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Practical VAT Newsletter

More Complications on Equine and Rural VAT

Julie Butler considers the rising complexity of VAT in equine and rural affairs.

It is fair to say that rural VAT is complicated and equine VAT even more so! A number of recent rulings have helped to make the whole situation even more of a nightmare to understand. All diversifying farmers are having to try to cope with a 'melting pot' of zero, exempt and standard supplies with some very grey areas of understanding now existing. Partial exemption is a problem that also needs to be fully considered by rural businesses and their advisers.

VAT and riding lessons

Riding lessons are generally provided to private customers. The 'golden glow' of the Olympics has increased the interest in horse riding and demand for riding lessons is now growing. In order to be competitive it is generally beneficial for the providers of the lessons to not have to charge VAT on the services they provide. There are ways of classifying riding lessons as an exempt supply and therefore making them more commercial and attractive to the private market. Such a direction does of course lead to the concern that the riding school will become partially exempt for VAT purposes.

How do riding lessons qualify as an exempt supply?

The provision of tuition in a subject ordinarily taught in a school or university by a person acting independently of an employer is an exempt supply for VAT purposes, under VATA 1994, Sch 9, Group 6, Item 2. Whether riding is a subject ordinarily taught in a school will turn not on whether it leads to a qualification. Indeed, riding is deemed by HMRC to be such a subject taught in schools and therefore can qualify as an exempt supply.

HMRC set out their views on the matter in the *VAT Manual* at VATEDU40200: the subject (learning to ride) needs to be 'taught in a number of schools on a regular basis' and the nature of the lessons needs to 'be of a similar nature and level'. The guidance explicitly observes that 'instruction and coaching in sport and recreational activities qualify as exempt private tuition, provided that the supply meets all the other necessary conditions'. Therefore riding lessons provided by a sole trader will qualify as VAT exempt. However, the supply will be standard-rated if it is carried on through a company due to the breach of the 'acting independently of an employer' condition.

As a result of the above VAT ruling on the provision of lessons, many riding establishments choose to trade through sole trades and partnerships and not a limited company. There are many riding schools and providers of teaching

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All cases and tribunals are commented on by Peter Hughes, chartered accountant and self-employed VAT consultant and speaker at VAT training courses (tel 01904 421570).

who worry about the lack of limited liability and so form LLPs as the 'trading vehicle' under which they conduct their businesses. Many riding schools have been advised by aggressive VAT consultants to form LLPs and take on their staff as LLP members in order to be able to ensure that the riding lessons qualify as an exempt supply.

Change to LLP for many riding schools

When LLPs were introduced the legislation provided that if someone was a member of a LLP they were automatically treated as self-employed, irrespective of the relationship with the LLP. This has led to situations where the classes of LLP member have been extended to include people who in practice are no more than employees but are able to take advantage of their self-employed status in order to enjoy other tax and NIC savings. This has been a great advantage to the riding school, and in qualifying for a VAT exemption.

Mixed partnership consultation

The 2013 Budget announced that the government would be looking at partnerships very closely.

The mixed partnership consultation document issued in May 2013 addresses the concerns of HMRC regarding abuse. The consultation proposes removing the automatic presumption of self-employment for LLP members.

- An individual member of a LLP will be treated as an employee (salaried member) if, on the assumption that the LLP is carried on as a partnership, he would be regarded as an employee of that partnership.
- If an individual member of a LLP is not treated as a salaried member, under the above test, he will be treated as one where:
  - the individual has no economic risk (loss of capital or repayment in drawings) in the event that the LLP makes a loss or is wound up;
  - the individual is not entitled to a share of the profits (other than a fixed share); and
  - the individual is not entitled to a share of any surplus assets on a winding up.

Riding school VAT caught in 'the bigger picture' of partnership review

At present the proposed partnership consultation changes which followed the 2013 Budget would appear to HMRC to be an attempt by businesses to avoid paying employment taxes (rather than VAT). Under the new proposals due for actioning in April 2014, they would class LLP members as employees and then tax them accordingly. Such an action would therefore mean any lessons given by the 'employees' (now not treated as LLP members regardless of the legal constitution in place) would be VATable, because they are no longer part of the proprietor 'umbrella'. The consultation ran until 9 August 2013 and is now closed, and HMRC are assessing the feedback.

If the changes go ahead from 6 April 2014 there will be a major impact on riding schools that have set up the LLPs in this way, i.e. with staff as LLP members giving lessons. A way forward could be for the employees of the riding school to invest some capital into the business or to take some aspect of the profits or losses as part of their remuneration package, demonstrating that they are full members of the LLP and thus proving they are proprietors rather than merely employees.

However, in reality, how many riding school employees would want to put capital into the business or take a share in the profit or loss? Where would the capital come from and would the employees want to put themselves at risk in this way? The whole VAT position of the riding school must be considered. The 'proprietor' riding lessons will still be an exempt supply and the riding lessons given by employees (who are not members of the LLP) will be standard-rated. The riding school will probably also provide hire of the school (standard rate) and liveries, which can be a mix of supplies.

VAT and liveries

A further complication of equine VAT is that of liveries, which are exceptionally complicated, especially as most farmers take in some liveries.

Guidance is given in VAT Notice 701/15 and VFOOD3140. In fundamental terms:

- Grazing as the main supply is zero-rated .
- Stabling as the main supply is exempt.
- Special purpose as the main supply is standard-rated.

This can also be more complicated when the services 'overcome' the principal supply of the grazing and stablings, as the supply then becomes standard-rated as the principal element is service.

Matters are complicated further by the fact that if the supply is exempt this will lead to partial exemption for the farmer providing the service.

Antiques Within Ltd

A recent First-tier Tribunal decision in *Antiques Within Ltd* (TC2507) could cause concern for horse liveries and the treatment of VAT, as if the matter wasn't complicated enough already!

As explained, horse liveries are a very complicated area and HMRC guidance looks to the principal supply following the *John Window* tribunal decision. Within the industry of horse liveries there can be standard-rated, zero-rated and exempt supplies for VAT purposes. It is therefore a question of what is the principal supply. Where the stable (which is the right over land) is the dominant supply, this is deemed to be exempt from VAT. Where the grazing, which is the supply of grass, is the dominant supply then it is zero-rated for VAT purposes. Where services dominate over the grass and stable supply, i.e. special service yards or full livery where it is the services which are the most dominant, then supply of livery can be standard-rated.

It is worth noting at this point in the article that it is generally considered by the author that most horse liveries are, in

actual fact, incorrectly treated in practice as there is much misunderstanding about what the correct treatment of liveries should be. There is a generic view amongst those in the farming and equine industry that there does not have to be any VAT charged, ie it is either zero or exempt without a full understanding of what is the principal supply. It might be argued, therefore, how does the decision by the tribunal in *Antiques Within Ltd* impact upon the interpretation of VFOOD3140? Many livery service providers often 'hive off' that part of business into a separate legal entity to avoid the VAT problems and to keep below the VAT registration limit. Such actions can be deemed to be artificial separation.

The facts of the Antiques Within Ltd case

Antiques Within Ltd rented out about 70% of the floor space in its shop to six or seven other antiques dealers. The fee of £50 to £100 a week charged to each dealer was deemed by the company to be 'rent of land'. As the company had not opted to tax the shop in question, the income was treated by Antiques Within Ltd as exempt from VAT. When the tenants were absent from the shop the landlord also tried to sell some of the tenants' stock when customers came into the premises. HMRC therefore deemed the fees charged to the tenants to be wholly standard-rated as relevant to a selling service. However, Antiques Within Ltd considered the supply to be wholly exempt as rent, claiming that the selling service was incidental to the land and should be ignored. The rent was deemed to be the principal supply by Antiques Within Ltd.

Composite supply

However, in the Antiques Within Ltd case HMRC argued against this view that the supply was fully standard-rated as being more than a bare land supply, and to go beyond the parameters of the exempt supply. The taxpayer took the view that the principal supply was the right to erect a stall, which was a bare land supply, which in the circumstances was exempt, and any additional value from the selling operation merely enhanced that benefit, so there was single exempt supply. Both HMRC and the taxpayer therefore advocated the 'composite supply' analysis but from opposite directions – one argued exempt and one argued standard supply.

Multiple supply

The tribunal was unhappy with both of the arguments presented. It said that the supply of the stalls with some service was a multiple supply, comprising a right over land (exempt) and a sales handling service (taxable) and therefore standard-rated. The tribunal thought that neither activity was more important than the other, and there must be two supplies, but left it to the parties to determine the nature of the split. Can there be seen a parallel to the livery situation? Will some of the supplies be taxable and some exempt?

The decision might prove to be difficult for HMRC on the basis of all of the cases it has gone through to establish that, for example, hair salon chair rentals are taxable as being part of a wider scheme of services (which it had to confirm by specific legislation in 2012). The decision also appears to conflict to an extent with the message conveyed in HMRC Brief 22/12 to the effect that the hiring of areas to erect stalls at exhibitions could only be a land supply if absolutely no other services were provided, and would otherwise be an advertising supply. In the circumstances it is anticipated that HMRC will appeal the decision. This also has a link to the livery situation and the amount of service given by the proprietor to individual horses and their owners.

Therefore the tribunal's decision in Antiques Within Ltd may cause even more confusion for all diversifying farmers and landowners who supply land and property mixed with some degree of service. The key action point is to fully review the nature of the supplies made. This increases confusion around horse livery, the importance of the composite supply and the fact that land and services are being supplied together.

Multiple supply and horse liveries

The problem is that horse liveries are invariably a multiple supply comprising of a right over land and a degree of service, i.e. exempt and taxable. Likewise, a grass livery can be a multiple supply which is made up of the supply of grass (zero) and supply of services. What impact will Antiques Within Ltd have on the VAT status of liveries? It is assumed where there is still a principal supply in a composite supply situation, the principal supply will still dominate. In Antiques Within Ltd the Tribunal thought that neither activity was more important than the other and therefore there were two supplies with the proportion having to be agreed.

Practical tip and horse liveries

The Antiques Within Ltd case is therefore a timely reminder for the VAT status on all horse livery situations to be reviewed so as to ensure the correct treatment is being applied in all trading situations. It is essential to ascertain what is the principal supply – the stable, the grass or the services? As if horse liveries aren't complicated enough with the potential for zero, standard and exempt supply all within the same business, there is now more confusion following the decision in Antiques Within Ltd. However, what a good opportunity to use this as a reminder – review all livery income to ensure the correct treatment for VAT. There is a lot of confusion in the equine industry regarding VAT, and the riding school partnership and lessons will be another complexity.

DIY VAT claim on dwellings with restricted use

Here is another example of where the rural world must understand the VAT scheme. Guidance on VAT refunds on self-build new homes on non-residential conversions has been given in VAT431C.

The DIY Housebuilders Scheme

VAT reclaim is one of the most lucrative schemes for private individuals because normally only businesses can reclaim VAT. The First-tier Tribunal's decision in *Jones v Revenue & Customs Commissioners* [2012] UKFTT 503 confirms that VAT can be reclaimed under the DIY Housebuilders Scheme ('the Scheme'). Stroud District Council had imposed restrictions under section 106 of the Town and Country Planning Act 1990 on a barn conversion and office. The Tribunal ruled that while the office was restricted, the barn conversion was not and VAT on this element could be reclaimed.

The case highlights the importance of understanding planning applications and permission as they relate to VAT.

The DIY scheme for new houses was further tested in the First-tier Tribunal.

The facts are as follow.

The taxpayer was a director of a retirement park containing static caravans for older people. He obtained planning permission to knock down and rebuild a bungalow on the site. Instead of doing this, he bought the adjacent paddock and received planning permission to build a new house there. Permission was given subject to the condition that occupation of the property was limited to a person who worked or had worked at the retirement park.

The taxpayer applied to HMRC for repayment of VAT incurred on the building under the DIY scheme. HMRC refused the claim because of the restricted use clause, which did not satisfy VATA 1994, Sch 8, Group 5, Note 2(c). The taxpayer appealed saying they wanted to claim back the input VAT via the DIY scheme. The tribunal agreed that the clause meant the property failed one of the tests for the DIY scheme to apply. The wording of the permission at the time of the build was relevant, regardless of the fact that the taxpayer had now applied to have the condition removed. The taxpayer's appeal was dismissed by the Tribunal.

The point to learn is that the conditions of a 'dwelling' specified in the legislation must all be met for a building to qualify as such and be eligible for a DIY claim. Farmers, developers and their advisers should consider the conditions for a successful DIY VAT claim at the beginning of a project rather than when the building has been completed. If the condition were to have been removed then the claim for VAT could have been used.

Practical VAT considerations

The key point is to review all rural VAT charges. There is much misunderstanding, as this article has shown. All rural businesses should undertake a 'VAT audit'. It is also essential to keep on top of all VAT changes and guidance in the world of farming and diversification. All forms of farm diversification (alternative land use) have a mixed supply of land and services and should be reviewed. **TPV**

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