

Equine tax issues – Part 2

Julie Butler looks at some further issues affecting equine clients

This is the second part of a two-part article on Equine Tax Issues in which we consider areas that could cause misunderstanding for equine clients and their tax advisers. In this part there is particular emphasis on VAT, valuations and ownership.

For the first part of this article, please see the November 2018 issue of *Small Business Tax & Finance* at p. 3.

VAT treatment of equine teaching

A large part of the equine industry involves teaching and training. Riding lessons have a complicated history when it comes to establishing whether VAT is chargeable when providing lessons to private clients.

Riding lessons have previously been defined by HMRC as 'being taught in a number of schools on a regular basis', they are therefore subject to an exemption from VAT as confirmed by HMRC's *VAT Education Manual* at VATEDU40200. There is a proviso that they are taught to a level similar to those being conducted by educational establishments across the country.

There is an issue, however, about what counts as a 'basic riding lesson' conducted to an educational level and thus qualifying for the exemption; and whether the instruction given is classified as specialist training beyond this level which, following guidance from HMRC, is treated as a standard-rated supply as detailed on *VAT Notice 701/30: Education and Vocational Training*. However, many argue that all riding lessons come down to the basic.

VAT treatment of horse dealing

Another large part of the equine world is the buying and selling of horses. The Second Hand Goods Margin Scheme is an optional VAT scheme which can be used in certain circumstances to benefit the business. There is an opportunity for horse dealers and 'pinhookers' to benefit from this scheme and help the profitability of struggling equine businesses.

It is essential for all equine businesses to confirm the VAT position on all transactions they are involved with. The treatment of livery and horse sales (including overseas) can be very complex and misunderstood.

VAT treatment of liveries

Following the VAT tribunal case of *John Window v Commissioners for Customs & Excise* (No 17186), it was

confirmed that the supply of livery was the main supply and it was the stabling which was a single exempt supply, and that the additional services provided were ancillary to the provision of such stabling. A key point of *John Window* was that the customers did not have the facility to look after the horse at home, so the stable was considered to be the main element of the supply.

An ancillary service is defined as something that does not constitute, for customers, a main supply in itself, but is a way to better enjoy the principal service supply. A supply of livery services that goes beyond the right to occupy a stable may include feeding, turning the animal out to graze, mucking out, worming and clipping, grooming and plaiting, and taking on any responsibilities for the welfare of the animal, including arranging for veterinary treatment, that follow the liability of the supply of stabling, i.e. the supply of stabling is the principal supply and can still be an exempt supply; the other services just follow the main supply.

For VAT purposes, Public Notice 701/15 states that the liability of the care of animals is standard-rated where there is a 'special purpose' yard. The supply of grazing is zero-rated. The supply of stabling is considered a licence to occupy land and is therefore exempt from VAT unless there is an option to tax.

The VAT treatment is complicated and must be considered in the context of IHT planning with every equine client being considered on a case-by-case basis.

With regard to the supply of services there is an obvious connection to the IHT case of *Vigne* [2017] UKFTT 632 (TC), mentioned in part one.

VAT treatment of commerciality

The First-tier Tribunal looked at an input VAT claim of over £70,000 on the purchase of a horse by *Goodman Equine Ltd*. One of the points raised in *Goodman Equine* (TC 2243) was the fact that the business making a loss was not in itself grounds to deny the input VAT claim. The key point in *Goodman Equine* was lack of any sales. There are plenty of tax advantages for the equine business to take advantage of that can help with cashflow and in some cases help the business survive but it is essential that the basic rules of commerciality are observed for both income tax, corporation tax and, as the case of *Goodman Equine* illustrated, VAT.

The 'tax guidance' for anyone advising in the equine industry starting a true commercial business is that HMRC might try to say the operation is not commercial. It is imperative to have a business plan in place and third party evidence where appropriate to support this.

Equine stock valuation – the cost of keep

The valuation of stock is complex and the wrong workings can result in the incorrect calculation of profit or loss. Equine businesses should prepare an annual reconciliation of opening and closing stock of horses and the movements during the accounting period. First, there are foals, most often born in the spring. Then yearlings, who the next year become two year olds and so on; an understanding of the development of young stock must be considered.

When considering each category of potential stock valuation a key point is that the 'deemed cost' will be needed if accurate figures are not available. For example, the cost of keep of each category may need to be included. However, the 'lower of cost and net realisable value (NRV)' rule applies so, if an animal has problems that place the NRV *below* cost, this must be considered. All stock valuations must be consistent and accurate so that they are not adjusted for the benefit of the taxpayer. The general rules, found in HMRC's Business Income Manual at BIM55710, state:

'Except where the herd basis has been adopted, both stallions and mares should be dealt with as stock in trade and valued individually at the beginning and end of each year in accordance with relevant GAAP on the usual basis of (i) cost or net realisable value (see BIM55705), whichever is the lower, or (ii) at fair value less costs to sell where FRS 102 or IAS 41 are applied. Stock valuations should also include any foals and, where appropriate, stud fees paid [nominations]'.

Equine stock valuation – the planning

If potentially valuable equine stock is held at cost, the timing of the profit can be planned around the sale. However, if a disaster awaits in the form of a valuation fall, the loss can be realised as soon as possible by reflecting this appropriately in the stock valuation.

HMRC tend to examine the stock values closely and it may be worth seeking a written independent valuation in some cases.

Equine stock valuation – sports horses

Artificial insemination (AI) or embryo transfer are prohibited by the rules of racing, although used routinely in other areas of equine sport. Through AI, stallions can compete at the same time as being used at stud, although

even those used for natural covering on mares can be frequent competitors too. Good performance mares in show-jumping, eventing and polo can also continue to compete while their genetic offspring is developing in another mare by way of in vitro fertilisation.

The tax adviser must understand the category into which their equine client falls – bloodstock, sports, competition or stud etc – and ensure the ground rules for accounting and tax treatment are established. Matching of costs and forensic analysis thereof is essential with all horse trading operations. Consistent treatment of private horses through the examination of expenses and valuation of stock is also key.

Forensic understanding of equine operation

The recent tax tribunal cases of disputing the commerciality of equine businesses, *Thorne v HMRC* [2014] UK FTT 730 (TC) and *R Murray* (TC3474), have highlighted the need for equine operations to consider evidence of commerciality.

The question of evidence to present tax and ownership arguments arises frequently in the tribunals. In *Ham v Bell & Ors* [2016] EWHC 1791, the High Court considered whether farmland used in a partnership was indeed held as partnership property or by the individual partners.

The emphasis here is on forensic understanding. Equine tax advisers must ask questions and the equine businesses must provide full information as to what is happening and being produced. The same need for understanding applies to probate and private client legal advisers in exercises such as will drafting for equine clients. To do this correctly, there must be understanding as to whether the stud farm is or is not partnership property as this will impact on 100% or 50% BPR when needed.

Conclusion

Horses can be part of a vibrant client base in a variety of ways and the quantum of the sums involved can be significant. The industry has a vast number of strands, e.g. ownership, livery, breeding, studs, competition, dealing, teaching and 'happy hackers'. There is a lot of specialist knowledge required and the tax treatment is complex.

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