



BREEDING THE SPORT HORSE TAX EFFICIENTLY

There are many breeders of sport horses who must regularly contemplate the age old statement “fools breed horses for wise men to ride”. It will therefore be extremely rewarding for the breeders to understand that there can be some considerable “tax breaks” for the stud farm. These tax reliefs incorporate VAT, income tax, capital gains tax and inheritance tax benefits. Indeed the establishment of business status of any equestrian activity can be very tax efficient.

The success of the author's book “Tax Planning for Farm and Land Diversification” has led to the proposed book “Equine Tax Planning” with great emphasis on the sport horse industry.

Equine tax has recently been given high profile in both the tabloids and broadsheets due to the beneficial Irish tax rules and Alex Ferguson, the Manchester United manager, enjoying the rewards from the potential stud fees of his horse Rock of Gibraltar tax free.

Under the Irish system the stud fees are not only tax free but do not have to be recorded on a Tax Return. There was a lot of hot air about Irish politicians fighting for change. However, these Irish tax reliefs support a great Irish industry and the risks to the economy are too great. The UK Thoroughbred Breeders Association (TBA) has fought to try and have UK benefits equal to the Irish.

A lot of the beneficial equine Irish tax rules shadow the current UK benefits for both capital gains tax and inheritance tax on land used for business in the equine business. The income tax reliefs of eleven years losses for stud farms also have great advantages for UK stud owners. For studs there are some important tax planning points in the advantages of business status with regard to the eligibility to capital gains tax, business asset taper relief, and the ability to roll over the gain into another business asset. With business asset taper relief resulting in 10% tax rates the emphasis on capital gains is important. It is not just the capital gains tax reliefs that are beneficial under the current legislation but also the inheritance tax position must also not be overlooked with regard to the agricultural and business property relief.

It is important to realise that a stud farm is a farm. It receives all the tax breaks of farming. The establishment of business status can be achieved with a relatively small number of horses. The average number of mares owned by TBA member/breeders is just two. Although many breeders are farmers, there is steady recruitment to the horsey set from those who progress from owning or part-owning a horse, to breeding one, two or more to race and/or sell. And provided you can show the tax inspector there's a reasonable chance of profit, you can set your losses against your total taxable income for up to 11 years (see above).

Horse racing however is not a taxable activity. Where, as is often the case, a stud farmer also races horses, considerable care may therefore be needed to ensure that the division between the two activities has been correctly made. In particular, attention should be given to any transfers of animals from the stud farm to training (that is, being kept for the purpose of racing) or vice versa.

The fact is that a loss from a stud or any commercial equine business can be offset against total income, yes that includes property income, earnings from employment, and stock market dividends (are there any left?) If stud owners want to find out more they can by going direct to the Inland Revenue website.

www.inlandrevenue.gov.uk/manuals/immanual/im2250/im2350b.htm (and ghtm).

Where the enterprise is clearly not being carried on a commercial basis and with a view to the realisation of profits, a challenge from the Revenue to disallow the losses on the basis of commerciality should be considered.

There are over 7,000 studs registered with the Thoroughbred Breeders' Association, and the British Equestrian Trade Association says there are about 1,600 breeders of non-thoroughbreds.

The tax reliefs are not restricted to stud farms. The current UK tax systems have excellent tax advantages for any form of BUSINESS. The tax losses can be beneficial to obtain refunds of income tax and these can underpin the business reliefs for capital gains tax and inheritance tax (let alone VAT).

So with farming in collapse the tax breaks for a stud farm can be enjoyed by diversifying farmers, new entrants and those who are effectively trading as a stud but do not realise the “tax breaks”. Perhaps it is time for the hobby stud to “come out” as a business, face the problems of greater paperwork but enjoy potential massive tax reliefs at all levels of VAT, income tax, capital gains tax and inheritance tax.

It can be argued that the expression hobby farming is too flippant. It is a passion not a hobby. However, that does not reduce the emphasis on profit or commercial approach.

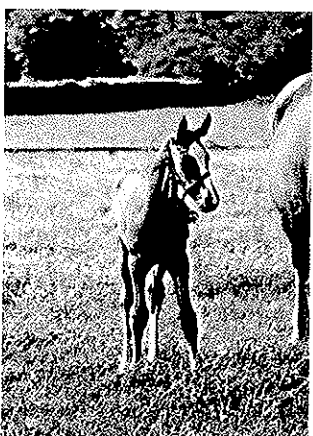
So what questions do stud owners raise? A few examples are set out below.

1. Is There a Minimum Number of Horses?

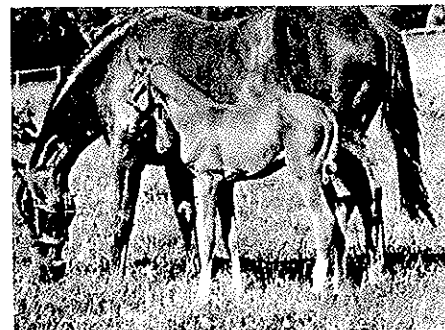
Answer

No. The criteria are view to profit and to be able to prove there is possibility for future profitability. The Customs and Excise give the following direction on acceptance for VAT registration that helps emphasise the business intentions.

“Breeding is a long term activity. A mare will not produce a foal every year, and the average may not be better than one year in two. A breeder therefore will normally need to own several mares before supplies (sale of offspring) can be made with any degree of regularity. However there will be exceptions to this, e.g. it is becoming more common to acquire one or two well bred mares, cover them by an expensive stallion and sell the offspring



for considerable amounts of money. In these circumstances we would accept there was a business activity and registration may be permitted. In cases of doubt the trader should be requested to submit written details of their business intentions. Where subsequently a trader is registered it should be as an intending trader.”



2. Converting a Previous Stud Hobby into a Business - are there problems?

Answer

In practice for income tax and VAT there is more scope for negative challenge by the authorities if there is a change from non-commercial to business. However each case will be assessed on its merits and proof of a view to a profit will be essential. The Capital Gains tax purposes to move the stud property from private to business use restricts the valuable business taper relief. This is known as tainted taper. For inheritance tax relief the stud property must have had business status for two years.

3. What proof will the Inspector require that there is a genuine trade? Will the Inland Revenue check “sudden” profits in year eleven or year six after that?

Answer

The stud must be run on a commercial basis with a view to realisation of profit. The key factor is potentially profit making. The Revenue will look for “fudged” or “convenient” profit. For example:

- . restricting business expenses in the year that needs to be profitable
- . recognising sales/expenses in the wrong year
- . manipulating stock valuations

4. Allowable Los's Period.

Once the first loss period of eleven years has been taken advantage of and a profit achieved can a further loss period of eleven be allowed by the Inland Revenue?

Answer

No. The eleven year period is to allow for the intrinsically long term profit making nature of a stud farm. Once recognition of the long “lead” in period has been provided the farming rule of “a profit every six years” applies. If there is a profit in say year two we are back to the six year cycle.

5. How Can Input Vat Claim be Maximised

The claim for VAT relief, especially input VAT on repairs to improvements of stud premises is valuable to the stud owner. What criteria will Customs and Excise impose to allow registration and to allow input VAT claims?

Answer

In order to achieve registration there must again be the intention of making a profit. It must be a business. The Lord Fisher case made the principal that an activity pursued for pleasure and social enjoyment is not business even if undertaken in an efficient and businesslike manner. The Prens case favours the breeder as it ruled that regular taxable supplies are not necessary as breeding horses is a long term activity. The Turnbull case ruled that although there was an element of hobby there was the simple commercial objective of achieving a good bloodline, which could produce profit issue, which was a business.

In order to claim the input VAT the goods or services would have to have been purchased in the course or furtherance of the business of stud farming.

6. Are there problems with change of premises?

If the stud business continues but there is a change of stud premises are the inheritance tax reliefs (I HT) kept intact?

Answer

In principle yes. The replacement property provisions apply. Problems could arise with a temporary move to rented accommodation, as these will obviously not be eligible for IHT. If death occurred in this transitional situation then all inheritance tax reliefs would be lost.

It is impossible to give comprehensive answers in print and the overriding rule is that each problem should be dealt with in depth and professionally. The tax reliefs are potentially very beneficial for Income Tax, VAT, Inheritance Tax and Capital Gains but tax planning cannot be looked at with anyone of these taxes in isolation or aspect. Every case must be reviewed “in the round” and tailor made for the taxpayer according to the facts of their case and what they ultimately want to achieve.

If anyone has an area on tax planning they would like covered or they have questions they would like answered then email direct to j.butler@butler-co.co.uk. There are interesting times ahead.

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