trade or profession or is a director of a trading company in which he or she owns more than 25% of the equity capital. Farming companies irrespective of their land valuation are now charged to tax on their farming profits.

48. In addition, an individual with non-farming income who farms land with a rateable valuation between £20 and £100 (the profits from which are not otherwise chargeable to tax) now has his personal allowances restricted. This could reduce his allowances by as much as a half.

49. There are 9,000 farmers occupying farm land of £100 rateable valuation and over and an estimated 4,000 traders etc., occupying farm land between £50 and £100 valuation who will be charged to tax on their farming profits under this Act.* Up to 10,000 people are likely

*The total number of farmers is less than the total number of landholders. This is because some landholders have a principal occupation other than farming. For example, in the 1966 Census almost one-third of landholders had principal occupations other than that of farmer. The following data. from the 1966 Census give the distribution of landholders/farmers by range of valuation.

Number of landholders and farmers by valuation, 1966

Valuation	Landholders		Farmers (landholders who are also farmers)	
£	Number	%	Number	%
0–20	175,094	62·9	107,955	54·2
20–100	93,270	33·5	82,332	41·3
Over 100	9,788	3·5	8,820	4·4
	278,152	100·0	199,107	100·0

to be affected by the restriction of allowances. A summary of the provisions of the 1974 Act, as amended by the 1975 Finance Act, is given in Appendix 1.

3.4. Rates

50. Land, farm dwellings and some farm buildings are valued for rating purposes. Rates are paid in the normal way on farm dwelling houses. Farmers also pay rates on farm buildings erected before March 1959 but farm buildings erected since then are exempt. In addition, there is total exemption from rates on any increases in valuation due to the enlargement or improvement of existing farm buildings, where the work has been completed since 1 March 1959.

51. The Agricultural Grant de-rates effectively much of the agricultural land. The Exchequer pays the grant to local authorities to enable them to give rate reductions to occupiers of agricultural land in county health districts in their areas. About one-half of all farmers pay no rates because of this. The proportion of total rates on land relieved by the Agricultural Grant is shown in the following table.

Year	Gross Rates on land	Agricultural Grant	Net Rates on land*	Proportion of the Rates on Land met by the Agricultural Grant
	£m	£m	£m	%
1961–62	14·028	5·824	8·204	42
1969–70	27·192	18·907	8·285	70
1970–71	30·060	20·677	9·383	69
1971–72	35·699	24·387	11·312	68
1972–73	41·038	27·896	13·142	68
1973–74	40·415	27·449	12·966	68
1974†	33·987	23·255	10·731	68
1975	45·00	30·00	15·00	67

*The data for net rates on land refer to rates on *land* payable by *landholders* after Agricultural Grant relief. These data differ from "rates paid by farmers" (see table in para. 120) which relate to rates on *land* and *farm buildings* excluding *farm dwellings* paid by *landholders*.

†9 months.

3.5. Capital Taxation

52. In February 1974, the Government issued a White Paper which made proposals for a radical re-shaping of the capital taxation system. The White Paper argued that the three existing death duties, namely, estate duty, legacy duty and succession duty, were inadequate to achieve the social objectives of improving the equity of the tax system and of reducing inequalities in the distribution of wealth. The White Paper recommended instead a capital gains tax, an annual wealth tax and a capital acquisitions tax on gifts and inheritances. Bills providing for the capital gains tax and wealth tax have since passed into law. The Bill establishing the capital acquisitions tax is still before the Dáil.

53. As the Council has already given its views on this package, it is not our intention to provide a further analysis. However, as any proposal for the taxation of farm profits can be fully evaluated only within the context of the total tax burden, a brief outline of the main effects of these capital taxes on farmers is given below.

54. The Capital Gains Tax Act taxes realised capital gains at a flat rate of 26%. A gain from the sale of most forms of property will be taxed. However, there are exceptions. Gains from the disposal of wasting chattels with a predictable life not exceeding fifty years (which would include livestock) and a principal private residence will not be taxed. Various exemptions and reliefs are provided and there is full exemption for the first £500 of gains realised in any one year. A farmer over 55 selling qualifying assets worth not more than £50,000 is allowed full relief on any capital gains tax, and there is marginal relief where the consideration exceeds that figure. In addition, any premium paid under the EEC Farm Retirement Scheme will not be included in the sale value of the land. A farmer over 55 disposing of the whole of his assets of not more than £150,000 to one or more of his children (or to a niece or nephew who has given substantial assistance in running the farm for the previous 5 years) will be relieved of the full amount of capital gains tax. Marginal relief is available where the sale value is more than this. A farmer may defer his tax on the gains from selling his farm if he buys a new farm within a specified period*.

*This "roll-over" relief also applies to farm buildings and plant or machinery.

55. The annual wealth tax is a tax on net wealth over £70,000 for a single person or over £100,000 for a married couple. The rate of tax is 1% on the excess over these thresholds. Even where wealth tax is payable, the effective rate of tax will, in the majority of cases, be well below 1%. A principal private dwelling, normal household furniture and effects, livestock owned by a farmer, bloodstock, the growing of timber, certain superannuation benefits and annuities and objects of national, scientific, historic or artistic interest are exempted under certain conditions.

56. The Act recognises the fact that the return from farming is low as a percentage of current market values for agricultural land. Hence a farmer is entitled to deduct from the value of agricultural land or farm machinery worth less than £500,000 the lesser of 50% or £100,000. Otherwise land and machinery, being trading assets, qualify for the general relief for such assets in that they can be valued at 80% of market value for wealth tax purposes. Where the market value of land is inflated far beyond its value for farming by its potential for urban development, the farmer can value it at its agricultural use plus 25% if he wants to.

57. The capital acquisitions tax will be levied on property gifted during the lifetime of the donor as well as property passing on after his or her death. It will be levied at progressive rates on a successive slice principle. There will be different scales of rates for different classes of beneficiaries. The scale depends on the relationship of the person from whom the gift or inheritance is derived. The rate of tax on gifts is 25% below that referable to benefits taken on a death. Property is to be valued at its open market value and farmers will benefit from a concession that agricultural land can be valued by deducting the lesser of 50% or £100,000 from its market value.

3.6. Comparison of Tax Situation with Other Sectors

58. The owner-occupied farm is by far the most common form of organisation in farming and is similar to the unincorporated business in other sectors. For both, profits will be taxable under Schedule D (with the proviso that not all farm profits are taxed at present). There will be few differences in arriving at the calculation of taxable profit.

Farmers are entitled to a Farm Buildings Allowance to offset annual wear and tear which is at a different rate to industrial buildings; for commercial buildings, no allowance is given at all. Farmers have also been given a transitional concession, being allowed to opt for a notional basis of assessment. For many small traders, a net worth basis of assessment is used where books are not available, though there is a statutory obligation to maintain such books and records for tax purposes. A similar working arrangement could be used for farmers.

59. Companies are liable to corporation profits tax as well as income tax at the standard rate of 35%. The rates of corporation profits tax are 7½% of the first £2,500 of annual profits and 23% of the rest. Income tax is paid at 35% of the profits remaining after corporation profits tax has been deducted. The effective rate of corporation profits tax is approximately 50% except for small profits where it is lower.

60. Industrial companies are entitled to the same rate of wear and tear allowances for plant and machinery that applies to farming. Industrial buildings have an initial allowance of 50% which may be claimed for capital expenditure incurred up to 31 March 1977, and an annual allowance of 4%. The most important relief for industrial companies comes through the export profits tax relief. This relief is given to companies (not firms or individuals) exporting goods manufactured in Ireland and amounts to relief of 100% from income tax and corporation profits tax on the profits attributable to any export sales of manufactured goods over the base level of export sales in 1955 or 1956. This amounts to a very substantial relief; discounting the tax saving at 10% where the return on capital employed is, say, 15% per annum over a 15 year period of operation, results in the present value of tax saved amounting to 60% of the value of the fixed assets.

61. In comparing the incentives given to industry and agriculture, it is not sufficient merely to look at those provided through the tax system. Investment grants are a form of incentive directly comparable to tax allowances. These must be considered concurrently. The great majority of farmers can qualify for grants at the rate of 50% for investment in land reclamation and improvement and at the rate of 30% for investment in farm buildings and other fixed assets such as fixed plant

and machinery. In addition, farmers in the "development" category may qualify for a 10% grant for mobile machinery and equipment. For a relatively small minority of farmers the rates of grant are somewhat lower than the 50% and 30% mentioned above.

62. These grants are calculated on the basis of current standard costs which are updated at regular intervals. This, coupled with the fact that the grants are calculated on a flat percentage basis, means that the scale of grants keeps pace with cost changes. This is a considerable improvement on the former system which consisted, particularly in the case of buildings, of a flat rate of grant based for example on the floor area of the building regardless of the cost.

63. For acceptable industrial projects where the investment does not exceed £1 million, or the investment per job is not over £10,000, grants may be negotiated up to these maxima:

(*a*) in Designated Areas, 50% of eligible costs or £5,000 per job, whichever is the less.

(*b*) in non-Designated Areas except Dublin County, 35% of eligible costs or £4,000 per job, whichever is the less.

(*c*) in Dublin County, 25% of eligible costs or £3,000 per job, whichever is the less.

For larger industrial projects, grants are based on the numbers of workers employed, location and type of project; the grant being negotiated with the IDA.

64. The table in paragraph 65 overleaf compares the incentive effects of the present package of grants and allowances for industry and agriculture. Only capital grants have been considered, as subsidies relating to current sales (such as payments under the Beef Cattle Incentive Scheme or the Disadvantaged Areas Scheme) are a form of income supplement rather than an investment incentive. Both industry and agriculture get a wide range of other assistance from the State. For industry, training grants, R and D grants, and the services of Córas

Tráchtála, are examples; in farming, the advisory service and An Foras Talúntais. As these benefits are difficult to quantify at the individual company or farm level, they are not included in the table below.

65. In order to compare the value of grants with that of tax incentives, we need to establish the present value of the tax savings that arise for both industry and agriculture compared to the situation in the absence of any form of tax incentive. As the tax treatment of machinery and plant is the same for both industry and agriculture, we are concerned with the differential treatment of buildings for tax purposes, the differential capital grants, and the existence of the export profits tax relief for industry. In the table which follows, it is assumed that both the company and the farm are making sufficient profits to derive maximum benefit from the tax allowances, and that the rate of taxation is the same for both at 50%.

Present Value of Incentive per Unit of Capital Expenditure

Nature of Incentive	Present value of incentive to	
	The Company	The Farm
Additional Allowances for buildings*	·21	·24
Capital grants for buildings†	·25	·25
Capital grants for plant and machinery†	·25	·25
Export profits tax relief** (company wholly exporting)	·60	—

*It is assumed that the "normal" depreciation rate for buildings is 4% per annum. Anything above this is treated as an incentive.

†The maximum rates of grant have been taken for both industry and agriculture.

**It is assumed the return on capital employed is 15% over a 15 year period.

From the table it is clear that farms and companies get about the same benefits in terms of tax concessions and capital grants on buildings and machinery, but companies gain substantially from tax relief on export profits.

Chapter 4: THE TAXATION OF AGRICULTURE IN EEC COUNTRIES

4.1. General Framework

66. The taxation of income from agriculture is of two main types:—

(1) Taxation of actual income from farming activities, calculated with general conventional accounting practice. Under such systems, agriculture is given little or no special treatment compared with other economic and commercial activities. Such systems are operated in Denmark, the Netherlands and the United Kingdom.

(2) Taxation of farming income presumed to have been made. This notional or "presumed" income assumes some direct relationship between farming income and some factor or factors which are more easily measurable or verifiable than income. Such systems operate in Belgium, France, Federal Republic of Germany, Ireland, Italy and Luxembourg.

In France, Federal Republic of Germany and in Ireland, both systems operate concurrently. Certain sections of the farming community are taxed on actual profits, others on notional income. The level of threshold varies from one country to another.

4.2. Basis for Estimating Notional Income

67. Notional income is often based on the estimated value of agricultural land. In the Federal Republic of Germany, for instance, the notional income is based upon the Einheitswert (standard value) of the farm. This Einheitswert results from a complicated calculation based upon soil classification, climatic factors, proximity to markets and transport facilities, average crop yields and livestock densities, building accommodation and so on. In Ireland, as we know, it is based upon the land valuation made by Griffith in the 1850s, in which soil classification and crop yields were major determinants.

68. Alternatively, the notional income may be based upon data of physical yields for different products produced in different geographical areas for "average" farms. This forms, for instance, the basis of the forfaitaire system in France for farmers whose income from farming falls below a specified threshold level. Currently, this level is a revenue turnover of Fr. F. 500,000. In Germany a farmer is obliged to keep accounts for taxation purposes when his turnover is more than DM 250,000, his profit from farming and forestry is more than DM 12,000, or his farm capital, valued according to the Einheitswert* calculation, is more than DM 100,000. Such a valuation may be between 10% and 20% of the present market value. It is interesting to note that both the French and German revenue thresholds are roughly £50,000.

4.3. Current and Future Trends

69. European experience suggests that at some stage, the taxation of agriculture is to be put on to the same system as other economic and commercial activities. In the United Kingdom, this happened in the 1940's. Up until then, British farmers had been assessed for income tax upon the rateable value of their farms similar to Ireland.

70. In Denmark, the liability to keep accounts for taxation purposes was introduced for farmers in 1954. Before 1954, farmers were normally taxed on a notional basis, and there was no liability to keep accounts as a basis for declaration of taxable income. However, this did not prevent farmers from voluntarily keeping accounts for their income tax returns. Nor is this surprising in view of the long-standing tradition of farm book-keeping amongst Danish farmers. The liability which was introduced in 1954 comprised only some of the farms—that is, those with an assessed land value in 1950 of 40,000 kr. or more. As a result about 23,500 farms out of a total of 201,500 farms became accountable. Since 1954 this liability has gradually been extended to cover an increasing number of farms. In 1974 the liability applied to all farms above 15 ha.† or with an assessed farm value in 1973 of more than 175,000 kr. This means that about 60,000 farms out of a total of 130,000 farms today have become accountable.

**Soil Classification, Land Valuation and Taxation—The German Experience* C. J. Weiers and Ian G. Reid, Centre for European Agricultural Studies, Wye College, 1974.

†1 hectare = 2·471 acres.

71. The following table shows the change in the last 20 years of the relative contribution of Danish agriculture to the economy.

	1954	1974
(*a*) Agriculture's contribution to GNP	17%	6·5%
(*b*) Working population employed in agriculture	19%	8%
(*c*) Number of farm holdings	201,500	130,000

The Danish picture for 1954 shows an interesting similarity to that of Ireland in 1975 as regards the position of agriculture within the total economy.

72. It can be seen, therefore, that in Europe the general trend is towards the taxation of agriculture on a similar basis to that of other economic and commercial activities. Where there are mixed systems, the tendency is to lower the threshold level and so bring more and more farmers within the scope of an actual profits based system. Such a trend seems inevitable as the average farm business grows in size and becomes more comparable to businesses in other sectors. It is also a political and economic fact that central governments as well as local authorities are requiring ever greater tax revenues and that farmers' political power lessens as their industry's proportional contribution to their national economies diminishes.

Chapter 5: CRITERIA FOR A GOOD FARM TAXATION SYSTEM

5.1. Equity between Taxpayers

73. The first criterion in any tax system is that it should distribute the burden of paying for government expenditure equitably. It must be fair to be accepted politically. Controversy frequently begins on what is meant by equity. The concept requires agreement on a measure and definition of "well-offness" and of personal family circumstances. This can be measured on an income scale or on a wealth basis. In this report we are concerned principally with well-offness defined according to income. The equity criterion then requires that all those with the same income should pay the same amount of tax, and people not equally well off should pay different amounts.

74. The marginal rates of tax indicate different amounts paid by people of different incomes.* These broadly represent society's present view of how people in different circumstances should be treated. Some will consider this inequitable, either because the rates are too steeply progressive or not progressive enough. We shall not be too concerned with this issue. Rather, our main concern from an equity stand point will be with whether there is a case for the continued exemption of certain farm profits from income taxation.

5.2. Incentives to Productivity

75. Any tax system can affect the efficiency of production and the incentive to produce. A second criterion must be to ensure that farm taxation gives the maximum incentive to a farmer to develop his holding and expand productivity in the national interest. There is an enormous potential for expansion in the agricultural sector which if released could provide a real impetus to the development of the whole economy. Substantial benefits can be gained from the increased exploitation of this natural resource, with its low import requirements and its close linkage with domestic industry which supplies agricultural inputs and processes the output. Historically, agricultural output has increased relatively slowly in spite of rapid increases in output per man. This bias towards a reduction in the farm labour force rather than an intensification of production occurred because of the market situation facing agriculture. Now, membership of the EEC has lessened the market constraint to expansion. The Common Agricultural Policy allows access at reasonable prices for Irish food products to European markets. It is important that the farm taxation system make every effort to encourage farmers to make better use of their resources, to intensify production and to undertake the necessary investment on farms.

*However, the marginal rate of tax paid by people with the same income can also vary because not all people qualify for the same tax reliefs and allowances.

5.3. Low Administration Costs

76. A third criterion of a good tax system is that its administration costs should be low. Administration costs can be of two kinds. There are costs on the collection side such as the inspection of records and administration. There are also costs imposed on the taxpayer when he is obliged to keep records and employ accountants. Generally, the less complex the system and the fewer the concessions and exemptions, the lower the administrative costs. Simplicity in operation should therefore be another objective of the tax system.

5.4. Other Considerations

77. Fourthly, the revenue implications of any proposed changes must be taken into account. The government can expect a certain amount of money from the full operation of the present income tax scheme for farmers—our estimate would be around £10 million. While these sums are small in the context of total government tax revenue of around £1,000 million, the cost of any revenue foregone and any potential revenue from alternative sources should be a consideration in the evaluation.

78. Finally, the possibility of the eventual tax harmonisation within the EEC should be borne in mind. There has been little progress in this area so far. Article 99 of the Treaty of Rome calls for the harmonisation of indirect taxes, but Article 100, dealing with direct taxes, calls merely for an approximation of laws. So far, the establishment of a VAT structure by a number of Directives in 1969 and some activity in the corporation tax and excise duty fields have been the only achievements in this area.

79. It does not necessarily follow that movement towards economic and monetary union in the longer term would require much greater co-ordination of tax structures than at present. Because economic and monetary union would mean an end to national exchange rate, money supply and interest rate policies, it could put a greater premium on fiscal flexibility. This might require deliberate differences in fiscal policies. But although there is as yet no legal framework for similar tax structures throughout the EEC countries, it is clearly of interest to set developments here within the European context as discussed in Chapter 4.

5.5. Special Circumstances of Farming

80. In view of these criteria, a valid question to ask is if there is any reason why agriculture should not be brought within the tax code in the same way as any other trade. We have already seen (paragraph 58) that there are only minor differences in the treatment of farm profits for tax purposes under the 1974 Act and the treatment of profits of other unincorporated businesses. In fact, the main difference in treatment between agriculture and other sectors lies in the availability of relief on the export profits of manufacturing industry. This was specifically designed as a measure to encourage exports and the creation of employment in export-oriented industries. It would not be appropriate, in view of the marketing structure of agricultural produce, to suggest that this relief be extended to farmers producing agricultural produce which is exported eventually by another agency. Indeed, where a manufacturing firm does not export directly (but merely supplies materials for a firm which is exporting), it does not benefit from this measure. It is also likely that the EEC would not take kindly to any

extension of this scheme. However, there is a case for some form of incentives to encourage investment and increased output and employment in agriculture.

81. A second argument sometimes advanced in favour of the differential treatment of profits from farming is the low return on capital invested in farming. From an income tax point of view, this is not relevant. Each income is taxed equivalently to any other, regardless of whether it took longer hours or harder work, or represented an efficient or inefficient use of resources. If there is a nil income, then no tax is payable. The point can also be made that though the average rate of return on capital invested in farming (including farm land) is low, the marginal return on additional investment in farms where extra land need not be bought is usually very attractive. This argument has more relevance to a discussion of capital taxation, where a tax on the market value of farm assets can amount to a sizeable proportion of farm income, when the return on those assets is low. Thus the fact of a low return on farming capital could have an important and adverse effect on the funds available for reinvestment where both income and wealth taxes are imposed together. This fact is recognised by the provision in the Wealth Tax Act of a ceiling whereby the combined total of wealth tax and income tax paid by an individual shall not exceed 80% of his total income as ascertained for income tax purposes. There is, however, a proviso that in no case shall the wealth tax payable be less than 50% of the tax as assessed.

82. Farming is also unique in that in contrast to other businesses there is considerable price and volume variability over which the farmer has little control. Livestock production is a biological process. A finished beef animal is not ready for slaughter until three years after its mother is put in calf. The market for beef may have slumped in the meantime, but there is little a farmer can do to stop the process once it has begun. Price, too, is notoriously volatile depending on a world market where very small changes in the level of world production can turn a shortage into a surplus or *vice versa*. A consequence is that farmers are likely to experience greater income variability than other groups, although this variability is different for different farming systems.

83. Finally, decision making in farming is very much influenced by the structure of family farm ownership and control. The farmer is both owner, manager and worker. This is in contrast with a corporate business, where senior managers who make investment decisions may not be affected personally by the taxation which reduces the rewards from that investment because their remuneration comes from a professional salary. Hence a greater tax on the rewards from corporate investment may not reduce the enthusiasm with which he goes about his managerial tasks. On the other hand, the farmer and the small businessman could easily decide that the post-tax extra benefits may not be worth the sacrifice, effort, risk and worry of investment and development. Moreover, there is a difference between the farmer and the small businessman which was recognised by the Commission on Income Taxation. Many older farmers without mortgage commitments can survive by adopting a "status quo" policy without the farm regressing. On the other hand, a small businessman who makes no effort to go forward runs the risk of going backwards because of competition. The "stick effect" of competition is a natural incentive which the farmer does not have.

84. We conclude that there is need for some reliefs and modifications to the general tax code to meet the special circumstances in farming. However, a general principle behind any modification must be that it would result in increased investment and additional productivity and that such modifications will remain only as long as there are such increases. Only in this way can the equity principle be maintained in that in the longer run, both the Exchequer and the community as a whole would benefit from the enlargement of the taxable capacity of the individual farmer.

5.6. Alternative Systems—Notional Income

85. There are two main alternative methods of taxing farmers which can be considered in relation to the criteria discussed above. These are the notional income tax and the actual income tax systems. Both systems should provide equity both between farmers and non-farmers and between farmers themselves. Both systems should also provide the same total tax revenue. The multiplier would have to be increased substantially above its present 40, if this were to be achieved. Moreover,

to collect the same revenue, the option of falling back on to the notional basis of assessment, if the notional basis underestimates income, would have to be dropped. As between farmers, inequities arise because of the present anomalies in the land valuation assessments, and also because a farmer whose actual income is less than the notional income through personal ill-health or disease in his crops and livestock would pay more than his equitable share of tax. Even if the system of assessing notional incomes as between different farmers was refined inequities between farmers would be still likely to continue.

86. The great advantage of the notional income tax system lies in its ability to meet the criterion of providing incentives for development and growth. Those who run their farms efficiently pay a lower average rate of tax than those who farm inefficiently. Old farmers and those who have no economic aspirations for their land have the choice of farming more intensively to pay this tax or selling their farms to those who will. On the other hand, more than averagely efficient farmers have an incentive to continue further investment because the marginal return will be tax free. A secondary advantage is that costs of administration are likely to be low for a notional income tax scheme.

87. However, the notional tax system would seem unfair to some farmers. They would be assessed for income tax on an income which they may not have earned. To keep a rigorous notional system fair between farmers and non-farmers the option of moving on to an actual income tax system could not be continued. Because the "fairness" of income tax is based on the principle that those who earn most pay most tax, there could be strong objections by the less efficient farmers against the introduction of a notional income tax system. Under the present notional basis, farmers have the option of presenting accounts if they feel unfairly treated by the notional assessment.

88. Even from a development perspective, a rigorous notional tax system has one drawback. A keen developing farmer taking over a run-down property which may have a relatively high notional income would suffer financially in those early years when capital is hard to get.

5.7. Alternative Systems—Actual Income

89. The alternative of an actual income tax is the one introduced by the 1974 Act. Farmers pay tax according to their income and this is seen to be fair. Although costs of administration are higher than for a notional income tax system, these costs can be reduced by exempting those farmers below a certain size from furnishing tax returns. It can be argued that the process of keeping accounts for tax purposes makes farmers more business-minded and thus aids farm management. But the crucial drawback to an income tax system based on actual accounts is that it reduces the post-tax marginal return and therefore the incentive for development.

90. Nevertheless, we favour the retention of the actual income system on the grounds of its greater acceptability to both farmers and non-farmers alike. Hence, we recommend:—**"That the system of income tax for farmers, introduced in 1974, whereby they are taxed on actual income be continued".** This makes it very necessary to consider ways in which the disincentive effects of an actual income tax system can be reduced. We consider such effects in Chapter 7.

91. However, we are very loathe to dismiss entirely the notion that there should be a charge on land to encourage its full utilisation. The need for structural reform in farming is vast, and progress to date has been slow. The Voluntary Retirement Scheme is a useful and necessary "carrot" in structural policy, but needs to be reinforced by a "stick". Rates, of course, represent a charge on land but have the disadvantage from a structural viewpoint that all holdings under £20 are exempt from rates. If all farmers paid rates, the Agricultural Grant meeting a fixed proportion of the charge, then more small farmers might be encouraged to opt for the Voluntary Retirement Scheme. The idea behind a rigorous notional income tax system could be incorporated into the capital tax system. This point is taken up later on.

Chapter 6: ANALYSIS OF PRESENT SYSTEM OF TAXING FARM PROFITS

6.1. Spreading the Tax Net

92. Every citizen who has sufficient means is called upon to make a contribution to government revenue through the system of income taxation. In principle, therefore, we feel that farming profits should be taxed in the same way as other incomes. Special reliefs and incentives may be justified within the tax code for particular circumstances or groups of people. We concluded in Chapter 5 (paragraphs 80–84) that there are circumstances in farming which would justify some different treatment. However, these circumstances would not justify treating one segment of the farming community differently from another.

93. At present, profits earned by persons occupying land of less than £100 valuation—£50 in certain circumstances—are exempt from income tax (though a farmer's personal allowances may be restricted if he or she has income from off-farm sources). In section 6 of this chapter, we discuss the unreliability of the rateable valuation as an indicator of farm productivity or income. It is sufficient to state here that it is certain that there are many farmers paying tax on their farming profits who are earning less than those who are completely exempt. Equal treatment within the farming community requires the removal of the thresholds based on rateable valuation for excluding farmers from paying income tax. There is also a revenue consideration. The existence of a large group of farmers exempt from taxation may encourage or assist the "hiding" of income in inter-farm transactions. These transactions are hard to detect if many farmers do not have to keep records. We feel therefore that, in principle, all farming profits should be taxed.

94. There is clearly a point at which diminishing returns set-in in terms of the additional revenue collected as smaller and smaller incomes are

brought within the tax net. Many small incomes would be exempt from tax because of the operation of personal allowances. Single persons earning £11 weekly and a married person earning less than £18 weekly do not pay income tax. If all farm profits were liable to tax, then the Revenue Commissioners would survey all farm accounts in the knowledge that a majority of them would not be liable for tax. Using a multiplier of £50 family farm income per £ valuation, the present married allowance would be approximately equivalent to the expected income from a farm of £20 valuation. Almost two thirds of all landholders, 175,000 in all, occupy land with a valuation of less than £20. The total number of individual income tax payers in all sectors is 740,000. We suggest, therefore, on the grounds of administrative convenience, that the farm profits of a farmer occupying land of less than £20 valuation for any year of assessment should remain exempt from taxation. Special provision might have to be made for intensive enterprises on these small farms.

95. It was put to us by one group of taxpayers that the expected revenue from taxing farmers in the £0–20 land valuation group could be greater than the expected revenue from the £20–50 valuation group. Most of these farmers, it was argued, already earned income from off-farm employment and hence their farm profit would all be taxable. While we would agree that many small farmers have a supplementary source of income we feel that for most of those concerned the sums involved are not too large.

96. We are firmly in favour of the Government announcing in advance and as soon as possible, its timing schedule for reducing the threshold. The present doubt and uncertainty in the minds of farmers over the £100 valuation threshold in a stage of transition from a no-tax to a tax situation is clearly evident. Farm development programmes must be re-examined, farm borrowing re-scheduled, financing plans altered. If the remaining farmers were now given notice of when to expect a change in their tax status, this climate of uncertainty could be reduced in the future. Farmers could take decisions knowing the consequences, and could now be introducing simple book-keeping techniques where this is not already done. Our recommendation is that the farm profits of remaining farmers should be charged to tax in two stages. Our

recommendation is set out as follows in what we regard as a reasonable schedule: **"That the threshold valuation for assessing income tax be lowered to £50 for the 1977/78 year of assessment and to £20 for the 1980/81 year of assessment".**

6.2. Duration of the Notional Income Tax Option

97. In paragraphs 85–91 above, we discussed the alternatives of assessing farm profits for tax on a notional income basis or an actual income basis. We favoured the use of the actual income basis, largely on the grounds of its greater equity both between farmers and non-farmers as well as between farmers themselves. A notional income option has been allowed for the 1974/75 and 1975/76 years of assessment as a transitional measure, in recognition of the fact that a majority of farmers have not kept farm records and accounts. The question arises whether this option should be continued and, if so, on what basis and for how long.

98. We favour extending the option for the notional basis of assessment for farmers whose farm profits were charged to tax under the 1974 Finance Act for one further year. In arriving at this conclusion we have been influenced by the relatively slow beginning that has been made by farmers in keeping accounts.* Up to the end of August 1975, there were 8,473 applications for grants towards the keeping of farm accounts, of which 8,247 have been approved and 5,120 commenced. The farm accounts service initiated by IFA and serviced by the Agricultural Institute is still in its initial stages and has less than 1,000 clients. We are aware that the delay in assessing farmers' tax in 1974/75 will mean a bunching of tax returns in 1975/76 and that farmers liable to tax are likely to have to pay tax for two years in 1976. In practice, much of the burden in instructing farmers in farm accounts will fall on the Inspectors of Taxes and the extension of the multiplier for a further year could help to ease this burden on the tax administration.

*All farmers who keep farm accounts, in a form capable of producing the specified information necessary to enable the farmer and his adviser to assess the progress and general management of the farm business, are eligible for a special grant payment from the Department of Agriculture over a 4 year period, for keeping the accounts. The amount of the grant is £60 in each of the first three years, and £80 in the final year, giving a total grant payment of £260 over the 4 years.

99. In paragraph 96, we recommended that the remaining farmers over a £20 valuation be brought within the scope of income tax gradually over the next five years. We recommend that each group of farmers charged income tax for the first time be allowed the option of a notional basis of assessment for a three year period. This would mean that a notional system would be in use for tax assessment up to 1984. Our recommendation therefore is: **"That the notional income option be allowed for farmers with a £100 valuation or more for one additional year and that the notional income option be allowed for a three year period for each group of farmers who become subject to tax as the threshold is lowered".***

100. We now consider what changes might be necessary in the multiplier system set out in the 1974 Finance Act if this system is to serve over a ten year period. A major problem from the point of view of revenue administration would be the possibility each year of switching from one basis of assessment to another. This would allow a farmer, for example, to make large purchases of cattle in one year (thereby making a loss or low profit) and then when selling them the following year to opt for the notional basis which would understate his income considerably in that year. Therefore it would be wise in future to rule that a farmer who has once opted for the accounts basis must remain within it. If so, this rule should not be applied in the 1976/77 year of assessment as farmers would not have been aware they were affecting their 1976 decisions when choosing in 1974 or 1975. We, therefore, recommend:—**"That in future a farmer who has once opted to use his accounts to assess his taxable income must remain with that system".** It is inequitable that a farmer should have an advantageous option not open to other taxpayers.

*We recognise that because of changes in the tax environment some farmers in developing their farms may have been caught in a tight liquidity situation because they planned their capital repayments on the basis of the continuation of the notional system of taxation. A possible way of dealing with genuine cases of hardship could be for assistance to be given in the form of special loans. Farmers should have the option of funding capital sums spent on the following items during 1969/70–1973/74 (four years before the Finance Act, 1974 came into effect):

(i) Farm Buildings
(ii) Purchase of land
(iii) Farm drainage
(iv) Farm roads
(v) Increase in breeding females of herd or flock

at a subsidised interest rate and an amortisation rate of not less than 20 years.

6.3. Composition of the Multiplier

101. An important question is whether the composition of the multiplier used at present in the notional basis should be changed. Our view is that the multiplier should vary to reflect the fortunes of the agricultural industry year by year and should be determined annually by the Government in consultation with farming organisations. The basis for the multiplier should be the national accounts aggregate figures of family farm income. Family farm income is derived from gross agricultural output by adding subsidies not related to sales (e.g. beef incentive subsidy, mountain sheep subsidy) and by deducting costs and other expenses including rates, depreciation and paid labour. Capital subsidies in respect of buildings and machinery are not included—this treatment is in line with income tax practice.

102. The notional income arrived at through the multiplier system is meant to approximate on average to a farmer's actual income for tax purposes. It is important, therefore, that the income figure derived from the notional system should allow the farmer the same capital allowances and trading expenses as a farmer assessed on an actual profits basis. Therefore, the items (1) rates paid on land, (2) depreciation of machinery and (3) remuneration of employees, which are deductible under the notional system, must be added back to the total family farm income when calculating the multiplier. (The income of relatives assisting can also be claimed under the notional basis but their remuneration is already included in total family farm income.) In keeping with the notion of comparability with the actual profits assessment basis, the 1975 national accounts figures should be used to calculate the 1976 multiplier and so on. However, preliminary 1975 figures would not be available for the 1976 Budget and estimates would have to be used. These estimates should be agreed each year by a special working party of government officials and farm organisation representatives.

103. The multipliers for 1974 and 1975, calculated on 1973 and 1974 farm income figures, would work out as follows:

	1973 £m	1974 £m
Family Farm income	365	323
Plus rates paid on land	13	14
Plus machinery depreciation	29·7	33
Plus remuneration of employees	29·2	35
Base income figure	436·9	405
Total land valuation	7	7
Multiplier	62	58

104. The actual multiplier used, 40, is below these figures and clearly was meant as a transitional figure to ease farmers into income taxation. However, it should be noted that the Farm Buildings Allowance cannot be claimed under the notional basis of assessment.* Either this should be altered or the multiplier adjusted to recognise this. Interest is also treated differently under the notional and actual profits bases of assessment. Interest paid on farm borrowings can be claimed as an expense under the actual profits basis without limit; it is not allowed at all as an expense under the notional basis though each farmer can claim up to £2,000 interest in the same way as he can claim a personal allowance. Again, we would favour making all interest paid a deductible expense under the notional basis, or else adjusting the multiplier itself to recognise this. It might be argued that allowing these further deductions would destroy the basic simplicity of the notional basis; this is not really valid.

105. Interest paid can be determined once a year by the farmer contacting his lending agency. The Farm Buildings Allowance would have to be calculated anyway in later years when the farmer moved on to an actual profits basis and should not prove a difficult calculation. The alternative of adjusting the multiplier would be arbitrary because of a lack of data.

*An individual or a company carrying on farming is entitled to an annual allowance in respect of capital expenditure incurred on the construction of farmhouses, farm buildings, cottages, fences or other works (including drainage, sewerage, water, and electrical installations, walls, glasshouses on farm land and land reclamation).

106. The argument that changes to the multiplier system would destroy its simplicity can be made validly against a further suggestion, namely, that the multiplier should be differentiated on a farm system basis. A single national multiplier suffers from the disadvantage that it is inevitably too high for a number of farmers. Partly this is because of its nature as an average, and partly because gross margins for different farm systems can differ. It has sometimes been suggested that separate multipliers should be calculated for creamery milk production, beef production, tillage production and so on. While multipliers could probably be calculated, their administration at farm level could be very complex. Each farm would have to be classified by the Inspector of Taxes according to its system and there would be wide grounds for dispute over the classification. We therefore do not favour a multiplier differentiated on a farming systems basis.

107. It can be said that a farmer who is dissatisfied with the notional income assessment has the option of presenting accounts. In practice, this is open to the objection that farmers being charged tax for the first time may not be geared to keeping accounts. For the group of farmers charged tax under the 1974 Finance Act, the multiplier was deliberately lowered to take account of this. For the two remaining groups of farmers to be brought within the scope of income tax (with £20–50 and £50–100 valuation), we recommend:—**"That the multiplier be increased systematically over three years to the full objective value but that it should be modified year by year thereafter to reflect the fortunes of agriculture".** This would have the advantage of encouraging farmers to keep accounts thus aiding the management of their farms. In addition, once the full objective value of the multiplier had been reached then the only variation would be to reflect general movements in farm profitability. This would accord with the principle of taxation according to ability to pay.

6.4. The Tax Treatment of Farmers with Other Income

108. A number of submissions dealt with the present tax treatment of farmers who have other income, arguing that it discriminated against part-time farming. It was also argued that agricultural productivity was being affected adversely because of its effects on the providers of farm

services such as contracting. In discussing the case of farmers with other income from non-farming sources, it is useful to distinguish a number of categories:

(i) farmers occupying land of £100 valuation and over with a source of income outside farming. This source of income must be added to their farming profit when making an income tax return.

(ii) business and professional men with income from farming. Where such persons occupy land over £50 valuation, their profit from farming must now be added to their other source of income when making an income tax return. Furthermore, it is not open to them to opt for the notional basis of asesssment. This is seen primarily as an anti-tax evasion measure to prevent such businessmen/farmers from attributing part of their non-farm income to an otherwise tax-free activity.

(iii) farmers occupying land between £50 and £100 valuation and providing a service (other than farmhouse accommodation) such as agricultural contracting which is related to their farming activities. In the past, though profits derived from these activities have been liable to tax in the ordinary way, it was likely that most farmers who undertook them would not have made significant profits. Thus assessments were rarely raised. These activities could be classified as a separate trade from farming which could mean that, under the 1974 legislation (see (ii) above), the farming profits of this group of farmers could also be liable for tax.

(iv) farmers occupying land over £20 valuation who are not otherwise charged to tax on their farming profits and who have their personal allowances restricted.

(v) farmers occupying land less than £20 valuation whose farming profit remains exempt and who remain entitled to their full personal allowances where they have other income. The tax treatment of these farmers has, therefore, not been changed with the introduction of the 1974 Finance Act.

109. We discuss first the farmers in group (iii) above, of whom the farmer doing a little contracting work is a good example. It is quite common that a farmer who has acquired a large and expensive piece of farm machinery will do some hire work for neighbours in order to achieve a better use of the machine. It was suggested to us that many of these farmers were now having second thoughts about this work because of the fear that they would be classed as engaged in a separate trade from farming, thereby making their farm profits liable to tax. This in turn has resulted in some farmers not being able to get contract work done. The Revenue Commissioners have agreed that where the agricultural contracting business is shown to be on a part-time basis and ancillary to the farming business, the contracting service would not be treated as a separate trade for the purpose of the 1974 legislation. We have not yet sufficient experience to know how this will be interpreted by individual inspectors of taxes, but we feel this assurance should relieve most genuine farmers. The net profit from the contracting service will continue to be taxable if there are not sufficient personal allowances (after restriction) to offset it. In any event, this is largely a transitional problem and once the threshold is reduced for all farmers to £50 valuation, as we have recommended in paragraph 96, then no penalty will attach to the provision of contracting or other farm-related services.

110. Farmers in group (iv) above are affected regardless of the source of their non-farm income, and in submissions it was argued that this provision discriminates against part-time farmers. It is suggested that these farmers have a role to play not only in the restructuring of farming but also in maintaining the rural fabric. They also form an essential source of labour in any development of rural industries.

111. The position of such a family in 1974–75 is examined in the table overleaf, comparing the tax position as it was, that is, with the restriction in operation and the tax position as it would have been, if the restriction had not been in operation. We assume a married couple with two children running a farm of £25 valuation where the wife is also teaching in a local national school.

	£
Income from farm	800
Income from teaching	2,600
Total Income:	3,400

	1974/75 Tax Position (without restriction) £	1974/75 Tax Position (with restriction)* £
Personal allowances	1,400	1,000
Taxable income	1,200	1,600
Tax at 26% (on first £1,550)	312	403
Tax at 35% on balance	0	17·5
TOTAL TAX:	312	420·5

*The personal reliefs are restricted by whichever of the following is the lowest:

(*a*) one-half of the aggregate of the personal reliefs,

(*b*) eighty times the amount by which the rateable valuation for the year of assessment exceeds £20, or

(*c*) the amount of the farming profits.

In our example, case (*c*) is applicable, that is, the personal reliefs would be restricted by £400 [(£25–£20) × 80].

In the example above, it can be seen that the restriction in 1974–75 increased the tax liability of our hypothetical family from £312 to £420·5. If, however, a similar hypothetical family outside agriculture, that is, a husband and wife with two children, is examined in terms of the husband and wife having a combined non-agricultural earned income of £3,400, a larger tax commitment results. In this case, the non-agricultural family would have had a tax liability of £560·5 in 1974–75, as compared with a tax liability of £420·5 for our hypothetical agricultural family.

112. We feel that this provision will not have a drastic effect on the number of people seeking off-farm employment. First, farmers under £20 valuation are not affected. This removes almost two-thirds of all farmers under £100 valuation from this provision. Second, the new legislation will not affect the farm family where the income from the

off-farm employment remains less than half the personal allowances claimable. Thirdly, the vast majority of those affected will be PAYE employees, for whom the question will not be whether to work a little less hard because their marginal rate of taxation is greater, but whether to work off the farm at all. We feel that the amount of money involved will be sufficiently small that the incentive to take an off-farm job will not be affected.

113. It is unfortunate that the tax paid by a farmer with off-farm income will be greater the larger his family and number of dependants. The larger the amount of allowances, the greater the effect in absolute terms of the restriction. It is open to a farmer to have his allowances restricted by the amount of his farm profits where this is less than half the allowances. While some inequities between farmers will remain, the alternative would be to insist on farm accounts for all farmers with over £20 valuation. The method of restricting the allowances, though crude, will mean that a majority of farmers with off-farm income will pay less additional tax than if asked to pay on a profits basis.

114. The restriction of allowances which can be claimed against off-farm income occurs solely because the farm profit is exempt from tax. We have recommended earlier that over a period of years all farm profits from farms over £20 valuation should be charged to tax, and the necessity for this provision would then disappear.

115. The question remains, however, whether the Government should try to introduce positive incentives to encourage part-time farming. There is no official view on part-time farming and its desirability. In fact, some current provisions for structural reforms of agriculture would seem to discourage it. For example, part-time farmers are not eligible for the full range of grants under the Farm Modernisation Scheme. A case could be made for part-time farming on the grounds either of retaining a larger number of small holdings than there would otherwise be because of the possibility of income supplementation. Such income would reduce the supply price of labour since it represents part of the opportunity cost to a worker leaving a rural industry and moving to a similar job in a town. Although it is argued that part-time farms have

a lower output per acre than many full-time farmers, this is no indication of economic inefficiency.* In fact, it could be shown to be the reverse insofar as they may have a higher output per unit of labour than a so-called full-time farmer. We recommend:—**"That there is no need to change the treatment for tax purposes of the earnings of part-time farmers".**

6.5. Rates under an Actual Income Tax System

116. Rates are a tax on the occupation of property, levied to finance the services of local authorities. They are a tax paid by everyone who occupies property, whether he be the tenant of a local authority house, a householder living in his own home, a shopkeeper or professional person using premises for his trade or profession, an industrialist occupying a factory, warehouse or office for running his business, or a farmer occupying land for farming. Nevertheless, strong feelings have been expressed against rates on agricultural land on the grounds† that:—

(*a*) they bear more heavily on farmers than on the rest of the community; and

(*b*) they are inequitable as between farmers themselves.

117. The inequity as between farmers is explained by two factors:

(i) differences in rates paid by farmers occupying land with the same valuation but living in different rating authority areas; and

(ii) discrepancies between land valuation, soil productivity and farm incomes.

118. Because of these alleged inequities, all the farming organisations

*Lucey & Kaldor found strong farm investment effects but also a shift from labour-intensive to labour-extensive enterprises. See their *Rural Industrialisation*, Geoffrey Chapman, 1969.

†In this section, when talking of rates paid by farmers, we mean rates on agricultural land, unless otherwise stated.

who made submissions to us were in favour of the effective abolition* of rates on land now that income tax applies. NITRO also supported the abolition of rates on land in the context of their proposal that income tax should be extended to all farmers.

119. The Commission on Income Taxation considered whether or not adjustment for rates on land should be made when income tax was based on actual profits. The Commission did not accept that rates on land should be regarded as equivalent to income tax, but did accept that rates payable on land absorbed a greater share of the income from land than the rates on business premises. They recommended that when income tax on farming profits was based on actual profits farmers should be allowed to subtract one-third of their rates from their assessed income tax as a credit. They felt that if the disparity between the burden of rates on land and on other business property changed in future years, then this credit for rates should be reviewed.

120. To place the discussion in context, it is essential to look at the trend in recent years in the amount of rates levied and the burden placed on ratepayers. The table overleaf shows the total rates paid by farmers as a proportion of total rates paid. This is compared with the proportion of national income going to agriculture. It can be seen that the farmers' share of the total rate burden has been gradually decreasing and moving into line with agriculture's share of the national income.**

*One suggestion, for example, was that rates paid on land would constitute a tax credit for income tax purposes. For all farmers whose income tax bill would be greater than their rates on land, this would effectively mean derating of that land. For all farmers it would mean the payment of either rates or income tax but not both.

**The figures cannot be taken to show that rates paid by farmers are proportionately greater than those paid by other sectors on some "ability to pay" criterion. The final column shows the proportion of national income going to the agricultural sector, not the proportion going to farmers. It would be necessary to add in PAYE and other income accruing to farmers before deriving the "rates paid" ratio to make that comparison. (Rates on farm dwellings would also have to be included on the other side). It would also be necessary to assume that the average income and the distribution of income were the same in both agricultural and non-agricultural sectors. Thus the figures do not say anything about absolute equity, but indicate that relatively farmers seem to have improved their position in the past 20 years. We discuss later the reasons for this.

Rates Paid in Recent Years

Year	Total rates £m	Rates paid by farmers* £m	Proportion of rates paid by farmers %	Proportion of national income going to agriculture %
1956	19·70	7·4	37·6	20·9
1961	23·20	8·9	38·4	20·5
1966	31·53	9·2	29·2	16·1
1971	60·16	13·3	22·1	13·7
1972	70·25	15·4	21·9	15·9
1973	71·23	15·1	21·2	17·4
1974	80·0**	16	20·0	13·9

*Excludes rates paid on farm dwelling houses.

**Annualised from a 9-month financial year.

121. The issue of rates on agricultural land would of course disappear should it be decided that the rating system itself as a source of finance for local government should be replaced by some other source. In the 1972 White Paper on Local Finance and Taxation it was stated that:—†

"The Government consider it essential that local authorities should have power to levy local taxes. Moreover, they believe that these taxes should be capable of financing a significant proportion of local expenditure, if local democracy and a sound local government system is to survive. Unless there is a direct financial relationship between a local authority and its electorate, local government will not have real meaning: the local authority will not be truly responsible and accountable to its electorate and its freedom to determine its total expenditure and the allocation of expenditure among services will be curtailed. Any major local tax must therefore be capable of being fixed independently at different levels in the different local authority areas and, given the proposals in the White Paper on Local Government Reorganisation, it must also be capable of being administered efficiently even by relatively small local authorities. Moreover, it must have a reasonable yield in every local authority area, irrespective of size or location.

"The Government have come to the conclusion that only the local rate satisfied the criteria referred to above and that the real issue is not the abolition of the rating system (with all the consequences this would involve for local financial independence and, indeed, for the tax-payer) but the reform of the system so as to eliminate its undoubted defects".

†Local Finance and Taxation (Prl. 2745. December 1972).

122. One of the commitments of the fourteen-point programme announced by the Parties to the National Coalition before the 1973 General Election was on the question of rates. The stated intention was to transfer, on a phased basis over a four-year period, from local to central taxation, that part of the cost of health services and local authority housing provided for letting which heretofore had fallen on the rates. The new Government on 30 March 1973, announced that, as the first phase in this transfer, local authorities in 1973/74 would be required to strike a rate in the pound for health services and local authority housing provided for letting equivalent to only 75% of the rates struck for these services in 1972/73. In the nine months financial year of 1974, the relevant rates were equivalent to 37½% of the corresponding 1972/73 rates; in 1975 it is 25%. In addition, the Government decided in 1974 to recoup to local authorities the full cost of malicious injuries to property caused by the use of explosives and attributable to the disturbances in Northern Ireland. Further relief for ratepayers from the burden of malicious injuries was provided by the Government when they decided that, where the cost of malicious injuries compensation to a local authority in 1975 or in any subsequent year exceeds the produce of a rate of 20p in the £, the excess would be recouped to that local authority from the Exchequer. As well as removing the burden of the health and housing services and easing the burden of malicious injuries, the Government is also committed to reforming the system of local taxation, with the primary aim of relating rates more closely to the ability of persons to pay. Work on this matter is in progress in the Department of Local Government and a report on the economic aspects of local authority finance and expenditure is being prepared in the

Economic and Social Research Institute. The ESRI report is expected to be available before the end of the year.

123. The farmers' organisations stated that they would be quite willing to contribute to local taxation through rates on their dwelling houses, but that agricultural land itself should be derated. Farm buildings erected since March 1959 and improvements to buildings are already exempt from rates. All other types of immovable property are rated. Why then should land be given this apparently privileged position? Farm organisations stated that rates on land and income tax represent a form of double taxation in that the income from working the land is taxed twice. Their argument of double taxation rests partly on the view that rates on agricultural land were a substitute for income tax which should be removed now that income tax itself has been introduced. This argument is taken up later. It was also pointed out that land in Britain and Northern Ireland (in addition to farm buildings) is derated, and it was contended that this burden of rates put Irish farmers in a disadvantageous position in competing on the European market. It was also argued that the services received by farmers from local authorities compared less favourably than those received by urban residents in return for payment of rates.

124. While rates and income tax must be paid out of the same income, this is true for all taxes (VAT, excise duties and capital gains tax). The tax structure uses a number of different bases for levying taxes, of which the occupation of property is one. It can be argued that there is no reason for treating land differently from other property.

125. It was argued that land is a different kind of property in that it represents a farmer's means of production, and that to tax both the means of production itself and the income arising from it is double taxation. The comparison was made between the plant and machinery in a factory, which is not rated and the land, which is. It seems to us that the comparison could equally well be made between the farmer's breeding herd and machinery, which are not rated, and the industrialist's factory premises and offices which are. All are means of production to those who own them, and neither economic theory nor conventional

usage gives reasons why the distinction above should be made. What could be significant in this point is that farmers may use a higher proportion of rated property in their business than non-farmers, particularly when considered in relation to the low return on capital invested in farming. This again, however, is a question of the relative incidence of rates between farmers and non-farmers, a point to which we return later.

126. The second argument against levying rates on agricultural land relates to the alleged discrimination against Irish farmers within the European Community if land remains rated here. Although land is de-rated in Northern Ireland and the UK, a number of other EEC countries do have land taxes of some kind. The following table sets out some comparative information.

Country	Tax based on land valuation	Comments
Belgium	Yes	Based on the cadastral income which in principle is reviewed every 20 years. The rate of tax is 3% of cadastral income for the state, plus 3% to 7% for the Province plus a surcharge of up to 60% for the municipality.
Denmark	Yes	A municipal land tax charged at an average rate of 3% of the value of the land. Revaluations are carried out every 4 to 5 years, the most recent being in April 1973.
France	Yes	Based on the cadastral value, with remissions of 30 years for land that is developed, 20 years for marsh land drained and 10 to 15 years for re-cultivation of fallow land.
Germany	Yes	Based on the basic site value with a rate of tax around 10% on average. The average levy equals 3% of gross yield.

Table continued overleaf.

Table continued.

Country	Tax based on land valuation	Comments
Holland	Yes	A land tax of 5–10 D.Fl per ha. has been replaced by a municipal estate tax for 1971–79. Rates on agricultural buildings and farm dwellings have been correspondingly increased by 300–500%.
Ireland	Yes	Based on cadastral income of land and buildings determined over 100 years ago. The net yield, having allowed for the Agricultural Grant, is around 3% of gross output.
Italy	?	No information.
United Kingdom	No	Rates on land and buildings abolished in 1926.

127. From the table, it can be seen that all EEC countries for which information is available have taxes on land, though in some cases these appear to be less onerous than the Irish rates. As already pointed out in Chapter 4, all of these countries also have taxes on income. It is not possible, however, to say whether Irish farmers are treated less favourably than their European counterparts. A complete balance sheet would have to look at (*a*) the relative amounts of income appropriated through other taxes and (*b*) the relative value of services provided in return for taxes. To the extent that differential taxation exists, however, rates have an advantage in being a fixed tax. In short, additional production is not taxed and therefore rates are not necessarily a disincentive to expand production for the European market.

128. We mentioned in the previous paragraph that rates are a fixed tax. Rates must be paid regardless of whether there is an income there to pay them. This can clearly be an unfair burden on farmers, or indeed any business person, in a year of difficult trading conditions or when, because of illness or disaster, the expected income from the farm cannot be earned. The social distress that may be caused by this is alleviated to

some degree by social welfare schemes. Local authorities already have the power to remit rates for needy people, who are generally recipients under social welfare schemes. The Agricultural Grant can be considered as a type of remission of a similar kind. We think that for farmers (and indeed other ratepayers) provision for deferment of rates, with interest, should be introduced in such cases. Such a scheme is used in New Zealand.

129. A final point made by those who argue that rates on land should be abolished is that the services received by the agricultural community for the rates paid by them compare unfavourably with those received by ratepayers living in urban areas. On this point, defenders of rates immediately point out that rates are a local tax on the occupation of property and are not and were never intended as a payment for services provided. A parallel is that central governments' income tax is not related to the services received by those liable to pay.

130. With regard to the inference that rural ratepayers may be subsidising the provision of services for urban dwellers, the position is that the county councils, the county and other boroughs, and the urban district councils are separate rating authorities for their own administrative areas; rural ratepayers are required to pay rates only towards those services which are provided in the county health districts. Where a county council provides a service for, or jointly with, an urban authority, an appropriate amount of the expenditure involved is demanded of the urban authority and levied on the urban ratepayers. Rates in any event do not cover the full cost of the services provided by local authorities. The following are the proportions of local authority expenditure currently met by miscellaneous receipts for services such as housing rents and loan charges, State grants and subsidies and local authority rates.

	All local authorities	County Councils only
Miscellaneous receipts	21%	16%
State grants and subsidies	41%	52%
Rates	38%	32%
Total:	100%	100%

The view persists, however, that farmers, some of them not very well off, and benefiting little from local authority expenditure themselves are subsidising residents of urban areas.

131. The following table shows the distribution of rates levied on county health districts in 1975 by type of expenditure. The rate appropriate to each local authority activity is calculated by first deducting any receipts due to that particular account and then subtracting any central government grants available. The balance remaining must be covered by the rates.

Roads	36·7%
Public assistance	3·2%
Health	8·7%
Sanitary services	16·6%
Housing	6·0%
General Purposes	28·8%
General Rate	100%

132. Health and housing expenditure are now minor items of local authority expenditure, and are scheduled to disappear entirely by the end of 1976. Certain free health benefits are available to people with an annual income not exceeding £2,250, and to farmers with rateable valuation not exceeding £60. This rateable valuation limit, it is understood, was primarily set to ensure that the proportion of farmers would be broadly the same as the proportion of non-agricultural employees qualifying for benefit. More than 90% of all farmers occupy farms less than £60 valuation. Farmers are entitled to avail themselves of local authority grants for new houses and house improvements, though they would not benefit from local authority housing. However, all health and housing charges will have disappeared from the rates by the end of 1976. The provision of public assistance by local authorities is also under review.

133. The charge for sanitary services is principally the cost of servicing debt for major schemes of water supply and sewerage, plus the provision of refuse collection. It is not a county-at-large charge, which means that each rating authority area is only required to pay for such services as it provides to its own inhabitants. Thus the inhabitants of a county

health area would not be required to pay for the water supply in a nearby urban area. Special rates of grant are available for the provision of water supplies to farmers. Because the local authority can give the same amount of grant as the State, farmers benefit twice from higher State grants for water, sanitation and housing. Where a house does not have sanitation, water provided or otherwise lacks services because of isolation, this is reflected in a lower valuation of the house for rating purposes.

134. Road expenditure by local authorities is financed according to the classification of the road in importance. The cost of major trunk and link roads, for both improvement and maintenance, is met by the State. For major urban roads, 100% of improvement expenditure and 50% of maintenance expenditure is met from central government funds; the balance of upkeep expenditure is levied on the urban area served by the road. Thus the great bulk of local authority roads expenditure which is met from county rates goes primarily on local roads used mainly by farmers. General purposes expenditure goes on a miscellaneous number of activities, such as libraries, fire services, supervising planning laws, contributions to the Vocational Education Committees and County Committees of Agriculture, which are difficult to apportion between urban and rural residents, but it is unlikely that a serious discrepancy exists. The picture that emerges is that on a strict benefit approach to rates, farmers as a community are not discriminated against in local authority expenditure. However, the discussion does not help to answer the question whether farmers are paying more than their fair share of this expenditure. This is the point we turn to next.

135. The table in paragraph 120 brought out the point that the burden of rates on the farming community has eased somewhat in recent years. The proportion of farm income going in rates has been relieved by a number of factors. First, the valuation of land has remained unchanged for over a century, while urban property has been subject to a "creeping revaluation". Although new properties in urban areas, and revision of valuations in the case of improved properties, are in theory valued by reference to the general run of properties in the locality, there is in practice some upward revision of valuations over time. The current method of valuing new properties for trading purposes is to take about

3% of their estimated reasonable capital value. In comparing this with land, if the current value of land in agricultural use is estimated at £320 per acre (an annual net yield of £40 per acre capitalised at 12½% per annum), then a valuation of £1 per acre represents only 0·3% of the capital value of land. A second reason is that new farm buildings erected since 1 March 1959, as well as extensions and improvements, have been completely de-rated. The change in the distribution of total valuation between land and other hereditaments is shown in the table in paragraph 4 of Appendix 2.

136. Third, the Agricultural Grant has considerably alleviated the burden of rates on farmers. The Grant amounted to £30 million in 1975, equal to 67% of all rates levied on land. Some examples of how the Agricultural Grant benefits individual farmers are given in the following table.

Effect of Agricultural Grant on Rates Payable by Farmers

Valuation	Per cent rates met by Agricultural Grant
£	%
20	100
26	77
33	61
50	50
75	44
100	40
150	37

137. The effect of these changes has been to reduce the proportion of farm income absorbed in rates. Whereas in 1958 rates made up about 10 to 11% of farmers' income in that year,* we have estimated that for the period 1972–74, the proportion had fallen to 5·3%. The equivalent proportion of business income absorbed by rates had fallen from between 6 to 7% in 1958 down to 4·6% in 1972–74 (see Appendix 3).

*Cf. Commission on Income Taxation: Fourth Report (Pr. 5731, 1961)—para. 84.

However, the incidence of rates on land differs from the incidence on businesses because the operation of the Agricultural Grant exempts approximately one-half of all farmers from payment of rates. This means that, after the Agricultural Grant is deducted, one-half of all farmers pay all the rates payable on land. We estimate that these farmers account for 70–75% of all farm income and thus that the proportion of income absorbed by rates in their case is 7% as compared with 4·6% for businesses. Thus it appears that rate-paying farmers still pay one-half as much again as their business and professional counterparts, as was the case in 1958.

138. There are two options in the light of this discrepancy. One is to raise the level of the Agricultural Grant by raising the proportion met by the supplementary allowance from 30% to 50%. The second alternative which was suggested in the Fourth Report of the Commission on Income Taxation would be to provide a tax credit of, say, one-third of the rates.* We prefer the first alternative for administrative simplicity. It is in line with the thinking of the Inter-departmental Committee which stated: "The Agricultural Grant provides a convenient method by which the incidence of local taxation on farmers generally, or on farmers of different classes, can be adjusted periodically according as the fortunes of agriculture vary in relation to other branches of the national economy".† We would envisage that after a period of three years the relative incidence of rates on farmers and non-farmers would be looked at again and the rate of Agricultural Grant varied in the light of the findings. Our conclusion so far is that the levying of rates on agricultural land is not in itself inequitable between farmers and non-farmers, though some adjustment through the Agricultural Grant is necessary. We therefore recommend: **"That the level of the Agricultural Grant be raised so that the proportion of income absorbed by rates is equalised between farming and non-farming businesses and that this level be reviewed regularly".**‡

*In addition to allowing rates as an expense for tax purposes.

†Inter-departmental Committee on Local Finance and Taxation: Report on Valuation for Rating Purposes (Pr. 8536)—page 22.

‡We feel that in future the Agricultural Grant might more appropriately be referred to as the Agricultural Rates Adjustment Fund.

6.6. Land Valuation and Equity between Farmers

139. There is, however, a second issue; whether the rateable valuation allows a fair distribution of the rates burden among farmers themselves.

140. Differences arise in the incidence of rates from county to county because of the uneven distribution of rating resources accompanied by a marked variation in the extent of local requirements. The differences can be quite substantial, as is shown by the following extract from the rating lists for 1975.

	County	Total Rate per £
High	Mayo	9·80
	Donegal	8·99
	Kerry	8·75
Low	Westmeath	5·13
	Kildare	5·08
	Meath	4·30

However, the following table shows that the variation in net rates paid as a proportion of family farm income between counties is fairly small.

Net Rates paid as proportion of Family Farm Income

	Valuation	£30	£100
Meath	Farm income	£1,272	£4,240
	Net rates payable	£43	£258
	Proportion of farm income	3·4%	6·1%
Mayo	Farm income	£2,715	£9,050
	Net rates payable	£98	£588
	Proportion of farm income	3·6%	6·5%

141. We would expect some variation in the proportion of rates in farm income between counties because of the differences in the structure

of farm enterprises in each county. We would also expect differences because local authorities have the power to vary the extent of services provided in some activities and to charge the rates accordingly. Nevertheless, there are one or two counties, Donegal for instance, which seem to be in an anomalous position. However, the alternative of, say a common county rate levied centrally and distributed to local authorities according to their needs would not necessarily equalise the burden between farmers in a fairer way. There is clearly a bias in the present valuation system itself which favours land in the very counties which tend to have high rate poundage, i.e. in areas where valuations are high, the poundage tends generally to be low and vice versa. We therefore do not recommend any change in the immediate situation. If, however, land valuation in each county were brought into line with each other according to a soil quality yardstick as recommended in paragraph 148 and yet poundage levels remained unchanged, then the present variation in the total rate per £ could be very unequal.

142. The inequity of the rating system as a measure of a farmer's ability to pay has been documented for some time.* It is not surprising, given the technical and economic changes in agriculture since then, that the Poor Law Valuation based on Griffith's assessment in the middle of the last century should no longer reflect accurately land potential and farm income differences. In an Agricultural Institute study† which investigated the relationship between rateable valuation, soil type and stocking performance, and farm income on a sample of 127 farms in four counties, a significant relationship was found between soil type and stocking rate and between soil type and family farm income. No significant relationship was found between valuation and either income per acre or soil type.

*The Commission on Income Taxation in its Fourth Report made estimates of farmers' income per pound of land valuation and buildings for 1957 ranging from £10·3 for farms over 200 acres to £17·2 for farms between 30 and 50 acres. These figures do not necessarily demonstrate the lack of relationship between valuation and farm income as they could simply reflect the fact that small farms are worked more intensively than large.

†J. Frawley, "The Poor Law Valuation as a Basis for Welfare Administration and Local Taxation", *Irish Journal of Agricultural Economics and Rural Sociology*, Vol. 4, No. 1, 1972/73.

143. The lack of correlation between rateable valuation and soil productivity is one of the main reasons why the valuation, at least in some areas, bears little correspondence to farm incomes. Another Agricultural Institute study* examined the data for Wexford and concluded that the distribution of valuation about the mean was very wide within each soil series examined, and that there was a lack of proper differential in valuation between soil series. Further evidence of the inconsistencies of the Griffith's valuation is given in a paper by Chambers† who noted the disparities in press reports of farm sales between the price per acre of agricultural land and the rateable valuation. There seems no reason to doubt the fact that farmers in similar circumstances regarding the size of their farms and the quality of their land can find themselves paying greatly different rates under the present arrangements.

144. The policy alternatives following on from the conclusion of the last paragraph are:

(i) to continue with the existing arrangements, using the Agricultural Grant to adjust the relative incidence of rates between farmers and non-farmers, but accepting the present distribution of valuations between farmers;

(ii) to revalue land on a points basis in order to get the correct relativities between land of different types, and periodically to decide the economic value of a point, thus effectively arriving at the relative distribution of rates as between farmers and non-farmers.

145. The first option was the solution favoured by the Inter-departmental Committee. They ruled out a comprehensive revaluation on the grounds of the time and expense involved, the difficulty in devising a formula for valuing land which would be acceptable and valid for any appreciable period; and the fact that so many agricultural holdings were in any case derated through the Agricultural Grant.

*J. Lee and J. P. Haughton, "Observations on Tax Assessment of Agricultural Land in Wexford County", *Irish Journal of Agricultural Economics and Rural Sociology*, Vol. 1, No. 2, 1968.

†A. Chambers, "Agricultural Land Prices and Rateable Valuation: A Note', 1975 mimeo.

146. We feel that the Inter-departmental Committee overestimated the difficulties involved in a comprehensive revaluation of land. In Appendix 5, we suggest a scheme based on soil quality, using the soil classification developed by the Agricultural Institute. We have been advised that such a scheme could be implemented, given adequate resources, within nine years.

147. In the meantime, we feel that provision should be made for appeals against land valuations which are seriously out of line with current productivity. As this would be necessary for only a temporary period, it would not justify too many resources being devoted to it. It is proposed that those farmers whose farm income is charged to tax and whose land valuations are over £1 per acre, and whose rates payable on land and farm buildings exceeds 10% of farm income for tax purposes (before deduction of capital allowances) should have the option of appealing to the Valuation Office for a revision of valuation. As this proposal is meant to alleviate individual cases of hardship, the Valuation Office should be empowered to revise the valuation where necessary in line with valuations of farms in the neighbouring area.

148. We recommend: **"That resources be allocated to the Agricultural Institute to complete their detailed soil classification for the 26 counties, on a farm by farm basis, and that the resulting soil maps be used as the basis for allocating the farmers' rates burden within each county".** Because the new system is likely to take at least eight years to implement, we also recommend: **"That farmers who pay income tax on their actual income and whose land valuations are greater than £1 per acre, and whose rates payable on land and farm buildings exceed 10% of farm profits for tax purposes (before deduction of capital allowances) should have the option of appealing to the Valuation Office for a revision of valuation. These thresholds of eligibility should be altered if necessary in the light of experience".**

Chapter 7: TAXATION AND INCENTIVES FOR AGRICULTURAL DEVELOPMENT

7.1. Farmer Motivation

149. For equity reasons, and to ensure that farmers contribute their fair share of national taxation, we have recommended that the system of actual income taxation be extended to all farmers. We have also recommended that local taxation be placed on a fairer and more equitable footing. We turn now to look at the effect of income tax on the expected rewards from development. We would like to see the income tax system give the maximum encouragement to the keen farmer who wishes to expand.* Many farmers are reconsidering their development plans in the current climate of uncertainty. Fears have been expressed that, in the longer run, the imposition of tax on farming profits could have adverse effects on farm production—leading to a reduction in the effort a farmer puts into his farm and resulting in a reduction in on-farm investment.

150. The feeling is that farmers are asking themselves: "Why should we get up at six every morning to milk cows and work seven days a week if half our additional earnings go to the taxman, and what is the point of intensifying production if all we are doing is keeping the taxman in business?" These subjective judgments of farmers may not, however, be the most reliable indicator of their likely intentions in the future. There is a tendency for individual farmers to place the blame for stagnation upon a socially acceptable cause such as taxation rather than

*It can be argued that the system of taxing Irish land in recent decades (including rates on agricultural land) was ideal from the incentive point of view and yet the slow rate of growth in agricultural output testifies to the small advantage taken of it. It must be remembered, however, that the lack of remunerative markets was a big constraint on expansion. However, following Ireland's accession to the EEC, new market outlets were provided for Irish farmers.

to blame old age, lack of enthusiasm or inadequate resources. The current stagnation in agricultural output owes as much to the recent difficult market situation for a number of commodities and the soaring cost of inputs as to the impending effects of taxation. The problem is to assess more precisely the likely impact of taxation upon farmers' will to develop.*

151. If we think of a farmer as a worker taking a decision either to put more effort into the farm in order to improve his income position, or to take more leisure, there will be two considerations in his mind. On the one hand, if his additional earnings are taxed, then clearly it becomes less worthwhile to put in the extra effort; the farmer may substitute leisure for effort. On the other hand, the farmer may well have certain aspirations for the future, either for himself or his children; he may aspire to a certain standard of living and require a certain level of income to achieve it; or his work may be motivated by reasons other than financial reward alone. If this is the case, he may decide to work even harder to try to maintain his after-tax income.** We can call this the "income" effect in contrast to the previous "substitution" effect.

152. Ideally, we should like to carry out research studies to see if the "income" effect is as strong or less strong than the "substitution" effect. Those empirical studies which have been done have normally taken groups of individuals such as lawyers, accountants and executives who have the option of deciding upon the length of their work week, upon the degree of responsibility or upon the arduousness of their labour. However, the conclusions are far from definite; generally they have found that a progressive tax system has only small effects on the supply of work effort and that for some people the income effect is indeed positive so that a tax increase induces more effort.

*Ideally one would like empirical data on the reaction of farmers to taxation, but it is too early yet to get evidence in the case of Ireland. We would recommend that a study of the development plans of farmers over and under £100 valuation be carried out in a few years to try to estimate the effect of taxation on farmers with over £100 valuation in comparison with similar enterprises and facing similar market conditions.

**For example, the introduction of the multi-tier price structure for milk may have led some larger suppliers to expand output to maintain income.

153. We can also think of the farmer as an investor. The effect on investment is likely to be more complex and more important. Taxation can adversely affect investment because the after-tax rate of return on investment is lowered and because the cash flow is diminished, thus making the financing of investment more difficult. The impact of taxation on the attractiveness of investment is reduced if the cost of the investment itself is treated in whole or in part as an allowable expense for tax purposes; in this case part of the cost of the investment is effectively met by the Revenue Commissioners. There is also a psychological effect in which taxation spurs development. The farmer reasons that it is better to plough surplus cash back into the farm rather than increase his consumption having paid a slice of this surplus to the taxman.

154. Nevertheless, under a progressive tax system and assuming that the farmer's income is increased by his development programme, the attractiveness of this programme will be reduced by taxation. There will be a secondary effect on farm liquidity referred to as the "leakage" effect. The cost of credit is such that the larger the proportion of the cost of an investment which can be met through retained earnings, the more likely that the investment will be undertaken. Likewise, the farmer's traditional aversion to risk emphasises the importance of the internal financing of investment.

7.2. Cash Flow: Grants versus Tax Concessions

155. The profitability or attractiveness of farm development can be measured by determining the additional cash accruing to the farmer as compared to what his cash position would have been if he had not developed his farm. As an example, a farmer earning a cash income of £2,000 a year may decide to develop his farm so that it becomes £500, £1,000, £3,000, £3,500, £4,500, £5,000 in the following six years.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
Cash flow, with development	500	1,000	3,000	3,500	4,500	5,000
Cash flow, no development	2,000	2,000	2,000	2,000	2,000	2,000
Marginal cash flow	–1,500	–1,000	+1,000	+1,500	+2,500	+3,000

156. The marginal cash flow can be added up and used as the index of profitability. However, because people prefer gains to arrive early and costs to arrive late, it is usual to compute the "present value equivalent" of this marginal cash flow. Future costs and returns are discounted using an interest rate to stimulate a farmer's preference for cash now rather than later. A tax system which is interested in providing farmers with an incentive to act in the national interest will try to maximise the present value of the marginal returns from development.

157. It is possible to improve the present value of the marginal cash flow by giving incentives for development either through the tax system or through the direct injection of capital grants or subsidies. Capital grants have advantages over tax concessions in that they can be more specific, they are highly visible incentives, they benefit non-tax-paying as well as tax-paying farmers (the real value of tax concessions is related to the farmer's marginal rate of taxation) and they preserve the principle of equal treatment of equal income in the tax code. There is a wide range of grants available to farmers under the Farm Modernisation Scheme, in addition to various input and output subsidies. Levels of grant are now governed by EEC regulations and it is unlikely that these levels will be increased in the future. Moreover, grants require considerable administration costs and may well prescribe unnecessarily expensive standards for the investment. Often, gaining official approval for a grant means delay. Thus, on close inspection, grants may be less attractive than at first sight. Nevertheless, grants and tax incentives can reinforce each other in stimulating development.

158. The Revenue Commissioners are frequently wary of proposals for additional investment incentives, particularly in the form of investment allowances. There have been only three examples of such allowances in Ireland: one, the special allowance for investment in the Designated Areas (introduced for a limited period), which is available to farmers in these areas also; the others relate to shipping (at present suspended) and to mineral development. In industrial experience, the value of these allowances frequently goes to the shareholder rather than the company. This argument does not apply to farming, where the shareholder and the manager are one and the same person, and investment funds must compete with living expenses for priority. The incentives described

below have a special relevance to farming, and may avoid the "problem of final incidence" associated with the payment of specific grants.

7.3. Possible Tax Incentives for Irish Farmers

159. The usual incentives of general depreciation allowances given to industry for buildings and machinery can be applied to farming. In agriculture both forms of investment need encouragement, particularly modern buildings for efficient animal production—the basis of Irish Agriculture. The existing allowable rates of depreciation for farm buildings and plant seem quite generous to us and when considered together with the grants available, are comparable with the aid given to industry (see paragraph 65). However, the situation should be kept under review. In the future there may be a need for additional tax incentives for farm buildings.

160. In New Zealand, where agriculture is based on grassland, a 100% depreciation on non-machinery/non-building farm investment has proved a useful incentive for encouraging farmers to plough back surplus cash into their farms. We enlarge on this incentive in paragraph 165.

161. The build up in stock numbers is the key variable in the development of Irish agriculture. A New Zealand tax incentive called the nil standard value scheme* virtually allows farmers to count the investment in extra stock as a tax deductible expense. A similar scheme known as the "herd basis" is used in the United Kingdom where the concession applies only to breeding stock. These incentives which encourage the build up in stock numbers are dealt with in paragraphs 173–175.

162. Notional expenses allowable as tax deductions have also been tried elsewhere. These aim at encouraging specific inputs and investments. Special initial investment allowances which are not subsequently subtracted from the value of the asset in the books are examples. New Zealand has tried an extra fertiliser deduction whereby 50% of extra

*See P. J. Charlton (1975), *A Practical Guide to Tax Planning*, AERU Publication Press, Lincoln College, Canterbury, and New Zealand *"Farmers' Tax Guide"*, Inland Revenue Dept, Wellington, New Zealand.

fertiliser expenditure in one year can be deducted for tax purposes from normal taxable income. As these notional deductions are essentially the same as grants and subsidies but in essence apply only to taxpaying farmers, we have not recommended their use on the grounds of inequity between small and large farmers.

163. Fluctuating income is one of the special features of farming and to aid farmers to develop their properties we have considered various incentives and concessions within the tax structure to help farmers continue their development in spite of the fluctuations in the fortunes of Irish agriculture. One such scheme is the New Zealand Income Equalisation Scheme in which farmers can pay surplus cash in a boom year into a Government equalisation fund without paying tax on it, but then pay tax, hopefully at a lower rate, when it is returned to the farmer in the subsequent year or years when his income may be much lower. This scheme has been demonstrated to be of minor value to farmers as an economic incentive* because no interest is paid on the surplus cash put into the equalisation fund. Its effectiveness is particularly reduced in an era of inflation. Moreover, there are difficulties in predicting income levels ahead and hence estimating how much cash to store in the fund. However, the income equalisation scheme does ease the problems of cash management in an environment of fluctuating income when large tax payments can be spasmodic. We do not recommend the equalisation scheme as a tax incentive, though it could be considered as an aid to farmers (and their accountants) in helping them avoid liquidity crises through the limited ability which farmers have to plan their finances ahead.

164. The alternative to the income equalisation fund approach is income averaging—an option available to Dutch, American and Australian farmers. Here tax is paid on the average of the farmers' income over several previous years. It has two benefits: firstly, it results in greater equity between those on a fluctuating income and those on a stable income and therefore can be recommended on the criteria of

*See A. T. G. McArthur (1971), *The Optimum Use by Farmers of the Income Equalisation Scheme*, AERU Pub. 17, Lincoln College, Canterbury, New Zealand and P. J. Charlton, op. cit.

equity between farmers and non-farmers whose incomes are much more stable. Secondly, income averaging has an incentive effect for those who intend to raise their incomes through farm development. Income averaging results in the tax bill being left astern. While the Commission on Income Taxation in its Fourth report did not recommend income averaging, it did say that if there was some strong demand for averaging farm incomes some limited option might be provided regarding it. We discuss the averaging option in section 6 of this chapter.

7.4. Free Depreciation on Land Improvements

165. The visitor to Ireland is impressed with the need to reorganise the layout of pastoral farms so that they can be managed for higher productivity. Those few who have streamlined their farm layouts are matching levels of output per man achieved in New Zealand where this has been a criterion of efficiency for many years. Layout requires investment in new fences, farm roadways and yards for handling stock. Moreover, land drainage is also required. With these improvements it is often difficult to distinguish between the repair of an old fence, or road, or drain and a new investment. Hence it is both a good incentive and administratively simpler for land improvement to be depreciated 100% in the year of installation or more simply to allow this class of investment to be classed as repairs and maintenance. This treatment simplifies the task for both accountants and Revenue Commissioners. However, we recommend a free depreciation which includes the case of 100% depreciation as it gives a greater degree of flexibility in handling all sizes of investment. In the case of large scale land development it may be better for the farmer to spread his depreciation over a number of years so that he can make full use of any tax allowances.

166. This incentive has both a psychological and an economic effect. Psychologically, Irish farmers resent paying taxes and would prefer to plough surplus cash back into the farm rather than raise their personal drawings and hence have to give a slice to the Government. The same policy can make economic sense in that these costs of developments are partially paid for out of tax. We therefore recommend: **"That free depreciation be allowed for development capital costs of fences, roadways, holding yards, drainage and land reclamation".**

7.5. Valuation of Livestock

167. A number of submissions stressed the need in the taxation system to avoid the taxation of profits due to stock appreciation— "paper profits".

168. At the outset, it is important to make a distinction between livestock appreciation due to a rise in the general price level and appreciation in the value of livestock due to physical growth of an animal. How to cope with the first problem has been a part of the accountancy profession's discussion of the effect of inflation on accounts. This effect gives rise to a general problem affecting all sectors and would not appear to have a significance peculiar to farming.

169. The other problem in livestock valuation is how to cope with the real appreciation in value due to the physical growth of the animals. The first question is this: if livestock are to be valued at the lower of cost or market value how do we arrive at a measure of cost—particularly in the case of home reared animals? A second question is whether this value should be taken into the computation of profit until it is actually realised.

170. Any method for the valuation of livestock based on cost or market value is acceptable to the Revenue Commissioners provided it is consistently applied. For farm animals which have been reared on the home farm, or bought at such a time that their present value bears no relation to the original purchase price, a method of adding up all the costs of feeding and maintaining the animals, and perhaps including a slice of the overheads, would be one possible way. As an alternative arrangement, the Revenue Commissioners have agreed that an estimate of cost based on a percentage of market value can be used. For immature cattle, a factor of 60% is to be used, and for sheep and pigs, a factor of 75%. It is intended that these percentages bear some relationship to the ratio of profit to sale value when the animal is finally sold. These factors would seem to be in line with farm management calculations.

171. The more vexed question is whether this value should be included in the calculation as assessable profit. The farmers' organisations claim that to do so would mean that farmers are being taxed on the unrealised

income, on a "paper" profit. The Revenue Commissioners reply that this stock figure merely balances in the accounts the expenditure on fertilisers, feed, and so on that the farmer can claim. Thus essentially they see the resulting profit figure as "neutral". They also argue that under a progressive tax system it is in the farmer's interest to write up his stock value in increments in order to avoid being taxed on the full scale when the animal is eventually sold.

172. An illustration of the problems that can arise under the present treatment of livestock inventories will suffice. Take the case of a dairy farmer building up his herd and rearing his replacements and additional stock. Suppose a heifer at one year is worth £100, an in-calf heifer at two years £240, a cow in production £200 and a cull cow £100. Suppose further that all stock prices remain completely stable over the period. The following changes will appear in the farmer's accounts as a result of adding one extra cow to the herd in year 3.

Year	Description	Opening Valuation	Closing Valuation	Change in Valuation
		£	£	£
1	Extra heifer calf reared	0	100 × 60% = 60	+60
2	In-calf heifer	60	240 × 60% = 144	+84
3	Heifer in production	144	200 × 60% = 120	−24
4–7	Cow in production	120	200 × 60% = 120	0
8	Cow culled	120	0	−120

A farmer paying tax on a preceding year basis will pay tax on the increase in his stock value in years 2 and 3, and will get a refund from the tax authorities in years 4 and 9. The effect of this is that the farmer is making an interest-free loan to the Government during this period, hardly the best incentive to expansion.

173. The growth of any livestock enterprise, whether in numbers or in unit value is liable for tax under normal tax accountancy procedures. The payment of this tax gives rise to problems of liquidity since the

increase in value is a non-cash "paper" increase and tax payments give rise to cash outflows. This is a disincentive to investment. The nil stock valuation procedure as used in New Zealand is one method whereby this disincentive is alleviated through the postponement of tax liability until there is a cash realisation upon the sale of the livestock. It is a postponement, not an avoidance of tax. In a period of inflation the longer the postponement the more attractive this procedure is.

174. Another procedure, but with more limited application, is the herd basis method of livestock valuation available in the UK.* The difference is that this method is restricted to the breeding herd or flock. The similarity is that the livestock valuation is not included in the Trading Account. Under the herd basis system, any profit on the sale of a whole herd or flock (or a substantial part of it) without replacement when the farmer retires or sells up, would not be included in profits for tax purposes. Nor would relief of tax on any loss from such a sale be given. Such tax treatment gives considerable encouragement to the expansion of a livestock enterprise.

175. We see two advantages in recommending the herd basis. Firstly, experience with this scheme in an overall taxation context similar to the Irish situation is readily available for use by both accountants and revenue authorities. Secondly, it places the emphasis upon the breeding herd or flock and it is this particular category which is of prime importance to the future development of the Irish livestock industry. We therefore recommend: **"That the 'Herd Basis' for valuing breeding livestock, as used in the UK, be introduced as an option".**

7.6. Averaging Income for Tax Purposes

176. In paragraph 164 the effectiveness of an averaging procedure as an incentive for farm development was described. In the following paragraphs, we look at this provision in more detail.

177. The equity basis for averaging rests on the cyclical and variable nature of farm incomes and the consequences of this for the tax payable

*Appendix 7 sets out the main points regarding the taxation treatment of livestock in the UK under the herd basis.

by a farmer. Where in any year a farmer's income falls below that amount which would be exempt by the operation of his personal allowances, the balance which would have been exempted is "thrown away" in that it cannot be carried forward. If the farmer's profit situation improves in the following year, then if the income for the two years could be averaged, the surplus of the second year could be allocated to the first and benefit obtained accordingly. There is a similar effect at higher levels in the tax scale because of the progression in tax rates. For an income fluctuating from a high tax bracket to a low one, the overall tax paid is greater than for a taxpayer with an income of the same average which does not fluctuate. The swings do not counterbalance the roundabouts, as shown below.

Calculation of tax on farm profits in two hypothetical cases
Personal Allowances equal to £1,000 per annum

	1	2	3	4	5	Total
I *Variable Income*						
Income, £	1,800	800	1,600	3,000	1,800	9,000
Tax payable	208	Nil	156	560·5	208	1,132·5
II *Stable Income*						
Income, £	1,800	1,800	1,800	1,800	1 800	9,000
Tax payable, £	208	208	208	208	208	1,040

178. There was a three-year averaging procedure up to 1929 which applied to the measurement of profits assessed under Case 1 or Case 2 of Schedule D. The change was made following a similar change in the UK in 1926 after the 1920 British Royal Commission on Income Tax commented adversely on the averaging procedure.

179. The Commission on Income Taxation considered the case for averaging in its Fourth Report in 1961. It made the following arguments against an averaging provision:

(i) for many people with fluctuating incomes, averaging is not helpful because the fluctuations occur within the range of their personal allowances and the lower limit of the next tax bracket; thus the tax paid throughout, with or without averaging, is in effect a proportional tax on taxable income;

(ii) the carrying forward of losses helps to spread farm profits and losses and would normally provide the full benefit of averaging as long as the total income of a taxpayer each year exceeded all his personal allowances;

(iii) averaging might mean that the tax payable on an unusually large income in any year might become due in a period when the taxpayer finds it more difficult to pay than he would have earlier on;

(iv) averaging would impose greater administrative burdens on both the taxpayer and the Revenue Commissioners.

The Commission concluded that if there was some strong demand for averaging farm incomes, then some limited option might be provided regarding it.

180. The main limitation of the Commission's view is that it was looking at the situation in relation to a static farm situation, rather than viewing income averaging as an incentive for development. We have recommended an income averaging procedure principally on the grounds of its incentive effect because it normally provides assistance to a farmer's cash flow in the crucial early years of his development programme it allows his tax bill to lag behind the assessable profits to which tax relates.

181. The Commission's arguments were based mainly on the criterion of equity. Its first argument implies that those on a fluctuating income do not pay, on average, more tax than those with the same average income which is stable. This is not correct so long as incomes cross tax bracket thresholds. Nevertheless, the extra tax burden from a fluctuating income does vary with the progressiveness of the tax rates, the degree of income fluctuation, and the average income level.* A steep tax progression, a highly variable income, and a low average income

*McArthur, A. T. G. (1969), "Extra Tax resulting from Income Variation with Special Reference to New Zealand", *Australian Journal of Agricultural Economics*.

result in a larger inequity compared with a taxpayer on the same average income. However, the average inequity of a fluctuating income is not as great as most would expect. The second argument concerning the carrying forward of losses is valid. However, farmers tend to avoid losses if possible by reducing expenditure because they have an aversion to debt. They may not be assisted much by this provision.

182. The third argument concerns the timing of tax payments and the difficulty farmers have in paying tax on income earned earlier. As compared with paying no income tax, paying tax under the existing system has a slight destabilising effect on post-tax income because a farmer in a low income year has to find the cash to pay tax on the income earned in a previous boom year. However, the destabilising effect of income averaging is a little less rather than a little more as suggested by the Commission.† Nevertheless, if income trends downwards, farmers using averaging could find that low incomes would coincide with high tax payments based on high incomes in previous years. But we are discussing income averaging as an option for farmers who intend developing their farms and raising their incomes. These farmers should have no difficulty in meeting their tax liabilities when using income averaging. The Commission's fourth argument concerning the additional administrative burden for the Revenue Commissioners was made before computers were widely available with their high capacity for storage and easy retrieval of information.

183. When the case for averaging rests solely on the equity principle, the aim of averaging is normally to provide a reconciliation of tax paid and assessable profits *after* the event. This usually gives rise to a refund of tax by the tax authorities where justified. Our aim is rather different; we wish to provide an incentive for the farmer who raises his income by development and therefore wish to give him the option of choosing to have his tax assessed on the basis of an average of a number of *previous* years' taxable profits. This difference in aim is fundamental; an ex-post averaging procedure would be totally useless as a tax incentive although it may solve some equity problems. Our approach avoids the difficulties involved in a recalculation of tax due to changes in the tax rates, personal reliefs and personal circumstances of the taxpayer. Each year the taxpayer would be taxed according to the tax provisions then in force, but his basic income would be calculated as an average of his taxable income in previous years. We recommend: **"That farmers have the option of basing their tax for the current year on the average income from the farm over the previous three years. Upon the termination of this option, the tax liability will be calculated on the last three years treated on a single year basis".**

184. Summarising our thoughts on tax incentives, discussed above, we wish to emphasise that our terms of reference specifically mentioned not just equity but also the importance of the growth and development of Irish agriculture. Our recommendations must be seen as a total package, which meets both these considerations. A one sided acceptance of our recommendations would either result in unfairness to other taxpayers or reduce the incentive for growth in agriculture.

†McArthur, A. T. G. (1970), *The Effect of Taxation Method on Post-Tax Income Variability*, AERU Tech. Paper No. 13, Lincoln College, New Zealand.

Chapter 8: ADDENDUM ON CAPITAL TAXATION

185. Whilst capital taxation is strictly outside our terms of reference, we recognise its fundamental importance to decisions about investment for the development of Irish agriculture, with the consequent requirements of considerable capital sums to finance new technology and changes in the size of farms. This finance will obviously come mainly from internal financing. But outside sources could well become more important not only for finance, but also for innovation and development drive.

186. Capital taxation has been changed recently, whereby its scope has been enlarged considerably. Much of the legislation appears to have been conceived in terms of businesses financed by a widely distributed share capital and thus isolated from the disruptive effects of the mortality of the owner/manager. Farming is still organised almost exclusively on the basis of the owner/manager.

187. We recognise that present legislation gives certain concessions in the taxation of agricultural capital. It also contains, however, some conditions which are potentially inhibitive. For example, the provision that the concession on the value of agricultural property is lost if more than 25% of a person's capital is in non-agricultural assets could deter some people from coming into farming from outside and bringing new capital into the industry. These people are not necessarily "hobby-farmers"; as innovators, they could contribute significantly to agricultural development.

188. Likewise, a farmer could be deterred from investing in businesses ancillary to agriculture such as meat or dairy processing co-operatives, since the 25% asset value provision might cause them to lose a valuable tax concession.

189. We also consider it desirable to increase the rate of inter-generation turnover in farm businesses. Senescence and old age militate

against expansion of his business by any owner/manager. But this is especially significant in farming where the farmer supplies not only managerial skills but also the major part of the physical effort. And this will become more important as the number of hired farm staff decreases. It is therefore important to facilitate and expedite the transfer of the farm business to the younger generation. One method would be to form a private family company in which management control is vested in the younger generation. But under present legislation, such a farm business would lose the concession on agricultural property valuation.* Another method, particularly in regard to the larger farm business, might be to lower exemption thresholds in the capital acquisitions tax with the increasing age of the donor. A further method, as used in Germany, is to make eligibility for State retirement pensions to self-employed farmers conditional upon proof of the handing over of farms to the younger generation. This is done by the farmer granting the tenancy of the farm to his son or some younger person. This method could have particular relevance to the smaller farm business.

190. We therefore suggest that the current capital taxation legislation be studied in the light of these special circumstances of farming.

191. The valuation of the land asset is fundamentally important to agricultural finance and taxation, particularly in view of its over-valuation in terms of current use profitability. Although this special circumstance has been recognised in current tax legislation, the disincentive of taxing the increased capital value due to farm development has not been dealt with. This might be effected by using standard values for land based upon the soil type classification recommended earlier for land valuation rating purposes, and similar to the procedure used in Germany under the Einheitswert valuation method.

192. Farm development also requires that assets of the business should be kept together in a large enough unit to be economic. The present exemption threshold for capital acquisitions tax and wealth tax should be continually reviewed because of the insidious effect of inflation on farm businesses.

*Other forms of land ownership, which qualify for exemptions and reliefs, such as trusts, joint tenancy or partnership, might be explored as methods of increasing the rate of intergeneration turnover in farm businesses.

APPENDIX 1

THE PRESENT TREATMENT OF FARM PROFITS FOR INCOME TAX PURPOSES

1. The profit from farming of all individuals occupying farm land the rateable valuation of which amounts to £100 and over at any time during the year of assessment is chargeable to tax. Where an individual or his spouse has another trade or profession, or is the director of a trading company and owns or controls more than 25% of the equity capital of the company, and occupies farm land of over £50 valuation at any time during the year of assessment, then his or her profit from farming is also chargeable to tax. Farming companies irrespective of their land valuation are charged to tax on their profit from farming.

2. In addition, an individual who has other income from a non-farming source, who is not otherwise chargeable to tax on his farming profit and who occupies farm land the rateable valuation of which exceeds £20 for a year of assessment, has his personal allowances restricted by whichever of the following is the lowest:

(i) one-half of the total of personal allowances;

(ii) eighty times the amount by which the rateable valuation for the year of assessment exceeds £20;

(iii) the amount of the farming profits.

3. Where land is either worked in partnership or jointly owned, an apportionment of the rateable valuation of the land is allowed in determining the valuation of the land occupied by each individual. Land taken on conacre by an individual is deemed to be occupied by him and he is taxed accordingly. From the viewpoint of a farmer letting

land, he is still considered to occupy that land for the purposes of determining his rateable valuation, but the rent receivable is taxed under Schedule D, Case 5.

4. There is a provision for marginal relief for farmers with no trading income other than from farming and occupying land between £100 and £119 valuation whereby the amount of tax payable is a graduated proportion of the amount assessed.

5. Three options regarding the method of assessment of farming profits for the 1974/75 year of assessment were given under the 1974 Act. The normal basis is accounts for the accounting year ending in the previous year of assessment. A farmer could opt, however, to be assessed on his accounts ending in the actual year of assessment 1974/75. For those farmers with no trading income other than from farming, a third option of calculating his farming income on a notional basis was given. The assessment could be based on an income of 40 times the rateable valuation of the land farmed, less deductions for rates payable on his land, labour costs, contractors' charges and machinery depreciation. The option of the notional basis of assessment was extended for a further year in the 1975 Finance Act.

6. Depreciation of machinery and plant is a deductible expense under all options outlined. It is calculated on the reducing balance method according to the following rates:

20% for road vehicles, such as lorries and cars;

25% for other mobile power-driven machinery, such as combine harvesters, tractors etc.;

10% or 12½% on all other plant and machinery.

7. For capital expenditure, a new allowance called the Farm Buildings Allowance has been introduced. Expenditure on farm houses, farm buildings, land drainage, fencing and so on incurred after 6 April 1971 is entitled to a capital allowance. One tenth of such expenditure net of grant can be written off in each of the following ten years. An initial allowance of 20% of expenditure on Farm Buildings incurred on or after 6 April 1974 was introduced in the 1975 Finance Act.

8. Expenditure on agricultural plant and machinery is eligible for existing investment incentives in the tax code. Free depreciation, meaning that from the 1974/75 year of assessment proportions up to 100% of the total cost of a new machine or plant (other than road vehicles) in excess of the *normal* annual rates of depreciation may be claimed and written off in any year of assessment, is available. The option of claiming free depreciation also applies to new machinery or plant, other than road vehicles, provided for use in the Designated Areas on or after 1 April 1967; and in the case of the rest of the country to machinery or plant provided on or after 1 April 1971. In this latter case, it is the written-down value for wear and tear purposes that is available for free depreciation. In addition, expenditure in the base period for a year of assessment on machinery and plant other than road vehicles which qualifies for free depreciation under the conditions above, also qualifies for a further 20% special allowance where the machinery or plant is provided for use in the Designated Areas.

9. The 1974 Act also covered the treatment of farm losses. A farmer is only entitled to claim a loss on his farming activities for income tax purposes where the farm income is chargeable to tax. Where this is the case, losses on his farming activity can be

(a) set against other income:

(b) deducted in arriving at the profits of another trade; or

(c) carried forward and allowed against subsequent income from the farm.

To qualify for this relief, the farmer must show that he is carrying on his business with a view to making a profit, and in any case, the relief by way of set-off under *(a)* or deduction under *(b)* is granted only for three consecutive years. Farm losses are not allowed under the notional system. Nor can any loss incurred prior to 1974/75 be carried forward.

10. In principle, the method to be used for the valuation of stock for tax purposes is the same as that used for other trades, namely the lower of cost or market value. The Revenue Commissioners have agreed with

the farming organisations that in the case of home-reared livestock or purchases of immature stock, cost can be taken as a proportion of market value on the date of the closing inventory (60% in the case of cattle, 75% in the case of sheep and pigs). Mature animals purchased for the herd should be valued at the lower of cost or market value, while in the case of stock on hand at the date of the opening inventory for the 1974/75 year of assessment, all animals may be valued at market value to avoid the taxation of profits made in the "pre-tax" era.

APPENDIX 2

FARMERS AND THE RATING SYSTEM

1. Rates are a local tax, levied annually by county councils, county borough corporations, borough corporations and urban district councils to help finance local services. They are based on rateable valuations determined for the whole State by the Valuation Office, under the direction of the Commissioner of Valuation, and subject to a right of appeal to the courts. The amount of rates which each ratepayer is required to pay is determined by multiplying the rateable valuation of the property by the rate poundage, that is by the amount of the rate in the pound fixed by the local authority. The basic valuation legislation is still the Valuation (Ireland) Act, 1852. Under that Act, the basis of the valuation of houses and other buildings is net annual value, that is, the rent which a tenant liable for rates, repairs, insurance and maintenance, might reasonably be expected to pay. In the case of agricultural land, the valuation represented the estimated net annual value thereof with reference to the average agricultural prices prevailing in 1849–51. Peculiar local circumstances, such as soil, elevation, water supply, proximity to markets and suitability for tillage, were also taken into account.

2. The Act provided for valuations to be kept in line with current values by "general revisions" at intervals not less than 14 years, and "annual revisions" of property other than land. Only two local authorities (Dublin city in 1908–15 and Waterford city in 1924–26) have applied a comprehensive revaluation since then. There has been no general revision of land valuation.

3. As only around 3% of all rateable hereditaments are listed for revision of valuation in any year, the impact of annual revisions, which

only apply to hereditaments other than land, has not had a major impact on the national scheme of valuations. To avoid the inequity that revalued properties would have higher valuations than the general run of property in their area, the practice of the Valuation Office has been to revalue properties in annual revisions with reference to the lower valuations of the majority of properties in the locality rather than on current rental values.

4. The following table summarises the distribution of rateable valuations between land, buildings and other hereditaments

Year	Land	Buildings	Railways, Fisheries, Tolls, etc.
	£000s	£000s	£000s
1922	7,145	3,668	539
1965	7,016	8,329	318
1972	6,979	10,755	281
1974	6,963	12,065	252

The effect of building and developments during recent years is reflected in the increase in the total valuation of buildings and the slight reduction in land valuation.

5. Rates are just one of the three main sources of local authority finance (the others being stategrants and subsidies and miscellaneous receipts—see table overleaf) and have been decreasing in importance as a source of revenue for local authorities. (Comparison between the figures before and after 1 April 1971 is not possible because of the transfer from local authorities to regional health boards of responsibility for administration of the health services on that date). However, local authority spending has been absorbing an increasing share of national resources. Not only has this share been increasing, but the cost of providing local authority services itself has been growing faster than costs in general. This is because wages and salaries form an exceptionally high proportion of the total cost of local authority services. Thus although rates have been meeting a declining share of total local authority spending, the amount raised through rates grew sharply in the decade to 1972/73.

The Sources of Local Finance

Year	Rates		Grants		Miscellaneous Receipts	
	Amount	% of Expenditure	Amount	% of Expenditure	Amount	% of Expenditure
1958/59	20·56	40·0	22·23	43·2	8·75	17·0
1968/69	38·29	33·9	58·62	51·9	18·54	16·4
1969/70	42·95	32·2	66·05	49·5	21·69	16·3
1970/71	49·93	32·0	78·33	50·3	26·64	17·1
1971/72	60·16	43·6	52·66	38·1	25·26	18·3
1972/73	70·25	41·7	56·70	31·3	28·79	17·1
1973/74	71·23	42·1	64·04	37·8	34·00	20·1
1974*	61·46	38·1	69·58	43·1	30·36	18·8
1975 (est.)	84·90	37·6	93·33	41·3	47·63	21·1

*9 months.

6. The main reason for the decline in the proportion of local authority spending met by rates has been the increase in grants and subsidies paid by the State. Until 1973 the main grants were the Agricultural Grant, Road Fund Grants and the subsidies towards housing and sanitary services loan charges. The relatively small increases in the absolute amount collected through rates since 1972/73 (in real terms, a decrease) has been due to the government policy of transferring health charges and housing subsidies to central taxation. This transfer will be completed by the end of 1976.

7. Rates are levied on all farm dwellings, farm buildings erected prior to March 1959 and agricultural land. It has been noted (paragraph 14 of the main report) that 67% of all rates on land are met by the Agricultural Grant. At present, the following scheme of abatements is in operation:

(1) a primary allowance of 100% of the general rate in the pound is given for holdings with a land valuation not exceeding £20;

(2) holdings with land valuations over £20 but not exceeding £33 qualify for 100% primary allowance, but the occupier is liable for the balance of rates on the portion of the valuation exceeding £20;

(3) holdings with land valuations over £33 qualify for a primary allowance of 80% of the general rate in the pound on the first £20 land valuation and a supplementary allowance of 30% on the balance;

(4) an employment allowance of £17 is given for each adult workman permanently employed on a holding during the preceding calendar year. This acts as a further allowance in the case of holdings with land valuation over £20. This employment allowance has remained at £17 since 1953.

8. It is estimated that almost 77% of all the 430,000 rated agricultural holdings in Ireland are of less than £20 land valuation and hence are completely exempt from payment of rates on land. Just over 10% (45,000 holdings) are of £20 to £33 land valuation, leaving a final 13% (54,000) of more than £33 land valuation.

9. The following table gives some examples of how the agricultural grant allowance would apply in individual cases in 1975. The figures are calculated on the basis of the average county rate of £6·60 in 1975 and are rounded to the nearest £.

Land Valuation	Gross rates on land	Primary Allowance	Supplementary Allowance	Total Allowance	Net rates on land
£	£	£	£	£	£
20	132	132	—	132	—
26	172	132	—	132	40
33	218	132	—	132	86
50	330	106	59	165	165
75	495	106	109	215	280
100	660	106	158	264	396
150	990	106	257	363	627

The amount payable in rates on holdings with land valuation over £20 would be reduced by a further £17 for every adult workman employed full-time on the holding.

APPENDIX 3

COMPARISON OF THE INCIDENCE OF RATES ON INCOME FROM LAND AND BUSINESS INCOME

1. The Commission on Income Taxation in its Fourth Report concluded (paragraph 86) that in 1958 rates on non-agricultural business properties amounted to about 6 to 7% of the income derived from them, as against 10 to 11% of the income from land for the same year.

2. We have made the same comparison using the same method as the Commission for the years 1972–74. Farm incomes have fluctuated so steeply in recent years that it seems best to take an average of the three most recent years to make the comparison.

3. *Agricultural Income:* The figures used are those for income from self-employment in agriculture published annually in the June issue of the Statistical Bulletin.

	£ million
1972	276·3
1973	364·5
1974	323

4. *Rates on land and farm buildings:* We wish to compare the burden of rates on the farming business (as distinct from the burden on the farmer) with other businesses and it is therefore appropriate to exclude rates on farm dwellings but to include rates on farm buildings as well as land. The figures are taken from the June issue of the Statistical Bulletin.

	£ million
1972	15·4
1973	15·1
1974	16

5. *Income of relatives assisting:* The amount of family farm income attributable to relatives assisting has been calculated to be (see Appendix 4):

	£ million
1972	39·5
1973	42·5
1974	51·6

6. Rates as a percentage of farmers' income work out therefore as follows:

	1972	1973	1974	Average 1972–74
	£m	£m	£m	£m
Agricultural income	276·3	364·5	323	321·3
Add rates on land and buildings	15·4	15·1	16	15·5
Total income before deducting rates	291·7	379·6	339	336·8
Less for relatives assisting	39·5	42·5	52	44·7
Balance accruing to farm owners	252·2	337·1	287	292·1
Rates as a percentage of income	6·1%	4·5%	5·6%	5·3%

7. *Business profits:* These comprise the items "trading profits of companies" and "other profits and professional earnings". The figures for 1972 and 1973 are taken from "National Income and Expenditure, 1973". As a breakdown of non-agricultural income in 1974 into these components is not yet available, the 1974 figure is estimated as 85·4% (the proportion in the last five years) of non-agricultural domestic income other than wages and salaries in 1974 published in "Review of 1974 and Present Outlook—June, 1975".

	£ million
1972	303·3
1973	388
1974	437.3

8. *Net rents from business lettings:* These are estimated to have been of the following order:

	£ million
1972	7
1973	8
1974	9

9. *Rates on business premises:* Fifty-four per cent of all rates are paid by dwellings (including the dwelling component of mixed hereditaments). If from the remainder we substract the amount paid by farmers in respect of their land and farm buildings, the residual gives an estimate of the amount paid by business.

	£ million
1972	16·9
1973	17·7
1974	20·8

10. Rates as a percentage of business and professional income may now be estimated as follows:

	1972	1973	1974	Average 1972–74
	£m	£m	£m	£m
Business profits, professional earnings and net rents from business lettings	310·3	396	446.3	384·2
Rates on business and professional premises	16·9	17·7	20·8	18·5
Total income before deducting rates	327·2	413·7	467·1	402·7
Rates as a percentage of income	5·2%	4·3%	4·5%	4·6%

11. Further information on the incidence of rates on farmers can be found in the Farm Management Survey data collected by the Agricultural Institute—the data for the most recent years are set out in the table overleaf. These show that rates as a proportion of farm income increase according to the size of farm, which we would expect to occur

because of the operation of the Agricultural Grant. The figures, unless otherwise stated, are for all farmers in the Survey. The rates figure in the Survey includes rates paid by farmers on their farm dwellings. This amounted in recent years to around £4 million or 20% of total rates paid by farmers. Therefore the Survey figure of rates paid by farmers has been crudely adjusted downwards by 20% for each group of farmers to account for this. The average number of relatives assisting per farm has already been reduced to full-time male equivalent, so the appropriate wage rate taken has been that for full-time male farm workers (see Appendix 4).

Size groups (acres)	15–30	30–50	50–100	100–200	200+
1972	£	£	£	£	£
Family farm income	520	958	1,778	3,051	4,013
Average number of relatives assisting per farm	—	0·1	0·3	0·5	0·3
Ralatives imputed wage @ £980	—	98	294	490	294
Farmer income	520	860	1,484	2,561	3,719
Rates on land and farm buildings	14	27	66	177	438
Farmer income before deduction of rates	534	887	1,550	2,738	3,757
Rates as a proportion of farmer income	2·6%	3·0%	4·3%	6·5%	11·7%

Size groups (acres)	15–30	30–50	50–100	100–200	200+
1973	£	£	£	£	£
Family farm income	604	1,224	2,172	3,950	5,722
Average number of relatives assisting per farm	—	—	0·2	0·4	0·3
Relatives imputed wage @ £1,080	—	—	216	432	324
Farmer income	604	1,224	1,956	3,518	5,398
Rates on land and farm buildings	13	28	62	178	399
Farmer income before deduction of rates	617	1,252	2,234	4,128	5,797
Rates as a proportion of farmer income	2·1%	2·2%	2·8%	4·3%	6·9%

Size groups (acres)	15–30	30–50	50–100	100–200	200+
*1974**	£	£	£	£	£
Family farm income	530	989	1,556	3,074	4,312
Average number of relatives assisting per farm	—	—	0·19	0·42	0·34
Relatives imputed wage @ £1,360	—	—	258	571	462
Farmer income	530	989	1,298	2,503	3,850
Rates on land and farm buildings	14	29	65	190	427
Farmer income before deduction of rates	544	1.018	1,362	2,693	4,277
Rates as a proportion of farmer income	2·6%	2·8%	4·8%	7·1%	10·0%

*Based on preliminary and partial data.

12. Although the Farm Management Survey figures confirm that the proportion of farm income absorbed by rates is higher on larger farms, it is not possible to determine from these figures the average proportion of rates in farm income for all farmers who pay rates. Rates are paid by every occupier of a holding over £20 valuation. The difficulty is to estimate what proportion of total income arising in agriculture accrues to these farmers.

13. A very approximate calculation can be made using the distribution of agricultural income in 1967 between holdings of different sizes contained in the report of the Committee on the Review of State Expenditure in Relation to Agriculture (Appendix 1). This report estimates the distribution of agricultural income in that year between holdings of different sizes and holdings classified according to their viability.

14. Two approaches are possible. One is to say that those farmers liable to rates correspond to the occupiers of "viable" farms, that is, those farms on which at least a total of 300 man-days are worked. Sixty-nine percent of agricultural income accrued to these farmers in 1967.

15. A second approach would be to assume that a holding of £20 valuation approximates on average to a size of 35 acres (on average, the valuation of one acre of farmland is 51p). Holdings over 50 acres accounted for 61% of agricultural income in 1967, holdings over 30 acres for 80%. One might estimate very crudely that 70–75% of agricultural income accrues to the occupiers of holdings over £20 valuation.

16. On this basis, rates on land and farm buildings, which accounted for around 5·3% of agricultural income in the period 1972–74 for all farmers, would account for approximately 7% of the income accruing to the occupiers of *rated* land.

APPENDIX 4

INCOME OF RELATIVES ASSISTING

1. The results of the 1971 Census show that there were 46,989 male relatives and 5,932 female relatives assisting on farms making a total of 52,921. In order to estimate the total number of relatives assisting in the years 1972–74, the trend in the series "males engaged in farm work" for members of family was applied to the 1971 figure. The number of male family members engaged in farm work declined by 1·9%, 2·4% and 1·9% in 1972, 1973 and 1974 respectively over the previous year. The following figures resulted:

Year	Total number of relatives assisting	Female relatives assisting	Male relatives assisting
1971	52,921	5,932	46,989
1972	51,915	5,819	46,096
1973	50,670	5,680	44,990
1974	49,707	5,572	44,135

2. The estimates of the income of relatives assisting have been based on the May rates of pay fixed by the Agricultural Wages Board. The rate of pay taken for men was the Group B top rate and the rate taken for females was the "non-Dublin, aged 19 and over" rate. Overtime—at the non-winter, non-Sunday rate was put at two hours per week. It was assumed that, of the male relatives assisting, only those for whom employment allowances (available only for full-time male workers) were given work full-time on the farm. The numbers of male relatives for whom employment allowances were given were as follows:

1972–73	25,804
1973–74	24,227
1974	22,327

3. It was further assumed that all females were working full-time and the part-time males half of their time. The apparent rise in the number of part-time male workers may seem implausible and could be the result of inconsistencies between the series used. Estimates of the income of relatives assisting farmers for the years 1972–74 are as follows:

Estimated Income of Relatives Assisting Farmers, 1972-74

	1972			1973			1974		
	Numbers	Wages		Numbers	Wages		Numbers	Wages	
		Weekly £	Annually £m		Weekly £	Annually £m		Weekly £	Annually £m
Full-time males	25,804			24,227			22,327		
normal hours		17·80	23·9		19·80	24·9		24·80	28·8
overtime		0·94	1·3		1·06	1·3		1·32	1·5
Other males	20,292			20,763			21,808		
normal		8·90	9·4		9·90	10·7		12·40	14·1
overtime		0·47	0·5		0·53	0·6		0·66	0·8
Females	5,819			5,680			5,572		
normal		13·95	4·2		15·95	4·7		20·98	6·1
overtime		0·78	0·2		0·88	0·3		0·88	0·3
Totals	51,915		39·5	50,670		42·5	49,707		51·6

APPENDIX 5

LAND REVALUATION OF THE BASIS OF SOIL QUALITY CRITERIA

Section A: REPORT ON THE USE OF SOIL SURVEY FOR TAXATION PURPOSES

by Dr. John Lee (An Foras Talúntais)

The National Soil Survey has a field staff of 7 graduates and 7 technicians in addition to laboratory and cartographic personnel. The graduate staff have other research commitments in addition to the Soil Survey project. The intention is to complete the survey of the country on a scale of 1:126,720 and the broad objective of the survey is the improvement of agriculture. The completion of the country at this scale will require in the region of 100 man years.

Soils are classified on the basis of their more permanent properties such as texture and drainage and mapped on the basis of the soil profile character. For this reason the maps serve as a permanent record. In our approach to soil mapping the primary soil category used is the *soil series*. This comprises soils with similar soil character and developed from similar parent material. The series is also the basic category in soil classification.

Field mapping is carried out on 6 inches to 1 mile (1:10,560) maps. The frequency of soil profile examination is dependent on the degree of spatial variation in profile character, and could vary from 1 to 50 observations/square mile. During the survey of an area, profiles typical of each soil series are selected for special study. Fresh profile pits are opened for this purpose with a depth of 4 to 5 feet. Each profile is examined and described.

Where soil series are recognised but where their distribution pattern

with contiguous series is so intricate as to defy clear-cut delineation on the map, a *soil complex* is mapped. The component series within the complex are named and where possible their relative proportions are given. In the countries mapped to date, complexes occupy approximately 3 to 12% of area. In two counties, the proportions were exceptionally high at 19 and 23%. An increased scale of mapping would eliminate these complexes.

The soil maps are published on a scale of one-half inch to 1 mile (1:126,720). The minimum acreage shown on this scale is 25 acres and so any uniformly coloured area on the published map may theoretically include enclaves of less than 25 acres.

A major problem in mapping soils is the delineation of boundaries between different series. Typical profiles representative of two different soil series may differ widely but where the series are contiguous, it is usual for them to merge, sometimes over a considerable distance. Consequently, a line on the map very often defines the merging zone between soil series but may not imply a sharp change in the soil character.

To date, soil survey bulletins and maps (1:126,720) have been published for Wexford, Carlow, Limerick, Clare, Kildare, Leitrim, West Cork and West Donegal. West Mayo and Westmeath will be published in the near future and it is expected that Meath, Laois and Offaly will be published within the next four years. This would bring the total area of the country covered to 50%.

While the equalisation of land taxes should rationally be based on soil maps and potential crop productivity, the present maps may not be sufficiently detailed for this specific purpose. However, they could serve as guides for an equalisation process and may in fact be adequate for certain areas. To improve tax assessment of lands, a first step would be the preparation of soil maps at a more detailed scale. Ideally these maps would aim to show subdivisions of soil series into *soil types* and more importantly, *soil phases*. The latter would cover variations in features such as slope, depth or stoniness that are important in soil behaviour and land-use. In order to do this, the field mapping rate would be reduced from the present approximate rate of 80,000 acres/man year to 20,000 acres. The expenditure involved and time required to cover the entire country at this intensity of mapping would be very considerable. However, in practice, an output of 30,000 to 40,000

acres/man year would probably be of adequate detail to serve as a basis for land evaluation at farm level. The expenditure involved would be difficult to assess with accuracy but at present costs would be in the region of £3·5 million (30,000 acres/man year) or £2·5 million (45,000 acres/man year). The man year requirement would be 450 and 300 respectively.

The translation of the basic soils data into a quantitative expression of productivity (the points system suggested) is a technical matter which could be handled.

It would be very difficult to indicate the time required to transfer the field map information to the land registry—this would be a clerical exercise involving area calculations.

It is the author's view that the utility of the present maps for land taxation purposes would need to be examined in the first place. This would require a pilot study.

Section B: METHOD OF ASSESSING RATES BASED ON SOIL TYPE

Let V_i be the average annual dry matter production per acre from Agricultural Institute trials on the ith soil type. V_i could also be the current average sale value per acre of soils of the ith type. Then

$$P_i = V_i / V_{max}$$

where P_i is the relative productivity index.

In a county, let B be the quantity of rates which the local administration normally extracts from the farming sector. Then the rate per acre for the best soil type R_{max} is

$$R_{max} = B / \sum_i^m S_i P_i$$

where S_i is the area of the ith soil type, there being m types altogether,

$$R_i = R_{max} P_i$$

R_i being the rate per acre of ith soil type.

The rates payable by the jth farmer T_j are

$$T_j = \sum_i^m A_{ij} R_i$$

where A_{ij} is the area of the ith soil on the jth farm, there being n farmers

$$\sum_j^n A_{ij} = S_i,\ i = 1, 2, \ldots, m,$$

and

$$\sum_j^n T_j = B$$

Hence the county gets its usual rate revenue from the farming sector.

As an example, assume there are three soil types in the country and given the following hypothetical data

Soil Type	Yield D M Per Acre	Relative Productivity	Soil Type Acreage
i	V_i	P_i	S
1 (max)	10,000	1·0	300,000
2	8,000	0·8	200,000
3	5,000	0·5	100,000

Assume that the usual income from rates in the country is £500,000, then the rates per acre for the three soil types are

$$R_1 = 500{,}000/(300{,}000\ (1) + 200{,}000\ (0{\cdot}8) + 100{,}000\ (0{\cdot}5)) = 0{\cdot}98$$

$$R_2 = 0{\cdot}98 \times 0{\cdot}8 = 0{\cdot}78$$

$$R_3 = 0{\cdot}98 \times 0{\cdot}5 = 0{\cdot}49$$

A farmer with 50 acres of soil type 1, 40 acres of soil type 2, and 10 acres of soil type 3 would pay

$$50(0{\cdot}98) + 40(0{\cdot}78) + 10(0{\cdot}49) = £85{\cdot}1$$

In collecting the data for this method it would be useful to keep in mind the relative productivity of each soil type when drawing boundaries between soil types. Where two adjacent soil types have divergent productivities it would be important to map carefully the boundary. Where the productivities are similar, rough definitions would be adequate for rating purposes. In other words, soil surveyors should be aware of the method whereby their maps will be used in rating in order to reduce the cost of producing "farm by farm" soil inventories. Further, to get the system going quickly, it would be desirable to select counties which have relatively homogeneous soil types of similar productivity to minimise the potential discord amongst farmers during the period of introducing the new system.

APPENDIX 6

SOME RELEVANT STATISTICAL TABLES

TABLE A.6.1

Comparative Structure of Total Tax Receipts and Actual Social Contributions 1973

Percentages

	Germany (FR)	France	Italy	Netherlands	Belgium	Luxembourg	United Kingdom	Ireland	Denmark
I. Taxes linked to production and imports (1 to 7)	33·9	43·7	36·8	27·1	31·7	31·9	39·2	58·4	39·3
1. VAT and general turnover taxes	14·3	24·1	16·3	15·0	18·1	12·0	7·1	16·2	17·6
2. Import duties and agricultural levies	1·0	0·7	1·4	1·8	1·3	1·2	2·0	2·7	1·2
3. Excise duties and taxes on the consumption of goods	9·2	7·4	13·7	6·8	7·7	7·6	16·2	27·1	14·3
4. Taxes on services	0·9	1·2	2·1	0·1	0·7	0·5	0·8	0·7	0·1
5. Taxes on land and buildings	0·9	1·6	([a])	0·2	([a])	0·8	*10·8*	*8·7*	3·7
6. Stamp, registration and similar duties	0·6	1·8	3·5	1·0	2·2	4·5	0·9	1·7	1·6

Table continued overleaf

APPENDIX 6—*contd.*

Table continued

	Germany (FR)	France	Italy	Nether-lands	Belgium	Luxem-bourg	United Kingdom	Ireland	Denmark
7. Other taxes linked to production and imporst.	7·0	6·8	1·4	2·3	1·7	5·4	1·4	1·4	0·8
II. *Current taxes on income and wealth*	32·9	17·8	22·2	34·6	36·1	39·5	42·1	30·4	57·8
III. *Capital taxes*	0·2	0·6	0·5	0·5	0·8	0·6	1·8	1·7	0·4
IV. *Total tax receipts* (I + II + III)	67·0	62·1	59·5	62·2	68·6	72·0	83·1	90·5	97·4
V. *Actual social contributions*	33·0	37·9	40·5	37·8	31·4	28·0	16·9	9·5	2·6
VI. *Total tax receipts and actual social contributions* (IV + V)	100	100	100	100	100	100	100	100	100

Source: Tax Statistics, 1968–1973, Statistical Office of the European Communities, 1974.

(*a*) For Italy and Belgium taxes on land and buildings are classed as current taxes on income and wealth.

TABLE A.6.2

Farmers classified in 1966 by area and rateable valuation*

Area of Land Held	Rateable valuation*								
	Not stated and under £2	£2 and under £10	£10 and under £20	£20 and under £30	£30 and under £50	£50 and under £100	£100 and under £200	£200 and over	Total
Not stated and under 1 acre	7,612	37	12	2	—	—	—	—	7,663
1 acre and under 5 acres	1,150	1,604	166	38	16	9	1	—	2.984
5 acres and under 10 acres	1,453	7,539	846	104	43	7	—	—	9,992
10 " " " 15 "	709	10,002	3,302	355	92	23	4	—	14,487
15 " " " 30 "	539	16,598	21,496	6,185	1,201	129	10	2	46,160
30 " " " 50 "	144	6,547	18,015	15,577	8,518	1,065	24	3	49,893
50 " " " 100 "	54	2,318	6,127	9,414	16,455	10,653	674	20	45,715
100 " " " 200 "	3	451	828	913	2,457	8,178	4,581	290	17,701
200 acres and over	3	157	243	211	186	501	1,712	1,499	4,512
Total	11,667	45 253	51,035	32,799	28,968	20,565	7,006	1,814	199,107†

*Includes land and buildings,

†This is less than the total of 200,625 farmers because of the *exclusion* of farmers enumerated in institutions or in non-private households, It does *include* persons described as farmers who were not themselves landholders.

Source: 1966 Census of Population, Volume IV, Occupations—Table 12.

APPENDIX 7

THE "HERD BASIS": TAXATION TREATMENT OF LIVESTOCK IN THE UK

1. Farm animals and other livestock are treated in different ways for the computation of the taxable profits of farmers and other traders under the UK Tax Acts. Generally, the livestock kept by farmers and other traders are treated for the purposes of income tax as "trading stock". However, farmers or traders can choose *once and for all* to have "production herds"*, that is, herds of mature animals kept for the sale of their produce or progeny as opposed to slaughter, dealt with separately as capital assets, on what is commonly referred to as the "herd basis".

2. On the *trading stock basis*, the cost of animals acquired is deducted in the accounts and the price of animals sold is brought in as a receipt. The valuations of livestock on hand at the beginning and end of the account are included for tax purposes in arriving at the results of the trading. On the *herd basis*, the valuations of production animals are not taken into account in computing trading profits. In other words, the cost of the original herd or flock, or of additions to an existing herd or flock that increases its numbers is not deductible. The herd basis, therefore, gives farmers an opportunity of having an eventual profit exempt from all taxes. In addition, it avoids tax on increases in annual valuations resulting from inflation.

3. Under the herd basis, any profit on the sale of a whole herd or

*Herds or flocks, such as dairy herds or live flocks, that are kept for the sale of milk, young animals or other produce. It does not include herds of animals which are themselves intended for sale, e.g., cattle which are intended for sale although they meanwhile produce calves or milk for sale—such animals are treated as trading stock.

flock (or a substantial part of it†) without replacement, will not be included in profits for tax purposes, nor will relief from tax be given in respect of any loss on such a sale. It should be noted, however, that a profit or loss on the sale of individual animals without replacement will be taken into account. Account will also be taken of the profit or loss on the sale of a small part of a herd or flock. Where animals in a herd are replaced, the sale proceeds of the old animals are included as a trading receipt and the cost of the animals added in replacement is deducted as an expense.

4. When a farmer elects to adopt the herd basis for the treatment of his production herd for tax purposes, it means that neither the initial cost of his herd, nor the cost of any animals added to his herd to increase its numbers, will be deducted as an expense in calculating his profit or loss. There are certain other conditions which apply when the herd basis is used. For example, when a farmer replaces an animal in his herd, the sale price of the *old* animal will be included and the cost of the *new* animal can be deducted in arriving at a profit or loss. But if the new animal is of better quality, the extra cost of the new animal due to the element of improvement will not be deducted. Again, if a farmer sells a herd and buys another herd of the same kind, the conditions of the herd basis apply only with regard to a herd of the same size and of the same quality. If the new herd is larger than the old herd, the cost of the additional animals will not be deducted as an expense in the farmer's accounts.

5. If the whole of a herd is sold within a period of twelve months without replacement, any profit or loss on the sale will not be taken into account for taxation purposes. But if within five years of the sale the farmer begins to acquire a new herd, the new animals will be treated as replacing the old animals. The sale price for the old animals will, however, be credited in the accounts at the time when the new animals are acquired, although it may have been received much earlier.

6. Once a farmer has made an election for the herd basis, it will continue to apply to all production herds of the same class kept by

†A reduction of 20% or more is regarded as substantial.

him. Even more important is the fact that he will not be able to revoke the election in subsequent years. However, if he ceases to keep any production herd of that class for a period of at least five years, he will have a new right to make an election for the herd basis if he subsequently acquires a new production herd of the same class.

7. In short, adopting the herd basis is a means whereby the initial cost of the herd, and of permanent additions to it, do not rank as a deduction and the value of the herd is not brought into closing stock. If there is a casual sale from the herd, the profit or loss is brought into account in the trading results. However, the outright sale without replacement or the running down of the herd is an occasion when the gain or loss is not accounted for tax wise.

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