Wolves in sheep clothing?

Russell Cockburn looks back on the days when Cumbria's sheep farmers tried to, er, pull the wool over his eyes…

A week or so ago I attended a parish council annual dinner in the village next to ours (just as a hanger on, my wife is involved in local politics). Anyway, it was an excuse for a good night out!

During the meal I chatted to the farmer sitting next to me whose flock of Herdwicks had started lambing the night before, so he was looking a bit tired and was expecting to be up most nights for the next few weeks or so as he has 1,300 ewes ready to lamb. At times like those I am reminded how pleasant it is to work in a comfortable office even during the hectic January tax season!

This afternoon I had occasion to think about this chap again when, glancing out of my window just after lunch (I often work from home), I beheld a dozen or so sheep who had escaped the field opposite and were happily munching away on the new growing snowdrops in the verge. A quick post on the village Facebook page soon alerted him to the problem and he turned up in his Land Rover to shepherd them back into the field.

Lambing starts early here in West Cumbria compared with many other parts of the north of England (late January) and this feature of the local farming economy reminded me of some of the more interesting discussions I had as a trainee tax inspector (many years ago) with farmers and their tax advisers/accountants about stock valuations – a couple of which I thought I might share with you.

Wet behind the ears

Most of the farmers I dealt with in those days clearly thought I was a little wet behind the ears (I was), and that they could pull the wool over my eyes (they could and frequently did), to the extent that they would so confuse me with their tales (they usually did) that they would sometimes end up paying less tax than they started out owing. I know, I don't think I was a very good tax investigator.

My first tax enquiry on a sheep farm involved an argument about 'lambs at foot' for a farmer whose flock also started lambing in late January and who, for some unusual reason that I never really understood, had a February 28th year end for his annual accounting period. My boss had handed me the case and said that he through there was something missing from the stock valuation included in the accounts for the ewe flock as it showed hardly any lambs at foot, although the lambing period had probably started in mid to late January. On further investigation the farmer admitted that his flock had begun lambing that year on the third week in January and that by the end of February he would have had at least 800 little darlings gambolling around his lower fields in their little plastic jackets. What he was not willing to agree was that they should be included in his stock valuation as in his view they had no value at the year-end only a few weeks after they were born.

HMRC does not agree with this viewpoint and never has done. I had to politely explain to him that the department's view was and is to this day that some value must be attributed to these very young animals even if it was to be a purely nominal amount.

HMRC's view is that the valuation of immature and 'unweaned' animals should normally be calculated using their long accepted 'deemed cost' method if actual costs cannot be identified (which is not normally easy). This method is based on the open market value of animals of a similar age and type and is acceptable to HMRC generally where farm animals are treated as stock in trade. In these cases it is then acceptable to base the 'deemed cost' on a 75% of market value for sheep and HMRC also accepts that it can be appropriate to value mother and young together because that is what at that stage would be regarded as 'the market unit'. Now while the value of such very young animals may be small it nevertheless has to be included, and I often had lengthy discussions with farmers about these matters.

The only situation where the above method of stock valuation is not appropriate is where the lambing mother is part of a farm flock that is dealt with on the 'herd basis'. On this method mature animals are treated as in effect a fixed asset rather than as stock in trade for tax purposes. Where this is the case HMRC takes the view that even where there is no market or a very limited market in for unweaned lambs at foot it is still not acceptable to leave such animals out of the annual year end stock valuation. If this is the case then a cost basis is usually acceptable to HMRC and these costs, which in such cases must normally be identified as the costs of production should be included as the year end valuation and then should be carried forward to be set against the eventual sale price.

Thorny valuation issue

Commonly, when I raised this somewhat thorny valuation issue with most sheep farmers they tended to look at me as though I had just crawled through one of their ubiquitous hawthorn hedges or from under the nearest rock and then subjected me to a tirade of gentle abuse, usually littered with anecdotes about having to chase lambs all over their fields just in order to count them for their accountant at the year-end. So no wonder it was difficult to be accurate about how many they actually had. This latter point was of course nonsense; farmers, in my experience, know exactly how many lambs their flock has produced, it's their livelihood after all and they spend hours of hard labour bringing them into this world, usually in the depths of freezing winter nights. They are going to make very sure they count them properly and look after them as best they can.

Lower of cost and net realisable value has long been established as the general principle for accounting and tax purposes where such stock valuations are concerned, but there is no doubt this is not an easy subject and remains controversial to this day, when it can clearly be argued that there is in fact no normal market at all for such young animals. Indeed, many listeners to our local Radio Cumbria about this time of year will be aware they offer a 'lamb bank' service, by which lambs that have been rejected by their mothers or are surplus to requirements can literally be 'farmed out' to other farmers who have ewes which have lost their progeny for some reason.

Many farmers quoted this to me as clear evidence that lambs that were only a few weeks old have no real value and no market existed for them, and I usually found myself agreeing with them and accepting purely nominal values for such young stock just to settle the matter. However, where the mature flock is, say, 2,000 breeding ewes, even this can result in a significant uplift in the year end stock value and a resulting settlement that met with the approval of my boss in the tax office. Happy days!

Gone with the wind

The other interesting excuse I remember was the farmer whose stock was clearly much lower than it should be at his February year end – which he put down to wind! Not the gastric variety but a great storm which literally blew about 50 or so poor little lambs off the fellside in the course of one dreadful night.

As a trainee inspector at the time my boss was sitting in on the meeting and raised his eyebrows well past the level of the ceiling at this unexpected explanation. He immediately left the room and returned after a few minutes with a map of the local area and three files for the farmers whose land surrounded the taxpayer under investigation. He then said he had checked the prevailing wind on the night of the storm with the Met Office and proposed to check the stock of the other farms in the downwind direction, to see if they had had an unexpected increase in lambs at foot. Needless to say, this bullish approach met first with incredulity from the farmer and then a realisation that perhaps we were not quite so naive about farming matters as he expected.

When a farmer suffers a sudden loss of stock, for whatever reason, it is also common to see an increase in their vet's bills at around the same time, if illness or some unexplained deaths have occurred. Farmers rarely let such matters go unchecked so the absence of such extra expenses also casts doubt on the veracity of their often amusing and sometimes incredible justifications. That is not to say that such reasons for shortfalls cannot be genuine at times, they often are, but needless to say the inventiveness and imagination of such, 'customers' always gave me cause for amusement and frequently brightened up the life of what could sometimes be a rather tedious civil service day.

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