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Irish Cooperative Organisation Society

Irish Co-operative Organisation Society Ltd

Pre-Budget Submission 2018

September 2017

Mr Pascal Donohoe, TD
Minister for Finance
Department of Finance
Upper Merrion Street
Dublin 2

1st September 2017

Re: ICOS 2018 Pre Budget Submission

Dear Minister,

The Irish Co-operative Organisation Society (ICOS) welcomes this opportunity to outline its priorities in advance of Budget 2018.

ICOS is a co-operative umbrella organisation that represents, serves and promotes the interests of commercial co-operative businesses across multiple sectors of the Irish economy including the agri food sector. ICOS represents 130 co-operative societies that collectively have over 150,000 individual members, with a combined turnover of €14 billion and employ more than 12,000 people in Ireland. The majority of Irish dairy businesses are multi-purpose co-operatives with interests in milk processing, liquid milk, consumer foods, agri-trading and feed milling. There are 11 milk processing and 13 milk purchasing co-operatives located across rural Ireland. Irish dairy products are exported to 155 countries worldwide, valued at €3.38 billion in 2016. ICOS also represents over 60 livestock mart co-operatives, which provide a valuable alternative market outlet for farmers, with a collective turnover of over €1 billion that is geographically spread right across the rural economy. Furthermore, ICOS represents a range of societies including community and rural based enterprises and services.

The agri food sector continues to play a crucial role in Ireland's economic recovery with agri food exports valued at €11.15 billion in 2016, marking growth of over 56% since 2009. The agri food sector makes a strong contribution to job creation in rural areas, accounting for 8.6% of total employment. Critically, the increase in export value from the agri food sector has been achieved using inputs sourced from the local economy, creating a much wider multiplier effect across rural Ireland.

The adoption of budget 2018 comes at a time of unprecedented uncertainty for the Irish agri-food sector. The decision by the UK to exit the European Union will result in major upheaval as the UK is Ireland's largest market for food and drink, accounting for 37% of exports in 2016. Additionally, income volatility remains a significant threat to the achievement of the Government's Food Wise 2025 strategy for the agri-food sector. For example, the farmgate milk price has fluctuated from highs of circa 40 cent per litre to lows of circa 20 cent per litre within a relatively short time period in recent years. This leads to great uncertainty at farm level which impacts on day to day business decisions and long term planning and investments. Furthermore, this uncertainty impacts the broader rural economy as with times when prices are low there is a tendency to reduce expenditure to control costs.

Income Stabilisation Measure:

Consequently, in Budget 2017 the Government outlined several measures designed to provide a comprehensive taxation response to income volatility. This included an agreement by the Departments of Finance and Agriculture, Food and the Marine to engage further to consider potential 'Income Stabilisation' tools, whereby some income might be deferred in a period of high prices and drawn down in a period of lower prices, to see if these are possible for a future introduction. ICOS is proposing a co-op structured scheme for consideration by the Departments of Finance and Agriculture.

As an amendment to the Finance Act, ICOS recommends that a milk, grain or livestock supplier can enter into a voluntary agreement with their co-operative or approved purchaser of primary agricultural produce to defer up to 5% of their gross annual income in order to stabilise their annual farm income. The deferred income can be drawn down at any time and subject to income tax at the time of draw down. The maximum period the deferred income can be retained in the scheme is 5 years. The deferred income will be held in a bank account for the specific purpose of the scheme using the milk quota regulations as a precedent. The scheme proposed by ICOS includes the following advantages:

1. The proposed scheme can result in a significant stabilisation impact on the income of a typical family farm enterprise
2. The primary reason for a farmer to avail of/enter the scheme is to stabilise his/her income in order to manage market volatility
3. The proposed scheme incurs a minimal cost to revenue and can be considered cost neutral
4. It is designed to ensure compliance with EU state aid rules under the De-Minimis Regulation

<u>The proposed scheme by ICOS including broad concepts and the operational characteristics are outlined in more detail in Annex 1.</u>

ICOS also fully supports measures designed to improve equity in the income tax system. We support the full implementation of the commitment contained in the Programme for Government that the Earned Income Tax Credit will match the PAYE credit by 2018.

Addressing the challenge of BREXIT

The UK's decision to exit the EU is an unparalleled threat to the Irish economy and the agri-food sector in particular. The UK is an important high-value market for Irish agri food, valued at €4.13bn in 2016 including €825 million in dairy products and more than €1.1 billion in beef products. The shared land border between Ireland and Northern Ireland has resulted in the development of a highly integrated agri-food sector, with large volumes of trade annually in live animals, finished products and products requiring further processing including dairy products and ingredients.

The resulting uncertainly has already caused severe market disruption with the Euro at its strongest level against Sterling in eight years resulting in a very challenging trading environment for Irish exporters. The European Commission has signalled its intention to provide aid to sectors and economies to adapt to a post Brexit scenario. The Government should investigate with the European Commission similar measures to deal with current Brexit related Sterling weakness.

Although formal exit negotiations between the UK and the EU have begun, there remains immense ambiguity with regard to the future trading relationship. In the meantime, investment insecurity and market volatility are dominant issues for the sector. Additionally the UK's withdrawal from the EU will constrain the funding available for agriculture under the EU's common budget at a time when it will be most needed. It is therefore critical that Government take action now and introduce measures to assist the sector in preparing for the future and overcoming these immense challenges.

ICOS supports increased funding for key State agencies such as Bord Bia and Enterprise Ireland to support the promotion of Irish agri-food exports on new markets and product diversification. The Government should investigate the requirement for a national export credit scheme to assist businesses in expanding to new global markets. Expanding to new markets can put a strain on cash flow, due to upfront logistical, marketing and regulatory costs. Government backed export finance, in the form of loans, guarantees and insurance policies would ensure businesses have affordable and secure finance to manage cash flow and therefore reduce risks. In addition, the Government should work with the European Commission to establish a temporary state aid system to allow for the sectors most affected by Brexit to receive all necessary support.

Further, ICOS recommends the utilisation of EIB funding in the agricultural sector and by rural businesses so they can adjust if necessary to new arrangements between the UK and EU including investing in product diversification to target new markets and altering supply lines and routes to market. Additionally, EIB financing should also be made available at farm level through the introduction of Financial Instruments (FIs) under the Irish Rural Development Programme.

Measures for the livestock marts sector

The livestock marts sector provides an important alternative and secure market for farmers to trade their animals. The mart is a key focal point across many rural towns and is a valuable social service to their communities. There are many challenges facing the livestock marts sector including increased costs such as insurance. Rising local authority rates are also a significant issue due to a process of rates equalisation being enforced by local authorities.

ICOS is reiterating its call for the introduction of a fairer system of rates collection for livestock marts. The current model of rates levy on livestock marts needs to be reviewed by Government. In general, livestock marts are only open for business, one or two days per week, yet are charged for the full business week of trading. Additionally, the typical mart premises have a very large footprint but in reality only the sales ring is where the commercial business activity of livestock sales takes place. Large areas of car parking and cattle/sheep pens make up the majority of space. ICOS suggests a pro rata basis calculating rates to be levied on marts based on the number of days trading annually rather than the standard method, which presumes a commercial activity will be ongoing 5 days per week, every week.

In conclusion, ICOS strongly believes that the proposals outlined in our pre-budget submission will better equip the agri-food sector, farm families and their co-operatives to manage existing and long term challenges. ICOS would like to request a meeting with you subject to your busy agenda in advance of this year's budget to discuss our pre budget submission and to specifically outline our proposed income stabilisation measure. We look forward to hearing from you regarding this request and to engaging with you and your officials on these important issues in advance of October's budget.

Martin Keane

Martin Keane
President

ANNEX 1: ICOS Proposal for an Income Stabilisation Measure in Budget 2018

Background:

ICOS is proposing an amendment to the Finance Act to establish an income stabilisation measure to help farmers deal with extreme income volatility. For example, the farmgate milk price has fluctuated from highs of circa 40 cent per litre to lows of circa 20 cent per litre within a relatively short time period in recent years. This leads to great uncertainty at farm level which impacts on day to day business decisions and long term planning and investments. Furthermore, this uncertainty impacts the broader rural economy as with times when prices are low there is a tendency to reduce expenditure to control costs.

Income volatility – why an income stabilisation measure is required in Budget 2018?

Income volatility is a constant feature of European dairy markets since the removal of comprehensive market support measures at EU level in the 2004-2006 period. Indeed, we are currently emerging from our fourth significant price trough, with very weak markets in 2006, 2009, 2012 and again in 2015/16. External forces outside the control of farmers and their co-ops such as weather, geopolitical events, animal disease, currency and macroeconomic events can conspire to lengthen or deepen the volatility curve. Further, the decision by the UK to exit the European Union has added enormous uncertainty for the entire agri-food sector. Exchange rate volatility is the immediate concern. However, the continuation of unrestricted trade between the EU and the UK is of paramount importance as the UK accounts for 50% of Irish beef exports and 30% of dairy exports. Moreover, 60% of Irish cheddar cheese exports are destined for the UK market. Brexit also presents a particular threat to the current highly integrated all-island milk processing structures.

Initiatives to combat income volatility by Irish co-ops

Irish dairy co-ops are proactively engaged on the issue of income volatility. For example, there has been much greater use and uptake of fixed milk price schemes which allows farmers to voluntarily lock in a reasonable price, and perhaps a margin, for a portion of their annual supply. Such schemes are already in existence and are being more widely offered. Additionally, in cases where processors are not in a position to physically lock in a back-to-back contract for a portion of their production, tools should be available to allow them to enter into a financial hedge. However, the current European Dairy Futures market lacks liquidity, and the nature of the Eurex index introduces Basis Risk to Irish operators. All parties need to work to establish a liquid functioning European futures market which is reflective of the nature of Irish dairy exports.

Furthermore, Irish dairy co-ops supported the farmgate milk price above market returns in both 2015 and 2016, which is central to the co-operative ethos. There are also examples of schemes introduced by co-ops to assist farmers with income volatility. An example of this is where a co-op established an income volatility fund where the additional profits of that year were distributed in subsequent years to farmers based on their milk supply. The fund was outlined on the balance sheet as a separate item.

The role of agri-taxation

The Food Wise 2025 Report identifies price volatility as a specific threat to the agri food sector and recommends the development of measures to mitigate the risk of income volatility. ICOS in particular acknowledges the implementation of a range of agri-taxation measures contained in recent budgets. However, we strongly believe that an additional measure is required to stabilise income at farm level. The Department of Agriculture, together Finance, need to re-examine the introduction of an income stabilisation tool which will allow farmers to use periodic high prices to sustain them in weaker markets.

In Budget 2017, the Departments of Finance and Agriculture agreed to engage further to consider potential 'Income Stabilisation' tools, whereby some income might be deferred in a period of high prices and drawn down in a period of lower prices, to see if these are possible for a future introduction. This was a welcome development.

ICOS Income Stabilisation Measure – Proposed Broad Concepts:

In advance of Budget 2018, ICOS is proposing a co-op structured scheme for consideration by the Departments of Agriculture and Finance. (Based on a development of the ICOS "555" proposal). We are suggesting the following broad concepts:

1. A milk, grain or livestock supplier can enter into a voluntary agreement with their co-operative (or approved purchaser of primary agricultural produce) to defer up to 5% of their gross annual income in order to stabilise their annual farm income.
2. The deferred income shall not exceed 5% of annual gross receipts.
3. The deferred income can be drawn down at any time with the provision of a reasonable notice period, and subject to income tax at the time of draw down.
4. The maximum period the deferred income can be retained in the scheme is 5 years from the date the deferred income is introduced to the scheme (The scheme will operate on a 5 year rolling; first in-first out basis).
5. The accumulated or combined funds will be retained in a bank account kept for the specific purpose of the scheme.
6. As part of the annual audit, the auditor would verify the bank balance and ensure it reconciles to the deferred creditor account.

Deferred Income Bank Account:

The co-operative/purchaser shall manage a deferred income bank account (DIBA) on behalf of their suppliers. It is suggested that will operate as follows:

1. The participants of the DIBA will be treated as deferred creditors on the balance sheet. The DIBA will be an asset on the balance sheet.
2. The DIBA will be interest bearing, with the interest accruing back to the individual on a pro rata basis.
3. The interest will be calculated on a quarterly basis.

4. An individual can withdraw their deferred income from the DIBA at any time, subject to a reasonable notice period. The notice period may be waived under exceptional circumstances.
5. Lodgements to the DIBA requires written application from the individual to authorise payment of the money into the account. Upon receipt of this application, the co-operative/purchaser should ensure that the funds are transferred into the DIBA within a set period.
6. Lodgements to the DIBA will be restricted to a set window each year to reduce the administration burden on co-ops. For example, a two month window for lodgements should be established prior to the preliminary tax deadline of the 31st of October.
7. The DIBA should be reviewed on a regular basis to check and rectify any potential errors on the account.
8. The DIBA should be reconciled on a monthly basis in line with the monthly payment run.
9. The balance on the DIBA should at all times reconcile with the balance on the deferred creditor on the balance sheet.
10. Upon receipt of written notice, the funds will be transferred to the individual and the corresponding amount deducted from their deferred creditor balance.
11. The co-operative/purchaser is prevented from using the deferred funds of an individual to offset debt from a trading account in their name.
12. The application form will include a legal disclaimer from the co-op outlining that the individual farmer is responsible for adhering to the terms and conditions of the scheme related to the individual's tax affairs, e.g. a tax clearance certificate may be required as part of the schemes terms and conditions.
13. In order to ensure compliance with individual's state aid thresholds under the De Minimis provision, the purchaser will make available to the relevant authority all necessary information.
14. Dual milk suppliers can only defer up to 5% of their annual gross milk receipts with each individual co-op they supply.
15. It is the responsibility of the individual to ensure that they withdraw the appropriate funds within the timeframe laid out in the scheme.
16. An annual statement will be issued to each participant of the scheme. An individual may request a statement sooner than this if required.

Milk Quota Regulations – An important precedent:

The Milk Quota Regulations (SI 227/2008) provide for the payment of a levy, known as the "super levy", on milk deliveries in excess of Ireland's annual national quota. The levy was payable by individual producers who exceeded their quota, expressed in terms of volume and fat content. The levy was paid by the State but the money was collected by the co-op on behalf of the individual producer who exceeded their quota, after the allocation of unused quota. The co-op ensured collection of the levy by making appropriate estimated deductions from the milk suppliers monthly milk cheque in the months leading up to the end of the quota year (31 March). The deducted monies were held in a bank account for this specific purpose.

A key component is that the co-op was restricted in the use of these funds, which was either to pay the levy to the State and/or refund the supplier with interest if the deducted funds exceeded the individual's liability under the milk quota regulations.

Section 30 of SI 227/2008 is outlined below. This provision in the milk quota regulations provides three important precedents for the establishment of an income stabilisation measure:

1. Co-ops were allowed to deduct a portion of income from a supplier
2. The funds were retained in a bank account for a specific purpose
3. At year end on the co-op balance sheet, the funds would be shown as an asset and a corresponding creditor liability to the Department and/or the farmer

Deduction of levy by milk purchaser

30. (1) In accordance with Article 80 of the Council Regulation, if, during a quota year, the quantities delivered by a producer exceed his or her available milk quota allotted to that milk purchaser, the milk purchaser may deduct from the sums owed to the producer, an amount of levy that would otherwise be payable by the producer.

(2) The milk purchaser shall pay all amounts deducted under paragraph (1) into a bank account kept by him or her for that purpose.

(3) A milk purchaser shall not use monies deducted under paragraph (1) other than to pay levy to the Minister or to refund the producer.

(4) If the amount deducted in respect of potential levy exceeds the amount of levy actually payable by an individual producer, the milk purchaser shall refund the overpayment and any interest pertaining thereto to the producer.