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Practical VAT Newsletter

Barter and farm diversification – the VAT traps

Farms are having to diversify to survive which provides both VAT planning opportunities and VAT traps which need to be considered, Julie Butler explains.

Barter – the concept and reality

The rural community has thrived on the concept (and reality) of the system of 'barter' for centuries. It is quite normal for a day's shooting to be swapped for work to the farm, or for grazing to be exchanged for field maintenance. Hay bales can act as currency in return for building work or repairs to vehicles. All very innocent, rustic and encourages a paper-free environment, but this can underpin what can only amount to potential VAT non-disclosure or even VAT fraud. There are standard rated goods being exchanged for exempt and zero rated goods.

Exchanging goods and services of VATable supplies for zero rated or other supplies, by way of barter, with neither transaction entered in business records has to be rectified with correct recording of the detail.

Barter and zero rated farm supplies

Historically the farm VAT Return has been a very straightforward affair, i.e. agricultural supplies at zero rate and the claim of input VAT at the standard rate. But the move to diversification in recent years has made the Return more complicated, e.g. the question of rent received on residential cottages and the review as to partial exemption or the disallowance of certain elements of input VAT such as private usage of the farm assets etc. Most but not all diversified activities have to charge output VAT at the standard rate and this creates a problem in identification of the appropriate VAT rate.

For example, the Single Farm Payment (the main farm subsidy) is outside the scope of VAT. However, there are situations where VAT is payable, e.g. on the sale of the entitlement without land. If a farmer is not trading, a VAT deregistration will have to take place and there will be no opportunity to claim VAT.

VAT exempt residential and commercial lets

The VAT position on farm property lets is very complex and becomes even more so if barter is involved.

As the farm workers have disappeared, their cottages have been re-let. Likewise, old agricultural buildings, such as pig sheds and dairies which are no longer needed, have been converted and let out for residential use. With the exception of furnished holiday lets (see later), residential lets are an exempt supply for VAT. Often the farm income has grown with the residential lets, but the input VAT on the

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All cases and Tribunals are commented on by **David Betton** of KPMG LLP Indirect Tax Legal Services

expenses of the whole enterprise has been reclaimed. What of consideration for partial exemption?

Where a farmer lets a mix of commercial and residential property, the complexity of partial exemption can make opting to tax on the commercial buildings (as explained in Notice 742A) a very attractive alternative. This is because it may allow all the input tax, in respect of both standard-rated commercial and exempt residential property, to be reclaimed in full.

If job related accommodation is proved to be tax-free by virtue of it complying with the 'performance' or 'customary' rules, then the input VAT will be able to be claimed, but only if there is no lease in place.

Inheritance tax telief consequences

In the farming community (with the average age of a farmer being high) it is possible for (in all innocence) the majority of farming activities to be dealt with via a simple barter arrangement, for example grassland exchanged for farm maintenance. As both items relate to the business, the farming community cannot see the problem of exchange. If the barter transactions are not reflected, the farm accounts might show almost no activity: how would this affect a claim for agricultural property relief (APR) under s 115 IHTA 1984 and business property relief (BPR)? Could the Accounts allow it to be proved that the land qualifies for APR or BPR? Could it be proved that the trade of farming was being undertaken? The IHT problem can be seen in *McCall v HMRC* [2009] NICA 12 on appeal with regard IHT pitfalls to grazing and duties.

For example, the haymaker might swap bales of hay in return for cutting, turning and baling. The hedge cutter might trim the hedges in return for grazing a few cattle, or for taking some calves to fatten. The end result can be a set of farm accounts showing little activity. The machinery might have belonged to the deceased, e.g. the hedge trimmer, the baler and the tractor but are just used by the contractor. But where is the burden of proof? Clearly the answer is to record and document barter arrangements as part of the contemporaneous accounting records. The farming family should also take photographic evidence of the machinery being used on the fields also being stored in the barns and outbuildings in anticipation of questions that might arise in future claims for IHT reliefs. The correct VAT treatment will therefore be important to support IHT claims.

Market value and production of sales invoices

Where barter is involved clearly the service or product provided must be recognised at market value (*Sharkey [HMIT] v Wernher* (1955) 36 TC 275) and a 'contemporaneous' sales invoice must be made out with sequential sales or fee invoice number and date. The business records must show how the invoice was settled, perhaps via a drawings journal or by the settlement of a purchase ledger invoice. Advice regarding the recording of such revenue is given in H M Revenue & Customs booklet *Self-Assessment – A General Guide to Keeping Records*. To quote direct from the booklet:

'Even if you do not record these through a till, you will need to make a record at the time the transaction takes place of the goods taken or supplied and their retail selling price.'

The Revenue do have the power to dictate what records are kept by businesses and all records should be kept up to date. Under new enquiry powers HMRC now have the right to enter business premises at any time to inspect business records, and would expect to find them up to date. Otherwise they could consider that the accounts prepared from them have not been prepared with reasonable care and any adjustment to accounts figures made by them under an enquiry could attract a higher penalty under the new enquiry regime.

"Grey" areas of VAT on diversified rural activities

What are the grey areas associated with diversification?

Shooting

There is some logic that as Shooting is a sport that starts with live birds and results in food products, Shooting can be VAT-exempt or zero-rated, but this is not the case – it is the right to shoot and take game that is being supplied and this is taxable at the standard rate. VAT is chargeable on the right to take game by virtue of its exclusion from the general exemption that is provided in respect of transactions in land.

The VAT on Shooting has been under close scrutiny over the last few years (see later).

Access to recreation and sports facilities

The fairly recent VAT Tribunal case *Polo Farm Sports Club* (20105) has highlighted the fact that the whole area of VAT on the provision of sports facilities and, indeed, a lot of horse activities could perhaps benefit from clarification by HMRC?

The letting of land is generally an exempt supply for VAT purposes. However, as mentioned previously, the letting of sports facilities and sporting rights are automatically standard-rated. There are special rules for the use of sports facilities where there are lets in excess of 24 hours, or for the hire of facilities to the same user for a regular series of events (both then become eligible for exemption but can be opted).

Within the definition of sports facilities for VAT purposes, HMRC includes swimming pools, tennis courts and croquet lawns as well as areas of land that have been specifically designed or adapted for sporting activities. However, if the sporting facilities are let for non-sporting purposes then the exemption will apply. An example of this will be the letting of a swimming pool for a fashion shoot which is an exempt supply. Very complicated.

Most providers of sports facilities would prefer the supply to be exempt. Consequently, the decision creates difficulties where series of lettings arise with less than a whole day in between, where it has been assumed that they were exempt as long as there was no more than one letting per day. Are they now deemed to be standard?

Provision of livery services for horses

There appears a contradiction between the VAT treatment of shooting and fishing compared to livery yard services. Livery yards obtained a potential boost when VAT charged to clients with minimum service (*Business Brief* 21/2001) was deemed to be exempt. However, it comes with the downside of the 'exempt' supply – not being able to claim back input VAT and the possible complexities of partial exemption. This can cause large problems when the livery yard is part of a diversified farm.

This brief seems a contradiction to the basic principle of the grant of right over land, for the supply of land is exempt. However, *'full'* livery by definition means that the service is not ancillary to the supply of land. Full means a horse being *'fully'* looked after. The result is that there is a variance in the interpretation of *'full'*. In many establishments, DIY and part liveries are treated as exempt, but full liveries are charged standard-rated VAT as it is considered that by definition the volume of the services provided do not fulfil the basic principle of exemption criteria.

Problems can arise in deciding whether schooling and breaking in are provided. If the yard is mainly a specialist breaking yard, then any supply relating to breaking in will be standard-rated and the provision of livery services will be ancillary to this and therefore standard-rated. On the other hand, if the main purpose of the yard is livery, with schooling or breaking as an add-on, then the entire supply will be exempt.

The barter between exempt supplies and zero or standard rated supplies make the situation very complex, e.g. is the correct VAT being paid over if livery services are exchanged for, say, hay?

Standard rated supplies and diversification

The following are generally standard-rated:
(a) seeds, plants and cut flowers which are bought for their ornamental effect including trees and shrubs, e.g. Christmas trees;
(b) any produce which is held out for sale:

- as pet food,
- packaged as food for birds other than poultry or game; or
- for a non-food purpose,

(c) any crop that generally produces items that are not fed to humans or animals; or
(d) plants, seeds and fruit of a kind used for the production of perfumes, pharmaceutical products, insecticides and other non-food uses are standard-rated.

Artificial separation of business activities

Another VAT problem arising from the VAT complexities and farm diversification is the desire to separate the farming and diversified activities to combine the "ring fencing" of that area of the trade and possibly obtain a VAT advantage.

Holiday homes – furnished holiday lets (FHLs)

With the announcement in the Budget that the tax treatment on FHLs is changing then what of the VAT treatment of such lets? Guidance is from VAT notice 709/3 January 2002 section 5.2:

"If you supply holiday accommodation, or a site for such accommodation, you must account for VAT at the standard rate on any charges that you make regardless of the length of occupation or description of the charges."

The change in the FHL rules is effective from **6 April 2010**, i.e. the UK income tax, CGT and IHT advantages of FHL will stop on **6 April 2010**.

Will the standard rate of VAT cease from **6 April 2010**? Unless there is a change in the VAT rules it is assumed not. If the property is advertised as holiday accommodation then it is assumed it will remain standard rated.

There are obviously concerns of alternative VAT treatments which need clarity. The diversifying farmer will be VAT registered and so the holiday let if advertised as such will appear to stay subject to a standard rate charge. This will have the advantages of the diversifying farmer being able to claim back input VAT on repairs and improvements and not cause problems of partial exemption. However, that leaves the farmer with output VAT to private holiday makers and being attracted to barter … and so the circle continues.

Is there not a contradiction if FHL rules are repealed? Should standard rate be charged on letting? There are strong arguments to say that the standard rate of VAT should be charged if the previous FHL achieves business status in its own right.

Whilst the system of all properties that meet the qualifying conditions of the FHL rules means they are "FHLs" remains to **5 April 2010**, there is clearly scope for VAT planning – perhaps ensure all repairs and improvements are carried out before the deadline to maximise possible income tax and input VAT claims.

Clearly a time for careful measured VAT planning around all holiday homes past, present and future!

The shooting VAT exemption

One form of farm diversification that can also involve both barter and complexity is "game shooting". This can involve a lot of organisation and is often co-ordinated by a shoot manager away from the farm. As many of the members of the shooting fraternity pay for the pleasure in a private capacity and not many of the costs of the shoot involve input VAT this can have some VAT planning available.

It is considered that the shooting fraternity might have received a boost from two recent VAT cases which emphasise the need that subscriptions and fees to achieve exempt status must be closely linked and essential to sport. That sport can be game shooting. The shooting syndicate can be run separately from the farm as a members club and be VAT exempt.

The facts are that membership subscriptions charged by certain non-profit making bodies that provide access to sport are exempt from VAT. The problem arises that the exemption is not always clear in marginal situations. Some extra degree of clarity arises from the fairly recent cases (20739) of the *British Association for Shooting & Conservation Limited (BASC)*.

The appellant argued that part of its subscriptions were exempt, and one of its grounds for this approach was that it was a sporting body that provided services closely linked with and essential to sport or physical education on which the individual is taking part. The Tribunal did not agree. Although the BASC provided services in protecting the members' ability to carry out their shooting activity, there were no actual shooting facilities provided, with no land or equipment offered to members for participation in the sport. This meant that the supply was insufficiently closely related to, nor essential for, participation in the sport of shooting. Other well argued grounds for exemption from VAT were also rejected by the Tribunal. This decision could cause difficultly for organisations that are heavily involved in sport, where a similar detachment from the specific facilities for the sport exists but helps where there is a heavy involvement in the sport, e.g. a shooting syndicate.

The second case was *Canterbury Hockey Club* which comprises a number of different hockey teams. The clubs pay

newsfile

Cross border VAT change

HMRC have issued the following Guidance Notes in relation to cross-border VAT:

- Changes to the VAT refund procedure – explaining the new electronic cross-border refund system due to take effect across the EU from **1 January 2010**;
- Changes to the place of supply of services rules and time of supply rules in relation to cross-border supplies of services – explaining the revised rules for the place and time of the supply of services due to take effect in phases between **1 January 2010** and **1 January 2015**;
- Changes to EC Sales Lists – **1 January 2010** – explaining changes to the EC Sales Lists regime from **1 January 2010**, particularly the extension to apply to supplies of services, and further changes from **1 January 2012**; and
- Cross-border VAT changes **2010** – providing a summary of the changes announced in Budget Notes 74–77 (and covered in detail in the above-mentioned Guidance Notes) on the cross-border changes being introduced from **1 January 2010**: HMRC Guidance Notes dated 1 May 2009.

Vehicle scrappage scheme

HMRC have set out the VAT implications of the temporary vehicle scrappage scheme announced in Budget 2009 and which came into being on 18 May 2009. Under the voluntary scheme, the Department for Business, Enterprise and Regulatory Reform (BERR) pays a £1,000 subsidy and the manufacturer pays a £1,000 discount. The manufacturer may treat the VAT on their contribution as a discount to the output tax they have paid to HMRC on their sale of the car, but they must not reduce their output tax in respect of BERR's contribution. BERR pays the manufacturer £1,000, but the manufacturer must pass it on to the dealer within 14 days. The dealer should make no adjustments to the VAT they pay to the manufacturer, or claim from HMRC as input tax. The customer pays £2,000 less for the vehicle under the scheme: HMRC Brief 31/2009

Refund to statutory bodies

The Value Added Tax (Refund of Tax to Charter Trustees and Conservators) Order, SI 2009/1177 provides that from 1 June 2009 certain Charter Trustees, and from **1 April 2010** the Wimbledon and Putney Commons Conservators, are specified for the purposes of VATA 1994 s 33. The effect is that those bodies are able to claim refunds of VAT charged on supplies to, or acquisitions or importations by, them if those supplies, acquisitions or importations are not for the purpose of any business carried on by them.

"England Hockey" affiliation fees, and in return receive certain services from "England Hockey", e.g. courses for officials, and advice on obtaining sponsorship. HMRC said that the affiliation fees received by England Hockey should be subject to VAT. The hockey clubs were not the persons playing the sport so the supplies of the services could not be exempt.

The Canterbury Hockey Club appealed. The High Court referred the matter to the European Court of Justice (ECJ) asking whether the term 'persons' in the context of playing sport, included corporate persons and unincorporated associations or whether it only included human beings.

The ECJ ruled that the exemption applied to corporate persons and unincorporated associations, provided the organisation was "closely related to the sport". It was for the national court to decide that the services provided satisfied three conditions: they must be supplied by a non-profit making organisation; they must be closely linked and essential to sport; and the true beneficiaries of the services must be persons taking part in sport.

Canterbury Hockey Club and another v CRC (Case C-253/07), European Court of Justice, 16 October 2008

The key for standard rated VAT to be charged has to be the detachment from the specific facilities for the sport.

The advantage is that game shooting syndicates that are genuinely separate from the farm can claim the VAT exemption status and therefore do not have to charge output VAT on shooting services provided to club members. A shooting syndicate can now set itself up as a non-profit making members club and be exempt from VAT.

There is generally very little input VAT involved in a shooting members club. Are the three conditions met for the members club – a non-profit making organisation, closely linked to sport and are the true beneficiaries and the services those involved in the shooting?

Action plan

HMRC have stated that post the success (for them!) of the recent VAT "attack" on shooting they are looking very closely at all diversified farm and landowning activities.

It is often more than a decade since the last farm VAT inspection and VAT "internal audits" for farm and rural businesses would be very timely.

Talk to the client – what is really happening on the farm and land and is it reflected in the books and records?

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