

Special Alert: Changes to Herd Livestock Scheme

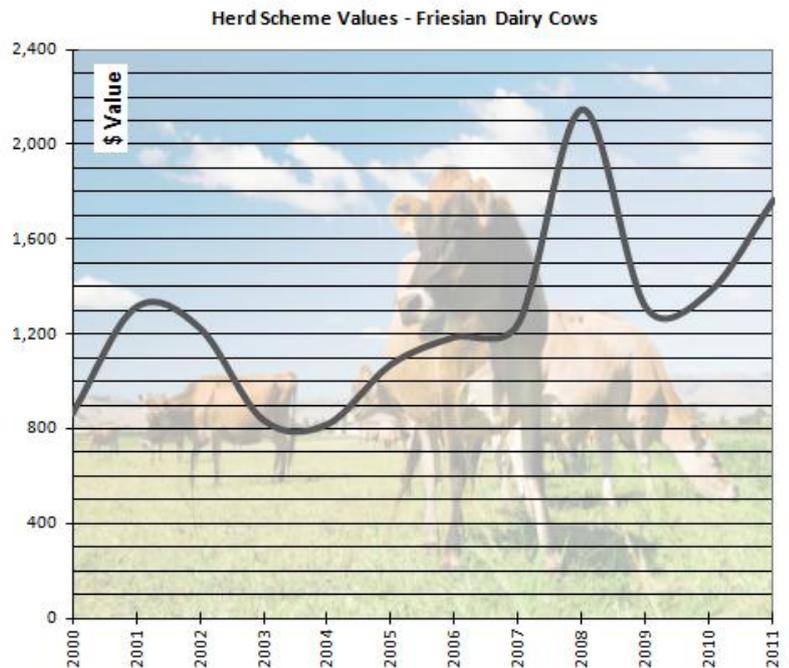
Change is here...

The Herd Livestock Scheme (officially called the National Average Market Value scheme) has been in existence since 1987. There were a few changes made in 1993 but essentially the scheme has remained largely unchanged over its lifetime.

On 18 August 2011 IRD released an official 'issues' paper which raised some concerns IRD had about how some taxpayers were using the herd scheme to their own advantage and - in IRD's view - gaining an unfair tax advantage over other taxpayers.

Over the last few years in particular there have been some massive swings in the National Average values for some classes of stock. This is demonstrated in the graph adjacent for Friesian Mixed Age cows. These valuation swings were never anticipated when the herd scheme was introduced.

Late in March 2012 IRD announced that they were changing two areas of the Herd Livestock Scheme to address the concerns they had raised in their issues papers.



Move to irrevocable elections

From 18 August 2011 (the date the 'issues' paper was released) farmers will not be able to elect out of the herd scheme. In other words, once you are in the herd scheme you are there for the long haul (there are a couple of exceptions noted below).

Previously if you wanted to exit the herd scheme you had to give a two-year notice to IRD that you were doing so - as an example if you wanted to exit the herd scheme in 2012 you had to file the election to exit when your 2010 income tax return was filed. Because some taxpayers were able to delay the filing of

their 2010 tax returns until March 2011 they were able to gauge exactly where livestock values were heading and therefore make a strategic decision about whether to remain in the herd scheme or exit it.

By exiting the herd scheme when values were at a high level the farmer was then able to obtain a tax deductible write down in stock values over a five year period.

Suggestions were made to IRD to simply extend the two year notice period to three years - making it harder to read what the market is doing in the future. IRD decided this was not ideal and have taken a much harder line.

'Farming looks mighty easy when your plow is a pencil and you're a thousand miles from the corn field.'

Dwight D. Eisenhower

What if I filed an election to exit after 18 August 2011?

Any elections to exit the herd scheme in future years that have been filed after this date will not be effective. IRD have said that farmers and their accountants became aware of the issues surrounding livestock valuations in the May 2011 budget and when the detailed issues paper was released. In order to maintain the tax base they are therefore backdating the application of this ruling.



Associated party transactions

If a purchaser of a herd is associated with the seller of the herd, the purchaser will be required to adopt the vendor's herd scheme elections and base herd numbers. This move is designed to stop taxpayers selling their herd from one entity to another (e.g. from a partnership to a company) and therefore essentially exiting from the herd scheme.

The definition for 'associated persons' for these purposes has yet to be released but it is suggested it should mean 'individuals within two degrees of association, spouses, family trusts and companies, whether owned by the trust or the family directly'.

What exceptions are there to these new rules?

There are now only two instances where you are able to exit the herd scheme:

1. When there is a change of farming operation to a fattening regime where a cost-based valuation regime would be more appropriate, and
2. Where there is a complete inter-generational change in ownership of the herd.



'Change is inevitable - except from a vending machine.'

Robert C. Gallagher

What happens now?

IRD are still looking at a couple of other aspects of the herd scheme and there may be some more changes coming in the future - these will however be relatively minor compared to these major changes that have just been announced.

If you have any concerns about your herd scheme valuations or would like some further advice on this matter please do feel free to contact us to discuss.

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