

When does a tax exemption become 'state aid'?

by Julie Butler

Stallion fees (nomination income) received from stallions standing in Ireland (kept on land in the state) are currently 'tax free' in Ireland. Until 1 January 2004 this income did not even have to be declared on the Irish tax return.

However, this stallion fee income stream does have to be declared on the UK tax return unless there is a 'bridge' between the UK owner and the stream, eg, Irish trusts and companies that reinvest the profits from stallions into other Irish assets.

The Irish bloodstock industry employs about 20,000 people and was worth €180 million in exports last year; it has been 'tax free' for the past 35 years.

The question of tax exemption on stallion fees and whether it amounts to state aid is now being investigated by the European Commission following complaints by Britain and Italy.

What is the definition of 'state aid'?

State aid has been regulated since the Treaty of Rome was first signed in the late 1950s, but only applied to Ireland (and the UK) when they joined the European Economic Community in 1973.

The current rules define state aid as:

- (i) any aid granted by an EU member state or through member state resources that;
- (ii) distorts or threatens to distort competition by favouring certain businesses; and,
- (iii) affects trade between EU member states.

A tax exemption is clearly within the definition of (i), an 'aid'. Application of the second and third criteria is more complex to define.

In relation to (ii), all Irish stallion-owners benefit from the same exemption, so competition between them is not distorted. However, the rules are applied so that 'aid' that alters the structure of an industry throughout a single member state can be deemed to distort competition within the confines of the EU. This interpretation also implies that (iii) is satisfied. In practice, the key issue is: should the advantage that the tax exemption gives Irish stallion-owners over their rivals in the EU be deemed to be state aid?

What is the difference between 'existing aid' and aid granted after a state joins the EU?

The state aid rules do treat 'existing aid' differently from aid granted after a member state signs up. The difference is that 'new aid' is illegal until the European Commission approves it, whereas existing aid is presumed lawful unless the Commission challenges it, eg, the tax exemption for Irish stallion fee income.

Once under investigation, state aid can only be permitted in accordance with strict criteria. The most obvious criteria potentially applicable in the case of stallion fees would be aid to promote certain economic activities, or aid to promote culture and heritage conservation.

Questions have been raised as to whether Irish stallion-owners are more worthy of government subsidy than, for example, the Irish high-tech multinationals that have transformed the Irish economy.

How far has the Commission's review progressed?

In February last year the Commission produced its 'preliminary finding', which stated that the stallion fee tax exemption is a state aid that should not be permitted. However, since then, the Irish finance minister, Brian Cowen, and the agricultural minister, Mary Coughlan, met EC agriculture minister Marianne Fischer Boel in Brussels on 12 May 2005 to discuss the problem. Initial reports say that the European Commission has agreed to work with the Irish government to find a way to maintain support for the horse-breeding industry, but in a way that does not break state aid rules.

It will be very interesting to see what the outcome of this is. One of the strong arguments that Mr Cowen put forward is that business could be lost to the US, Japan and Australia, something the European Commission would not want to encourage.

What is the position on dual hemisphere or shuttle stallions?

In the past the Irish Revenue has accepted that the nomination income from a stallion that is ordinarily kept on land in Ireland and is temporarily exported for genuine commercial reasons, and for a period that will not exceed two years, will be regarded as exempt from tax in 'Ireland'. It is accepted that dual hemisphere or shuttle stallions come within this description.

With effect from 1 October 1998, only profits derived from the service of mares within Ireland by dual hemisphere or shuttle stallions are regarded as exempt from tax in accordance with TCA 1997, s. 231. The profits arising from the servicing of mares outside Ireland by these stallions are

not regarded as exempt from tax under that section of the act. Such profits should be included in the return of income of the person entitled to them. This is key when looking at reasons put forward above for saying that business would be lost to countries outside the EU.

What is the UK tax position on the stallion nomination fee income?

Stallion fees are taxable in the UK under Sch. D case VI [Benson v Counsel (Inspector of Taxes) 1942 24 TC 178], in the pre-ITEPA 2005 terminology. This nomination income (Business Income Manual BIM55700) must be included on the tax return even if the costs of racehorse ownership far exceed the nominations.

BIM55730: *Farming; Stud Farms; Stallion Syndicates*, 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.'

In the UK 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 ICTA 1988 (as was), Sch. D, Case VI:

- the owner of the stallion share is not carrying on a trade of stud farming or horse breeding; and
- 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.

What has been said about the impact of Irish stallion fees?

Agriculture Commissioner Franz Fischler told British MEPs that the Commission had concerns about the compatibility of the exemption with state aid rules and was investigating it. Labour MEP Proinsias De Rossa, who highlighted the case and whose party has continually criticised the exemption, said: 'If the EU does rule the exemptions are an illegal state aid, then under EU competition rules the stud farms might be liable for up to 10 years' back tax with interest.'

So can the ruling of state aid be retrospective? It is generally considered that this will not be the case, particularly following the meeting on 12 May; but watch this space.

New state aid

What is an example of 'new aid' being introduced via the tax legislation and being deemed 'illegal' until approved by the European Commission?

The obvious example here is 'business premises renovation allowance', eg., following consultation launched in the 2004 pre-Budget report, the government will legislate for the introduction of the business premises renovation allowance. This will provide 100% capital allowances in Enterprise Areas for the costs of renovating business properties that have been vacant for at least a year. The scheme will be brought into effect subject to approval that it does not constitute state aid.

Positive action

As a result of the racing-is-tax-free image, many owners fail to tell their advisers about all their interests. Some UK taxpayers have Irish stallion shares and ignore them because of that 'tax-free' image. These events act as a reminder that the position is rather more complex than that. In addition, they may eventually shed some light on the extent to which targeted tax exemptions can be seen as state aid.

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