# Horses for courses

**Julie Butler** explores the complicated question of whether, how and why different equine businesses qualify for agricultural property relief or business property relief for inheritance tax

## Stud farming

Stud farms have the advantage over other equestrian activities in that they qualify for agricultural property relief (APR) and are not just dependent on business property relief (BPR) for inheritance tax (IHT). However, to qualify for BPR, there must be evidence of a business, which can, of course, cause problems when trying to claim the IHT relief.

The HM Revenue & Customs (HMRC) *Business Income Manual* (BIM55701) provides the following overview: "Stud farming, which in these paragraphs is taken to mean the occupation of land for the purpose of breeding thoroughbred horses, is a very expensive and high-risk activity. In some cases it may be carried on by wealthy individuals essentially as an adjunct to their racing activities. Nevertheless, for tax purposes it is treated as farming and thus – by virtue of ICTA88/S53 (1) – as the carrying on of a trade regardless of its commercial viability [...]" (www.hmrc.gov.uk/manuals/bimmanual).

The overview refers to thoroughbred (TB) horses, but what of sports horses? The principle should follow, provided there is a genuine stud activity carried on with the prospect of profit.

Horseracing, however, is not a taxable activity. When, as is often the case, a stud farmer also races horses, considerable care is needed to ensure that the division between the two activities has been made correctly.

The claim for APR will, of course, be restricted to the agricultural value of the stud farm. When reviewing APR claims, an understanding of the definition of agricultural value is vital. It is limited by the Inheritance Tax Act 1984 (IHTA 1984) section 115(3) as "the value which would be the value of the property if the property were subject to a perpetual covenant prohibiting its use otherwise than as agricultural property" (www.hmrc.gov.uk/ihta). Priority is given to APR under IHTA 1984 section 116(1) before BPR; that is, when property qualifies for both reliefs, APR is given first.

District valuers (DVs) have been known to argue for a discount of up to one third (or more) from market value in determining the agricultural value of a farmhouse. DVs tend to apply the definition from section 115(3) by assuming that the property was subject to an agricultural tie; however, this is thought to be unduly restrictive, in that the statute refers to "use", rather than to agricultural 'occupation'.

However, the market value of agricultural property might well exceed its agricultural value, and there could therefore, be a differential which would be chargeable to IHT over and above the APR claim. It is useful at this point to look at the scope of the claim for BPR as it may be that the relief could be claimed against the difference. To obtain BPR, the property must be a business, not just pure let equine property. Is there hope value?

Under IHTA 1984 section 116(1), APR takes precedence over BPR. When both of these are available in respect of a single asset, APR is given first, and BPR is given second. This can often happen in the case of a stud farm left in the estate of a deceased person. If the relevant conditions are fulfilled, APR will remove from charge the value of the land as valued for agricultural purposes, and the balance could form a claim for BPR, provided the relevant conditions are satisfied. It is therefore essential to see how and when BPR can be claimed against part of the stud that does not qualify for APR. The essential ingredient for a claim for BPR is that there must be a business.

## Horse livery

Is the horse livery activity a business, or is it a business excluded from relief as consisting mainly of making or holding investments (IHTA 1984 section 105(3))?

A recent case, *McCall and Anor (Personal Representatives of McClean Deceased) v R & C Commrs* (2008) SpC 678 7 April 2008, highlights the importance of providing services in addition to just letting out the land and buildings. The special commissioners did not accept that the grass letting provided was "akin to hotel accommodation for cattle".

Trading status will usually apply to a livery where an element of care is provided by the stable owner, such as feeding, 'mucking out', putting out to graze, or arranging for veterinary and farriery services. However, this may not be so sustainable when the stables are merely rented out as rental income for do-it-yourself (DIY) livery, with the horse owner having exclusive use of the stable. There may be a mixture of DIY and non-DIY activities, with trading status being secured on the basis that both activities will usually also involve a supply of feed to the stable owner (by the fact that the horse will be put out to graze in any event). It will, therefore, be necessary to consider each case on its own facts. BPR should be available, provided that the stable rent is not the main activity. The businesses of riding schools and horse trekking will be assessable as trading income and, therefore, should be eligible for BPR.

Livery yards obtained a potential boost when VAT charged

to clients with minimum service (*Business Brief*, 21/2001) was deemed to be an exempt supply. However, such advantage comes with the downside of the 'exempt' supply – not being able to claim back input VAT and the possible complexities of partial exemption. 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. 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. When a horse is sent to a yard that has the specific purpose of breaking in or schooling horses, rather than as somewhere to keep the horse, then the supply will be standard-rated. Provision of grazing is zero-rated (as food) – if there is a significant degree of care, then VAT is standard-rated. Horse liveries are not farming, and business should be separate from farming in the accounts and tax computation. The advantage of the complete horse livery service (as opposed to DIY) is that it is a business for tax purposes, and full BPR should be achieved. It will be difficult to argue that BPR applies to business assets that are subject to exempt VAT registration.

Full livery is when the livery provider is responsible for the complete care of the horse. The owner will come and go, and the livery provider should act in accordance with the owner's wishes but will be wholly responsible for the full care of the horse. Full livery is a trade, which will hopefully have the advantage of BPR. However, the provision of DIY livery is not always a trade.

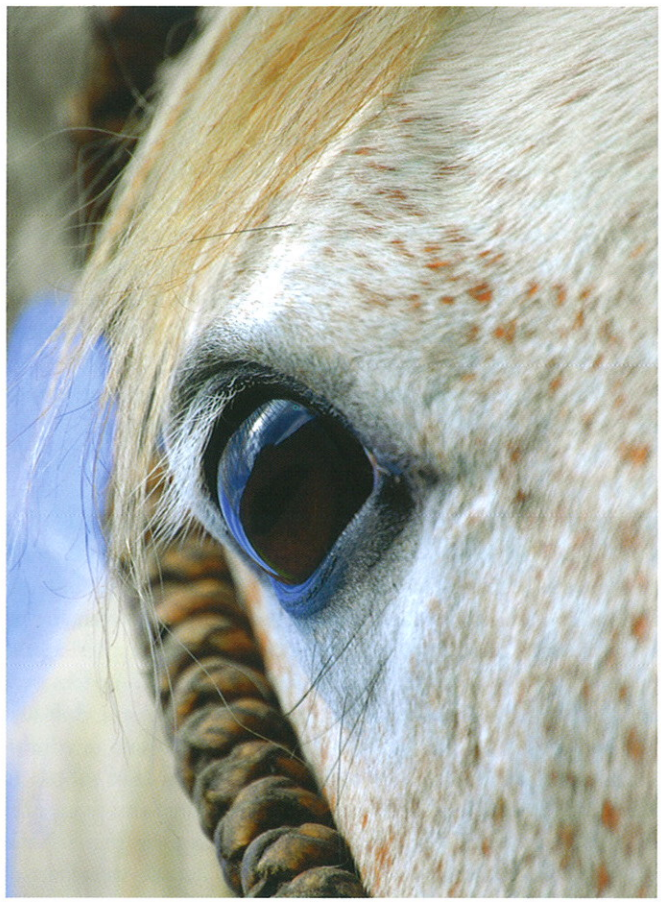
Finding out that their DIY livery operation is not trading income can be a shock for many landowners and farmers. It can also be a shock if it helps disallow BPR. The VAT complexities on the supply of land are a clear example of how all tax planning surrounding farms and lands has to be comprehensive and examined in the round. Short-term VAT advantages should not be taken to the detriment of IHT planning.

## Polo

The sport of polo has recently been brought into the equine tax limelight through a VAT tribunal case (see below). The letting of sports facilities and sporting rights is normally standard-rated. An example of sporting rights is the right to take game, which is standard-rated. However, there are debates over the element of land supplied with the facility and the split between exempt and 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). It is more difficult to claim BPR when there is an exempt supply.

Within the definition of sports facilities, HMRC includes swimming pools, tennis courts and croquet lawns, and areas of land that have been specifically designed or adapted for sporting activities. However, if the sporting facilities are let for non-sporting purposes – such as a swimming pool being let for a fashion shoot – then the exemption will apply.

Allowing access to recreational and sports activities is usually standard-rated, but there is a provision that exempts the supply in respect of a series of lettings, subject to tight criteria. One of these conditions is that each particular letting must not be less than one day apart. Clearly, where VAT leads, so does business



status and, therefore, BPR. As mentioned earlier, if the underlying activity on the equine property is an exempt supply, then there is every chance that BPR will be jeopardised.

A recent VAT tribunal case, *Polo Farm Sports Club* VTD20105, highlighted the fact that the whole area of VAT, the supply of land, the supply of sports facilities and horse liveries could benefit from clarification by HMRC. This could also have an impact on contemporaneous information to support a BPR claim.

It suited the Polo Farm Sports Club to make standard-rated supplies. It had not opted to tax the land in question. A dispute therefore, arose with HMRC, which said the club was making a series of lettings which should, therefore, be exempt. In this case, the lettings took place daily for several hours each day, and there was never a whole day between each letting. HMRC argued that this was, nonetheless, sufficient to fulfill the exemption criteria, since there was still 'a day' between each letting. However, the tribunal preferred the appellant's view that there had to be at least a clear day – a 24-hour period – for the rule to apply. The polo club won this case and achieved their standard-rated supply; this should also enhance the BPR claim on the polo property, but a lot will depend on the activity surrounding the letting.

## BPR – outbuildings

In practice, stud outbuildings often have a high probate value and therefore, a high potential IHT liability. Often, scope exists for planning permission and some form of development of the buildings when BPR will be needed as well as APR. >>

<< The *Arnander* case *(C J Farnander, D T M Lloyd and M M Villiers Executors of David McKenna deceased v HMRC* [2006] SpC 565) also placed focus on the outbuildings. For the appellants, Mr Massey argued that all the outbuildings were occupied for the purposes of agriculture, as they were used, or kept ready for use, predominantly for the purposes of the storage of farm machinery and utilities. His argument was that they were not used for any non-agricultural purposes.

In looking at any future APR or BPR claim on the equine property, the use of the outbuildings will be important.

## BPR – additional services or facilities

One case, *IRC v George (Executors of Stedman)* [2003] EWCA Civ 1763, [2004] STC 147, went to the Court of Appeal and is now the authority by which other cases might be read. In common with many other cases, *George* concerned a caravan site on which several activities were conducted, including: a residential park of caravans owned by their residents on which site fees were paid and profits made from the supply of utilities; a club and bar open to all; storage facilities for touring caravans; an administration office; let property; agricultural grazing land subject to licences; commissions from an insurance agency and from sales of caravans. It had been a feature of previous cases that services provided in connection with any lease or licence were part of letting and hence an investment activity. It was an important finding of the Court of Appeal in *George* that the characterisation of additional services or facilities depended upon the nature and purpose of the activity. The equine business must show service to help the BPR claim, and a lot of the utilities provided in *George* are similar to those in a riding school.

## BPR – integrated farming and equine business

The case of *Farmer (Farmer's Executors) v IRC* [1999] STC (SCD) 321 is worth examination in cases of integrated farming and equine business; the case is considered very helpful to the diversifying stud owner. It highlights sections of the Taxes Act and other cases that are relevant to the important interpretation of IHTA 1984 section 110, the net value of the business.

The judgments in *Farmer* and *George* have important implications for the majority of family equine businesses. Both judgments emphasise that it is possible to secure valuable BPR on let property.

There is no doubt that letting out property is currently one of the most efficient uses of assets available to the landowner and farmer. However, as with all areas of diversification, the tax efficiency and implications must be fully considered. The short-term income advantages must not be taken without fully protecting the IHT audit.

## BPR – the riding school

Riding schools generally offer a wide range of equine-related activities and training, including lessons at all levels, holiday accommodation, trekking and hacking, show jumping tuition, and dressage. They may also offer ancillary facilities such as an all-weather or indoor sand school; full, part or DIY livery; holiday accommodation; and tack and equine supplies. Reference has already been made to the case of *George*. Some riding schools are small-scale and offer only basic facilities, while, at the other extreme, others may have a whole team of British Horse Society-qualified instructors and quality horses or ponies. Once the VAT registration limit has been exceeded however, the VAT registered business will often have to charge VAT inclusive prices roughly equal to its non-registered competitors. This means that margins are often reduced, with the effect that larger organisations often have a lower gross profit than smaller ones. Apart from the relatively few cases where a customer is VAT registered and can recover the extra, prices have to remain competitive.

## BPR – horse tourism, trekking and riding holidays

This activity is not farming, nor is it agriculture, but it is a useful diversification activity for farming. The equestrian industry is now a major economic factor in many rural areas. No comprehensive survey of the sector is undertaken, so reliable statistics are not easy to find. Thus, there are many opportunities to offer equine recreational facilities – both to those who do not own a horse of their own and to those who can provide their own mount.

The range of establishments offering riding holidays is large. Details are available from the British Horse Society (www.bhs.org.uk). This can be an additional attraction of the furnished holiday let market and a diversification activity.

Many farms offering bed and breakfast or cottage accommodation also have suitable buildings to accommodate owner's horses. In locations with good riding facilities, this can be a strong selling point, and higher charges can be made. Customers expect certain minimum standards in any horse accommodation (see Bridle Riders Ltd at www.bridlerides.co.uk). As a comparison to *McClean*, they do provide 'hotel accommodation' for the horses!

## Summary

Equine IHT planning is complex. No one equine property, or the involvement of the proprietor or proprietors, is the same. The definition of, and difference between, providing DIY liveries and providing 'hotel accommodation' for the horse is complex, and the VAT legislation does not help in providing a guide to the difference between a trade and the supply of a space to keep a horse. Has the recent case of *McClean* given guidance? What this case has shown is that when the equine business involves letting, it is imperative to look to the degree of service provided.

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