



# Dairy Herd Lease

ACCOUNTANTS FAQ'S



### HOW DOES THE LEASE WORK?

The StockCo Dairy Herd Lease has been designed as an operating lease. It is backed by an IRD Binding Ruling to give certainty of the tax position.

At its simplest, StockCo purchases a dairy herd from the farmer and leases the herd back to the farmer. The farmer makes regular lease payments over the term of the lease.

Progeny and replacements belong to the farmer. This means over the term of the lease, the number of cows owned by StockCo decreases to zero as the leased livestock are culled. For example, a four year lease assumes that 25% of the leased herd are culled or die each year. As replacements and progeny belong to the farmer, by the end of the lease the farmer owns the entire herd again.

## Purchasing the Herd

### WHO OWNS THE LEASED HERD?

StockCo.

StockCo purchases the livestock for market value from the farmer or from a third party. The purchased livestock is then leased to the farmer to farm.

### HOW IS GST DEALT WITH FOR THE INITIAL PURCHASE?

Where StockCo purchases the livestock from the farmer, GST will need to be accounted for. StockCo will supply a buyer created invoice (or the farmer can produce a tax invoice) and StockCo will claim input GST at the time of the sale. The farmer should then account for output GST in the appropriate GST return.

### HOW DOES THE FARMER ACCOUNT FOR THE LEASED LIVESTOCK?

Because StockCo owns the leased livestock, the farmer doesn't need to account for those livestock in the farmer's balance sheet.

The farmer will need to consider the livestock tax valuation rules in relation to the leased livestock, which should effectively exclude the leased livestock from the tax valuation calculations in most cases.

Any livestock not sold to StockCo need to be accounted for as normal by the farmer (that is, the farmer still owns that livestock).

## Lease Payments

### HOW DO THE LEASE PAYMENTS WORK?

Lease payments are generally only made in the six months of the year that the farmer is cashflow positive (usually December to June).

### DO THE LEASE PAYMENTS HAVE GST ON THEM OR ARE THEY A FINANCIAL TRANSACTION?

The lease payments include GST.

GST paid on the lease payments should be claimed as input GST when the lease payments are paid (or when they fall due).

## Progeny, Replacements and Culls

### HOW DOES THE FARMER ACCOUNT FOR PROGENY AND REPLACEMENTS OF THE LEASED LIVESTOCK?

Progeny and replacements of the leased livestock are the property of the farmer. Therefore they will need to be accounted for in the farmer's balance sheet and in accordance with normal livestock tax valuation rules.

### WHEN ARE THE CULL PAYMENTS PAYABLE BY THE FARMER?

The farmer can either pay the cull payment each year, or the farmer can agree with StockCo to defer the cull payments to the end of the lease (giving the farmer a cashflow benefit). This will be documented in the lease agreement.

### HOW ARE CULL PAYMENTS CALCULATED?

The lease model assumes that a number of livestock are culled every year (for example, a four year lease might assume 22.5% of the herd is culled and 2.5% die naturally every year).

The lease permits the farmer to arrange for culls as and when the farmer sees fit. However because the actual numbers of culls and deaths, and the amount paid for a culled cow, vary over the term of the lease, the lease contemplates an annual "cull payment" to StockCo. This is equal to the assumed cull rate (i.e. 22.5%) multiplied by an agreed cull value.

### **HOW ARE CULLED LIVESTOCK DEALT WITH FOR GST PURPOSES?**

The farmer acts as StockCo's agent when arranging for livestock to be sold or culled, and the farmer should account for GST output tax on the sale of culled livestock at the time of sale.

The farmer should claim input GST when the cull payments are due or paid to StockCo, including when the cull payments are deferred to the end of the lease.

StockCo will account for output GST when the cull payments are actually paid by the farmer to StockCo (or when they fall due if no payment is made). This includes when the cull payments are deferred to the end of the lease term.

### **HOW ARE THE CULL SALES DEALT WITH FOR TAX PURPOSES?**

The farmer holds the cull sale proceeds as agent of StockCo at the agreed cull value. Any cull sale proceeds received by the farmer above or below the agreed cull value will be treated as a gain or loss to the farmer.

For practical purposes, the farmer may choose to reflect all the sales in the financial statements as income and then treat the annual "Cull Payment" due as an expense. This approach will be helpful when only part of the herd is leased and culls throughout the season could either originate from leased or farmer owned livestock.

### **IS THERE A RESTRICTION ON WHAT LIVESTOCK TAX VALUATION METHOD THE FARMER CAN USE FOR THE REPLACEMENT LIVESTOCK?**

No. The sale of the livestock to StockCo is to an independent (non-associated) party therefore there are no restrictions in subsequent years regarding what livestock tax valuation method that can be used for increases in livestock numbers. Farmers will need to apply the normal livestock valuation rules, for example maintaining minimum Herd scheme numbers in each class.

### **IRD PRODUCT BINDING RULING**

StockCo has obtained an IRD product ruling (BR PRD 21/04) that provides further clarification of the income tax treatment which can be accessed from the IRD website or at StockCo Capital's website

*\*\* This guidance has been provided to give a general explanation of the leasing product and the tax position. StockCo endeavours to the best of its ability and knowledge to ensure the information in this guidance is accurate and current. However StockCo cannot accept any liability for the accuracy or content of the material in this guidance. This guidance does not constitute legal or financial advice. Readers should take specific advice from a chartered accountant on ensuring they meet their tax obligations.*