

Put Out To Stud

The tax benefits of stud farms and racing are explored by JULIE BUTLER FCA.

MANY ATTRACTIVE TAX reliefs are associated with both stud farms and racing. The five-year hobby farming rules are, for example, extended to eleven, but most importantly perhaps, racing is not a taxable activity. The downside is that losses from racing are not tax allowable, no doubt because the Revenue believes that generally the costs of racing far outweigh the profits and it cannot risk the tax repayments that would result.

The recent launch of the 'attheraces' television channel on BSkyB together with the swift withdrawal of the Racing Channel, means that subscription racing has become more accessible to the general public. The farming crisis is in full swing, and one alternative land use is to invest in a stud farm and realise the eternal dream of owning a racehorse.

Easy loss claims?

The general practitioner must advise the client contemplating entering this business, but how easy is it, for instance, to claim a loss?

It is worth quoting the *Inspector's Manual* at paragraph IM2350g:

'Following discussions with the Thoroughbred Breeders' Association in 1982, Policy Division wrote to the association as follows:

"It has always been recognised that some ventures are by their nature unlikely to show a profit by the sixth year of trading and section 397(3) provides for loss relief to be continued after the fifth year where the claimant is engaged in a particular farming activity of an intrinsically long term profitmaking nature. We have long accepted that the breeding of thoroughbred horses is such a long term venture, and provided that a stud farming business is potentially profit making, we would not normally seek to invoke section 397(1) until after 11 years from the start of the business."

'The Thoroughbred Breeders' Association has circulated this text to its members.

'It does not mean, however, that all stud farming losses are relievable against other income up to eleven years from commencement. The requirement that the business should be potentially profitable, in other words, the question of whether section 397(3)(a) is satisfied, is important and should be checked in relevant cases. Nor should the letter be interpreted as meaning that the five-year period is extended where a run of losses arises in periods after a year in which a profit has been made, or where a business

is taken over as a going concern. Such cases should be dealt with individually on their merits.

'Where the enterprise is clearly not being carried on on a commercial basis and with a view to the realisation of profits, a Revenue challenge under section 384 should be anticipated.'

Revenue view

The *Inspector's Manual* at paragraph IM2350b sets out the overview as follows:

'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 section 53(1), Taxes Act 1988, as the carrying on of a trade regardless of its commercial viability.

'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.'

Accounting niceties

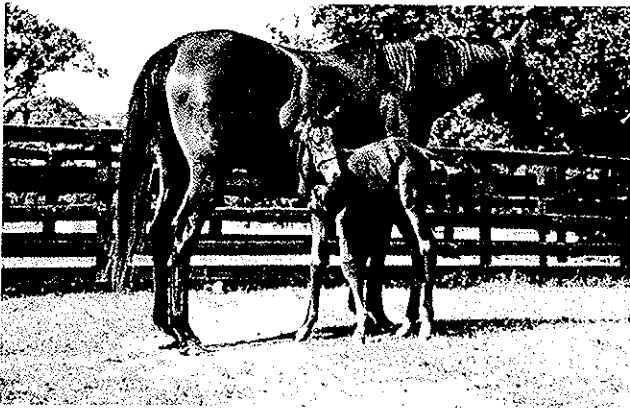
It is important to recognise the difference between racing and stud farms. The racing adjustment is fairly complex from the angle of accounting and tax treatment.

If the occupier of a stud farm races animals bred by him:

- The stud farm accounts should be credited when animals are transferred to training with the then market value of the transferred animals, as if they had been sold at that value (*Sharkey v Wernher* 36 TC 275).
- When animals return to the stud farm after racing, the stud farm accounts should be debited with their market value, at the time of return, as if they had been purchased at that value.
- If an animal purchased and not bred on the stud farm is brought into the stud after racing by the occupier, the stud farm accounts should similarly be debited with the then market value of the animal, as if it had then been purchased at that value.

The same treatment should be applied to a person who is assessable under Schedule D on the profits of dealing in thoroughbred animals by him, but on a stud farm occupied by some other person.

If a breeder transfers an animal to training and it is then returned to stud at a higher value after a successful racing career, then the uplift in the market value while it was in



training is tax free. Furthermore the value at which the animal is returned to stud is relieved over the rest of its life. The valuations of animals at the dates of transfer to or from training are, therefore, significant.

A form of income can be the stallion syndicates, and the tax position on the sale of the share in a stallion together with the sales of nominations must be considered.

Syndicates

The Revenue's *Inspector's Manual* at paragraph IM2350h states:

'Since the cost of buying a successful stallion outright is prohibitive for some bloodstock breeders, ownership may be shared in a syndicate. The usual form of syndication is into forty equal shares, representing the number of mares which, traditionally, was regarded as the standard for a stallion to cover in one season. Each syndicate member contributes towards the costs of keeping the stallion and is entitled to one "nomination" each season per share owned. The member may use the nomination to cover one of his own mares, or it may be sold on the open market. The shareholders appoint a committee which deals with the day to day management of the stallion.'

It goes on to say that where the occupier of a stud farm owns a share in a stallion for the purpose of obtaining service for his own mares, the tax treatment will depend on whether he has made an election for the herd basis.

The proceeds of any sales of nominations are treated as trading receipts. Any contribution by the stud farmer towards syndicate expenses will be an allowable trading expense. However, in the following situations the sales of nomination are assessable under Schedule D, Case VI:

- the owner of the stallion share is not carrying on a trade of stud farming or horse breeding;
- the owner is carrying on such a trade but does not use the stallion share for the purpose of obtaining service for his own mares.

Worth the passion

There is no doubt that some taxpayers are as passionate about horse racing as they are about paying as little tax as possible. Stud farming (possibly tied to a racing connection) could have significant capital gains tax and inheritance tax benefits as well. Provided the stud farmer can prove potential profit, and the conditions for business property relief and business asset taper relief, the whole area of stud farming becomes more and more tax attractive.

Furthermore, with the effective ten per cent capital gains tax rate from 6 April 2002, what better trade could be enjoyed on land that might have development value than a stud farm? A stud farm could be the way to secure the business reliefs without the aggravation of contract farming, provided all the assets have business status. Potential property developers could combine the passions of development profit, saving tax and stud farming all at the same time.

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The vigilant Tax Inspector should not be underestimated. However, there is scope to take advantage of the tax reliefs, if the project is well researched, documented and commercial.

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Where Was It?

A table of the latest dates of publication in *Taxation* of the following information items:

Investments of Negligible Value

25 Apr 2002, page 86; 17 Jan 2002, page 353; 25 Oct 2001, page 84; 2 July 2001, page 365; 12 Apr 2001, page 34; 18 Jan 2001, page 358; 19 Oct 2000, page 58; 13 Jul 2000, page 385; 20 Apr 2000, page 61; 20 Jan 2000, page 324; 14 Oct 1999, page 29; 18 Feb 1999, page 484; 12 Nov 1998, page 159; 16 Jul 1998, page 416; 7 May 1998, page 141.

London barristers who specialise in taxation
23 May 2002, page 218.

Interest on tax: ready reckoner
1 April 1999, page 6.

Useful addresses: Revenue clearances
17 May 2001, page 154.

Retail prices index table
9 December 1999, page 225.

Useful addresses: Revenue, Customs and Tribunals
16 November 2000, page 172.

Social Security Benefits 2002-03
24 January 2002, page 379.

Latest Index to Taxation
Index to Volume 147, 24 January 2002 at centre pages.

Index to Meeting Points in Taxation
Year 2000: 7 December 2000, page 274; Year 2001: 28 March 2002, page 633.