

FarmTaxBrief

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Briefing

'Appropriation from stock' – the impact of private usage on farms incorporating equine and bloodstock businesses

Appropriation from trading stock

When trading stock is taken from a business it *must* now be recorded at market value. There should be a notional accounting entry for the appropriation at this market value figure/calculation.

The long established rule in *Sharkey [HMIT] v Wernher* (1955) 36 TC 275 is still applicable. The rule established is that goods taken from stock by a trader for his own consumption are to be valued, for the purposes of calculating taxable profits, at market value, taken to be the price that the trader would have charged for the goods had they been sold to a third party in the ordinary course of his trade.

What types of expenditure might these typically cover for the farming and bloodstock worlds?

- a) hay and straw used for private horses;
- b) raw materials provided to the shoot by the farm.

Examples of entries could be:

- a) Use of hay
5 horses using 400 bales of hay @ £4 (market value) a bale
Dr Drawings £1,600 Cr Sale of hay £1,600

- b) 3 tonne of wheat for pheasant feed @ £160 (market value) per tonne
Dr Drawings £48 Cr Sale of corn £480

Conflict with GAAP

Some commentators and practitioners had argued that the rule in *Sharkey* conflicted with generally accepted accounting principles (GAAP), which require goods taken for own consumption to be valued at cost. They claim either that the decision in *Sharkey* was made (by the House of Lords), *per incuriam*, or that GAAP has become more significant, for tax purposes, since 1955.

The Economic Secretary to the Treasury informed the Committee that the Statement of Practice A32 Goods taken by traders for personal consumption will be withdrawn. Accordingly, the position of farmers – or at least farmers who have accepted the validity of the rule in *Sharkey* – will in practice be unaffected by the change from case law and Statement of Practice to the 2008 Finance Act.

Private use and calculating market value

Such is the nature of the farming, equine and bloodstock industries that there will be a duality of purpose involved in the expenditure. Let us, for

example, look at each of all the points raised above. It must be remembered that the new legislation only relates to the disposition of trading stock and work in progress and not to the provision of services or to the disposition of raw materials or consumables. Market value is the price 'it would have sold for in the market at the time' of the transaction.

a) Use of hay

Horses may be used to ride round the farm to inspect livestock, crops etc. With increasing costs of fuel this use becomes very attractive.

b) Livery owner

Livery owner uses own horse to give lessons on and the income is included in the accounts. The horse is used as a safe lead when exercising other horses and used to ride out with owners to discuss their needs and instructions. What of the private use of such horses?

c) Days shooting

The days shooting are only taken to control the shoot and to assess feedback from the guns combined with the need to entertain fellow guns.

d) Race horses in training

Is a trainer taking goods for private use, appropriating stock or marketing his business when they own shares (or legs) in racehorses?

The way a race horse trainer has to build the business, convince owners to have faith in the horse, develop owner relationships and use spare capacity means they have to often own shares ('legs') in horses they train themselves and consider the balance between private use, appropriation for stock and marketing cost.

The key has to be for the accountant/tax adviser to understand the client and to help them understand.

The provisions of service

Statement of Practice A32 states that inspectors should 'take a reasonably broad view' of the *Sharkey* principle. Specifically, it states:

'The case of Sharkey v Wernher (1955) 36TC 275 establishes the principle that where a trader takes stock from his business for private use or enjoyment or disposes of stock otherwise than by sale in the normal course of trade, the transfer should be dealt with for taxation purposes as if it were a sale at market value. Inspectors have been authorised to take a reasonably broad view in applying this principle.'

The decision is not considered to apply to:

a) Services rendered to the trader personally or to his household which should be dealt with in accordance with section 74(1)(b), Income and Corporation Taxes Act 1988 [now section 34(1)(a), Income Tax (Trading and Other Income) Act 2005];

b) The value of meals provided for the proprietors of hotels, boarding houses, restaurants etc, and members of their families which should also be dealt with on the basis that section 74(1)(b) applies;

c) Expenditure incurred by a trader on the construction of an asset which is to be used as a fixed asset in the trade.'

The consideration is that (a) and (b) above are covered by new s172A(2)(b), which states that 'trading stock' (to which the market value rule applies) does not include 'any services performed in the ordinary course of the trade'. 'Services' are apparently taken to include the 'service' of cooking or otherwise preparing food in a hotel or restaurant. The rationale of (c) above seems to be that the trader intended at the outset (at the latest, from the moment he began to construct the asset) that it would be retained as a fixed asset of his business. Accordingly, while the asset was under construction, it never became part of his stock of goods for sale.

Many farming and equine clients work very hard and find the concept of private usage or appropriation of stock or private use difficult to understand and will need explanation. Many clients might try and understand private usage but good practice has always been to communicate about the nature of the usage and to present a fair figure. The Finance Act 2008 has not changed that in any way – there is just greater emphasis on understanding what the client has undertaken with regard to appropriation from stock and what they might undertake in the future.

Appropriation of land

The Finance Act 2008 highlights the question of appropriation of stock at deliberate undervalue. The principle does not apply to 'bad bargains' or knowing there is a 'loss leader' to bring in more sales. The 2008 Finance Act endorses *Skinner v Berryhead Land Ltd* 46, STC 377 where land was sold at undervalue by a land-dealing company and the market value was deemed by

the court to be the correct figure. It is likely that such transactions could be debated by the District Valuer (DV) so if an independent valuation must be obtained this will help define market value and negotiations with the DV.

Interaction with capital gains tax

Section 161(1) TCGA 1992 provides that an appropriation of a capital asset into trading stock crystallises the chargeable gain, as if the asset had been disposed of on the open market at that time. Section 161(3), however, allows an election whereby no gain arises under s161(1) and the asset becomes trading stock at market value less the accrued gain (which effectively brings the asset into stock at cost plus indexation). Section 173 extends the rule for groups of companies, to

allow a transferee trading company to elect that a capital asset transferred from another group company be brought into trading stock at market value less the accrued gain. The new provisions do not mention these capital gains rules at all.

Client communication and understanding

Client communication and understanding of the business needs and history are the matters that might prove to be of key importance.

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