



---

---

## **PRACTICE NOTE**

---

---

**PN 26/89**

**Date: 11 September 1989**

### **Herd Basis Election**

#### **Introduction**

Sections 38 and 39

Part 2 of the Income Tax Act 1989 makes available to farmers and other persons carrying on trades of a similar nature the opportunity to have production herds treated as a capital asset and not as trading stock. One of the main advantages of an election is that it postpones tax on any increased value of animals in the herd until after disposal; in certain circumstances the profit arising on disposal is excluded altogether for income tax purposes.

Section 49

Year of effect - This legislation has effect for the year of assessment 1989-90

#### **Election Time Limits**

Transition

The Act does not provide for any transition. However, by concession claims in respect of existing herds will be considered valid if made by 30 June 1990.

Section 39

For herds acquired after that date (even though possibly not still held at the date of election) a claim will only be valid if made within 2 years of the end of either:

(a) the first year of assessment for which either a profit or a loss is computed to some degree by way of reference to animals held as a herd.

(b) the first period for which an account is made up for the claimants farming.

Section 43(2)

In the exceptional case of compulsory slaughter, a claim will be valid if made within 2 years of the end of the first year of assessment for which either a profit or loss is computed to some degree by way of reference to the respective compensation received.

## **Conditions**

(i) Standard elections shall have effect as from the year as described in (a) above and shall continue so long as the herd is held - they are irrevocable.

### Section 47

(ii) The farmer will be required to keep comprehensive records in order that he may, when requested to do so by the Assessor, supply full details of all animals held for the purpose of his trade and the products involved in the case of the herd(s). The Assessor will require a Return of such details to accompany the initial claim.

### Section 48

(iii) A valid election shall require revision of an assessment which has become final and conclusive.

## **General**

### Section 40(2)

#### **1 What in general is the effect of having your animals treated as a herd?**

The effect is that animals held essentially long term for the purpose of breeding or breeding and yielding a product, are accounted for separately to all other animals held essentially short term for the purpose of sale. The value of herd will therefore not feature in determining the end of year stock figure.

### Section 45(1)

#### **2 For what type of animals can an election be made?**

Although more generally applying to all the usual types of farm animals, an election could in fact be made in respect of more unusual animals, e.g. quail, deer or animals bred for their skins etc.

### Section 45 (5) and (6)

#### **3 What collections of animals can be treated as a herd?**

A collection of the same species, i.e. cow, sheep, pig, goat etc. provided that the products for which they are kept (i.e. the progeny themselves or milk, wool, eggs etc.) are common to all. In no way is 'herd' determined by breed (although a herd can in fact consist of animals all of the same breed). For example, a dairy farmer owning a herd of Ayrshires and a herd of Friesians (both kept for milk) cannot make separate elections; on the other hand, if he owned a herd of Ayrshires (for milk) and a herd of Aberdeen Angus (for beef) separate elections could be made.

#### **4 Now many animals are required to be held to qualify for election?**

There is no minimum a single animal can qualify.

Section 44

**5 Are there situations of animals not qualifying?**

Yes

(a) working animals e.g. horses, sheepdogs

Section 46(5)

(b) racing animals e.g. horses, pigeons, greyhounds

(c) exhibition animals e.g. exotic birds, zoo animals

Section 45

**6 At what time in the life of an animal can it be treated as a member of the herd?**

(a) In normal circumstances, only when it is mature. In the (4) and (6) context of this legislation, mature means when the animal is actually put to breed and not simply 'when it is capable of breeding'. In the case of poultry, mature means when it lays.

Section 45(2)

(b) In circumstances where, because of the nature of the land, only animals bred on the land can be used as replacements, immature animals can be treated as members of the herd.

(a) and (b) Section 45(2)

(c) Immature animals can also be included where the farmer can clearly demonstrate that they are being specifically held as replacements to prevent a fall in the number in the herd.

**Computation Of Profit Or Loss**

(a) The initial cost of the herd shall not be allowed.

Section 40.2

(b) The end of year value of the herd shall not be brought into account in computing profit.

(c) The cost of additions to the herd shall not be allowed.

Section 40.3

(d) The value of an animal transferred from stock to herd will be treated as a trading receipt.

Section 40.5

(e) The extra cost of a better quality replacement shall not be allowed.

#### Section 40.4

(f) In the case of replacements, disposal shall be set against the acquisition cost so as to give a net trading receipt or expense.

#### Section 40.6

(g) Where compulsory slaughter is involved and the replacement animal is of a poorer quality, the amount to be included as a trading receipt shall not exceed the cost of that poorer quality animal.

#### Section 40.10

(h) Where an animal is deducted from the herd, the surplus over or deficit under the animals herd value will be treated as a trading receipt or expense.

#### Section 40.8

(i) Where a whole herd is sold or within a period of 12 months there is a substantial reduction in herd numbers, the profit or loss arising shall not be taken into account.

#### Section 40.9

(j) However if within 5 years the farmer begins to acquire a new herd or begins to replace the substantial reduction it will be considered that he has effected a replacement and the respective proceeds of sale will be brought into account as if received at the time of corresponding acquisitions.

#### Section 40.7

(k) Where a whole herd is sold and replaced by a herd of the same class, it will be treated as a replacement to the extent of the number in the original herd or the newly acquired herd, whichever is the lesser. The difference shall be treated as additions or disposals.

### **Definitions And Principles To Be Applied To Movements Of Stock**

1. Animals may be added to the herd by way of:-

- (a) transfer from home-bred stock
- (b) transfer from stock of purchased immature animals reared on to maturity
- (c) purchase of a mature herd animal

2. Animals must be looked upon as being deductions from the herd when they are:-

- (a) transferred into stock
- (b) sold out of herd

(c) die or are compulsorily slaughtered

Section 43

and 40(12)

3. The following must be treated as disposal receipts:-

Any disposal proceeds for the living animal itself or its carcass (or any part thereof) including any compensation or insurance proceeds. In other words death or slaughter shall effectively be treated as a sale. Proceeds will be looked upon as being received in the year of disposal.

Section 40(4)

4. Expenditure ancillary to a purchase or sale e.g. transportation, quarantine, veterinary expense etc. will not be allowed in determining costs or additions or proceeds of disposals.

5. For transfers from stock to herd the value of the transfer will be the cost of rearing to maturity or alternatively, the cost of purchasing into stock plus the additional costs of rearing to maturity.

Section 40(3)

A generally agreed expedient is to value the transfers at 75% of the open market value or, in the case of cattle, 60%.

Section 40(5)

6. Where a replacement animal is of a better quality than the one it is replacing, the amount to be deducted shall not exceed the amount it would have been necessary to expend in order to acquire an animal of the same quality.

Section 42

7. It should be noted that in certain circumstances, the open market value may be substituted for the actual amount received (if any).

8. When referring to herd reductions (deductions from herd) substantial shall mean 20% or more.

### **Herd Basis Computation Examples**

<b>YEAR 1 - Commencement of herd basis election.</b>	<b>£</b>
Initial cost of herd - 65 mature animals @ £200	13,000
Purchase of 10 calves @ £60	600
	£13,600

### **Herd Account**

<b>65 mature cattle</b>	£13,000
-------------------------	---------

### Trading Account

<b>10 calves - allowable as an expense</b>	£ 600
--------------------------------------------	-------

### Year 2

<b>ADDITIONS/DISPOSALS</b>	
Bought 15 mature cattle @ £250 each	3750
Calves born 43	
8 cattle sold @ £300	(2400)
Matured 10 cattle - cost 60% of market value of £300	1800
2 cattle deaths	£3150

### Herd Account

<b>NO OF ANIMALS</b>		<b>VALUE £</b>
65	OPENING BALANCE	13,600
25	CATTLE ADDED IN YEAR	5,550
	Less replacements:-	
(10)	8 sold and 2 deaths $10/25 \times 5550 =$	(2,220)
80	CLOSING BALANCE	£16,930

### Trading Account

<b>Sale of 8 cattle</b>		<b>£2400</b>
	Less purchase price of 10 mature cattle to replace those lost and sold	
	$10/15 \times £3750 =$	(2500)
	Transfer to herd account 10 animals	1800
RECEIPTS		£1700

### Year 3

<b>ADDITIONS/DISPOSALS</b>	<b>£</b>
Bought 5 mature cattle @ £210 each	1050
1 death in year	---

<b>ADDITIONS/DISPOSALS</b>	<b>£</b>
24 calves born in year	---
Matured 28 at 60% of market value of £260	4368
	5418

### **Herd Account**

<b>NO OF ANIMALS</b>	<b>VALUE</b>	<b>£</b>
80	OPENING BALANCE	16930
33	CATTLE ADDED IN YEAR	5418
	LESS REPLACEMENTS:-	
(1)	$1 = 1/33 \times £5418$	(164)
112	CLOSING BALANCE	£22184

### **Trading Account**

<b>Additions in year transferred to herd account 28 animals</b>	<b>4368</b>
Less replacement cost 1 mature animal for 1 death	
$1/5 \times £1050$	(210)
RECEIPTS	£4158