

Will the equestrian property qualify for Inheritance Tax Relief?

Can a “lifestyle” dream of owning an equestrian property be tax efficient during life and escape “death duties” on death?

As part of Inheritance Tax (IHT) planning and compliance, the question has to be asked as to whether the equine property will qualify for Agricultural Property Relief (APR) and/or Business Property Relief (BPR). This is a question often asked by “High Net Worth” individuals seeking to invest in a fully functioning equestrian establishment.

Relevant Inheritance Tax reliefs

APR and BPR usually both give 100% relief, effectively full exemption from inheritance tax for qualifying assets.

But although similar, the two reliefs have different rules. Some of these are minor, but there are two very important differences that can affect the approach to tax planning.

Agricultural value v hope value

The disadvantage with APR is that it only exempts the “agricultural value” of the land.

When reviewing APR claims, an understanding of the definition of agricultural value is therefore vital. Agricultural value is limited by Inheritance Tax Act 1984 (IHTA 1984) s115(3) to:

‘The value which would be the value of the property if the property was subject to a perpetual covenant prohibiting its use otherwise than as agricultural property.’

The important point that any tax planner investor should worry about is the fact that the market value of agricultural property might well exceed its agricultural value and there could, therefore, be a differential which would be chargeable to inheritance tax over and above the APR claim.

This unrelieved value will generally arise

from possible future use for other purposes, and so is commonly known as “hope value”. If there is a high chance of obtaining planning permission for development, this could mean that the majority of the land value fails to qualify for APR.

BPR does not have this restriction. It is therefore 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. In order to obtain BPR the property must be a business not just pure let equine property.

Priority is given to APR under IHTA 1984 s116(1) before BPR, i.e. when property qualifies for both reliefs, APR is given first.

The farmhouse

APR has a huge advantage, that the inheritance tax relief can be extended to include the farmhouse, where you live, as well as the land that is actually used for agricultural activities. BPR will not do this; at best you might be able to claim relief on a small part of the value of the farmhouse if it is used as the farm office.

Despite the recent fall in the property market, for a small farm the farmhouse can still easily be more valuable than the surrounding land, so for many high net worth individuals this part of the relief will be the most important.

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 on a working farm. DVs tend to apply the s 115(3) definition 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’.

Clearly the best position is to qualify for both reliefs, to claim APR on the maximum

(including the farmhouse) and then claim BPR on the non-agricultural value. It is therefore important to look at the different types of commercial horse activities and see if they qualify for APR or BPR.

So what type of equine property qualifies for IHT tax relief, and which reliefs are available?

Stud Farms

Stud Farms - APR

Stud farms have the advantage over other equestrian activities in that they do qualify for APR and are not just dependent on BPR for IHT relief. You can therefore claim inheritance tax relief against the value of an “appropriate” farmhouse.

The claim for APR will of course be restricted to the agricultural value of the stud farm and not the full market value.

The stud farmhouse should qualify as a farmhouse for IHT purposes if it is of “character appropriate to the stud farm property.”

For equine activity other than stud farming it is unlikely that the farmhouse will qualify for IHT relief i.e. the use must be agricultural.

Stud farms - BPR

Best of all, as well as being able to claim APR, a stud farm should also qualify for BPR.

In order 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 Inspector’s Manual at BIM55701 sets 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 TA 1988 s 53(1) (ITA2007 s 9(1)) – as the carrying on of a trade regardless of its commercial viability.’

An important point here is that reference is made to the thoroughbred horse. But what of the sports horse? Does that achieve the same tax treatment? The principle should follow provided there is a genuine stud activity carried on with prospect of profit. The “bloodstock” stud industry has a possible tax advantage over the “sports horse” stud industry in that it perhaps possible to show future profitability more than the “sports horse”, but both can potentially qualify.

Unlike stud farming however, horseracing is not a taxable activity - it is outside the scope of tax. Where, 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 correctly made for tax purposes. It is however the love of horseracing that often leads to the purchase of the Stud Farm. Possibly just a few old broodmares and the desire to breed a few racehorses.

Claiming both reliefs

Under IHTA 1984 s116(1) APR takes precedence over BPR. In the situation where 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, 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. Simply for IHT business property relief the trade on the property must be run as a business.

The equine business must be commercial to qualify for BPR for IHT.

Horse livery

Horse livery is not farming, and so will not qualify for APR. However they may qualify for BPR. The livery business should be kept separate from farming in the accounts and tax computation.

Livery - trading status or income from lettings?

It is important to look at the different types of commercial horse activities and see if they qualify for BPR.

Is the horse livery activity a business, or is it a business excluded from relief as consisting mainly of making or holding investments? (s105(3) IHTA 1984)

BPR should be available provided that the stable rent is not the main activity.

There has been a recent case, *McCall and Anor (Personal Representatives of McClean Deceased) v R & C Commrs (2008) SpC 678 7 April 2008*, which highlights the importance of providing additional services to just letting out the land and buildings in order to qualify for BPR. The Special Commissioners did not accept that the grass letting provided was “akin to hotel accommodation for cattle” as was argued by the taxpayer.

The *McCall* case has been taken to the Court of Appeal, and although the taxpayer failed the judgement sets out the degree of service to differentiate between the letting of grazing and the business of grazing.

Trading status will usually apply to a livery where an element of care is provided by the stable owner, e.g. feeding, mucking-out, putting out to graze, arranging for veterinary and farriery services, etc. However, this may not be so sustainable where the stables are merely rented out for DIY (do-it-yourself) livery and where the horse owner has 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.

Full livery

Full livery is where 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 fully responsible for the full care of the horse.

Full livery will be a trade, and the trade 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.

VAT Advantage for liveries

Can the VAT status direct the IHT relief? An example would be livery yards.

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. Where a horse is sent to a yard that has the specific purpose of breaking in or schooling the horse, rather than as somewhere to keep the horse, then the supply 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.

Provision of grazing is zero rated (as food), but if there is a significant degree of care then VAT is standard rated.

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. In contrast, it will be difficult to argue that BPR applies to business assets that are subject to exempt VAT registration.

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 looked at in the round. Short term VAT advantages should not be taken to the detriment of IHT planning.

Polo and sporting facilities

The sport of polo has recently been brought into the equine tax limelight through a VAT tribunal case (see below).

A general Polo business with say grazing for polo ponies, livery, schooling etc should count as a business and therefore qualify for BPR.

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 where there is an exempt supply for VAT purposes.

The letting of sports facilities

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.

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 is charged there is generally a business, and so BPR should be available. 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.

However, if the sporting facilities are let for non-sporting purposes then the VAT exemption will apply. An example of this will be the letting of a swimming pool for a fashion shoot.

Polo - VAT Tribunal

A recent VAT tribunal case, *Polo Farm Sports Club* VTD20105, has 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 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 were daily for several hours each day and there was never a whole day between each letting. HMRC argued that this was nonetheless sufficient to fulfil the exemption criteria, since there was still 'a day' between each letting. But the tribunal preferred the appellant's view which was that there had to be at least a clear day, or 24 hour period, in order 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.

The equine outbuildings

Do the equine outbuildings qualify for APR?

In practice the stud outbuildings often have a high probate value and therefore a high potential IHT liability. There is often scope for planning permission and some form of development of the buildings,

when BPR will be needed as well as APR.

The *Arnander* case also placed focus on the outbuildings. For the Appellants, Mr Massey QC 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/BPR claim on the equine property the use of the outbuildings will be important.

BPR – The Importance of 'George' – 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 the other cases might be read.

In common with many other cases, *George* concerned a caravan site on which several activities were conducted. These included:

- 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 or a mixed equine property.

Let cottages – the importance of Farmer

Can IHT relief be obtained on let cottages? Many stud properties have a number of cottages incorporated into the Estate.

The case of *Farmer (Farmer's Executors v IRC [1999] STC (SCD) 321)* is worth looking at for obtaining potential IHT reliefs on integrated farming and equestrian. The case is considered to be very helpful to the diversifying stud owner. The case allowed BPR on 22 let cottages that were integrated into the main farming business. It highlights sections of the Taxes Act and other cases that are relevant to the important interpretation of IHTA 1984 s.110 the "net value" of the business. It is a directing and guidance for integrating let activity and business.

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

There is no doubt that currently the letting out of property is one of the most efficient (in terms of financial return) 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 via an IHT audit.

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, dressage, etc. 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, whilst, at the other extreme, some may have

a whole team of British Horse Society (BHS)-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.

The businesses of riding schools will be assessable as trading income and therefore both the business and the property should be eligible for 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 also to those who can provide their own mount.

The resulting business, provided it is a business, should qualify for BPR.

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 will 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 will 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 rather than pure rental income. The business of horse trekking will therefore be assessable as trading income and both the business and the property should be eligible for BPR.

Summary

Equine inheritance tax planning is complex. Every equine property and the involvement of the proprietor(s) is unique. 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 the provision of a guide to the difference between a trade and the supply of a space to keep a horse.

Has the recent case of *McCall* given guidance? What this case might have shown is that where the equine business involves letting it is imperative to look to the degree of service provided in order to try and achieve Inheritance Tax relief.

Correctly structured, the equine property can provide good business income, the opportunity to claim back VAT on repairs etc, to claim lifestyle expenses, and above all inheritance tax relief on a valuable property. □

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