

A racing certainty?

Julie Butler considers the VAT implications when selling a horse or a share in one.

If a horse is sold by a sole trader who is in business with another activity, there may be a worry that VAT will have to be charged even where the other activity is not VAT registered. This is because the sole trader VAT registration could be seen as relevant to all – in the words of the Principal VAT Directive – economic activities of the sole trader, including horse ownership. If it is not clear that the horse ownership comprises a business or a hobby, the business tests must be applied to help decide on the VAT treatment and the tax position. However, there is a further complication – if the sale is of a part share in a horse, the supply is deemed to be of services rather than goods. This rule applies unless all the shares are transferred simultaneously (see HMRC's *VAT Supply and Consideration Manual* at VATSC10140 – tinyurl.com/y28wbtp) in which case it will be the sale of goods.

The McMorris case

In *McMorris* (TC4204), the First-tier Tribunal found that Mr McMorris was not carrying on a trade while owning a horse. The primary issue was whether he should be allowed to set losses from a 'racehorse activity' against other income of the same tax year. To prove the eligibility of the losses, it had to be shown that they were the result of a commercial trade.

Mr McMorris had bought a half-share in a racehorse in February 2010 and agreed to meet half the training and racing costs. Initially, the racing results for the horse were positive. So many owners of horses refuse strong offers and the owners refused an offer of £50,000 to buy the horse. Unfortunately, the racing success did not last and, in summer 2011, the owners sold the horse for £1,000, of which Mr McMorris received half. In his 2010-11 tax return, he claimed loss relief for a trade that he described as 'racehorse'. HMRC refused the loss relief claim on the ground that owning a racehorse was a hobby, not a trade.

Key points

- Is the horse ownership an 'economic activity'?
- A loss claim must relate to a commercial trade.
- The hope of prize money and a profit on sale may not prove that commercial trade is being undertaken.
- The VAT scheme for racehorse owners can allow VAT refunds.
- Has output VAT been paid on sponsorship income?
- The sale of a share in a horse may be treated as a supply of services.
- The importance of the place of supply rules.



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The First-tier Tribunal referred to the badges of trade as explained in *Marson v Morton* [1986] STC 463. The tribunal decided that the deal was a one-off transaction. Further, because the taxpayer had not borrowed any money for the venture, there was no long-term plan for the operation and he 'clearly derived pleasure' from the project, all of which pointed away from the badges of trade.

Overall, the tribunal decided that the activities did not amount to a trade. The judge added that, given the informality of the arrangements between the co-owners, ITA 2007, s 66 was not satisfied because the activities were not carried out on a commercial basis. The taxpayer's claim for loss relief failed.

No business economic activity

As demonstrated by the *McMorris* case, if the activity is not a business, the sale of a horse should be outside the scope of VAT. If, by contrast, a situation meets the badges of trade criteria and qualifies as a business activity, the taxpayer would be able to recover VAT on the relevant costs. If the income of the operation consists of occasional prize money and the possibility of a profit when the horse is sold, HMRC may challenge the recovery of VAT on costs relating to it on the basis that a commercial trade is not being undertaken. The only reason to deny registration to someone owning or part-owning a share of a horse would be that it is not regarded as an economic activity.

The general rule is that all economic activities of the same person fall under a single registration, which could lead to the conclusion that output tax is due on the sale where there are other businesses. However, it is important to note the commercial and trading definitions before this charge is levied or VAT expenditure is reclaimed.

VAT registration for racehorse owners

Racehorse owners have some advantage regarding VAT registration with the VAT registration scheme for racehorse owners (see *VAT Notice 700/67* at tinyurl.com/y4dqw2tf). This started on 16 March 1993, allowing VAT refunds from this date to be claimed on racehorses in full training, as long as some output tax was recorded against these inputs.

In *Notice 700/67*, HMRC states that output tax is due on prize money if a racehorse owner is registered for VAT. However, the Court of Justice of the European Union (CJEU) ruled in *Pavlina Bastova* (Case C-432/15) that providing a horse for a race was not a supply for consideration if payment was entirely dependent on the horse winning (or achieving a high ranking). Therefore, to circumvent this point, HMRC insists that a level of sponsorship is received by the horse's owner that has output VAT charged upon it, to claim back input VAT under the scheme. HMRC normally expects to be satisfied that there is at least the prospect of regular income from sponsorship before agreeing to a VAT registration under the scheme.

Sale of part share of a horse

There is an important quirk for horse owners to watch out for. VATA 1994, Sch 4 para 1(1) confirms that although 'any transfer of the whole property in goods is a supply of goods', the transfer of any undivided share of 'the property in goods' is a supply of services. Thus, because a horse is deemed to be undivided property, the sale of, say, a 50% share is deemed to be a potential supply of services as long as the business:

- holds a valid VAT registration;
- has passed the various badges of trade tests; and
- is trading in the sale of horses.

As mentioned, the only variance to this rule is when all shareholders dispose of their shares simultaneously. In such cases, the entire horse is being disposed of and this counts as a supply of goods.

Treating a horse share sale as a service opens further complications involving the place of supply, which again can determine whether a VAT charge should be levied. The result is that, in such a scenario, advisers must follow the place of supply rules and *VAT Notice 741A* as follows.

If the transaction undertaken is business-to-business (B2B), with a company or business dealing in horses in the normal course of their trade, the service is deemed to have originated in the place where the customer belongs. If this is outside the UK, no UK VAT should be charged, although the transaction may be subject to local taxes in that other country.

If the transaction undertaken is business-to-consumer (B2C) – a private individual or a company that does not deal in horses in the normal course of trade – the service is deemed to have originated where the supplier is based; in other words, the UK, and therefore full UK VAT should be charged.

Planning point

The VAT margin scheme is available to a chargeable person who is in business and trading commercially, if they sell a horse but did not recover input tax on the original purchase.

For example, if a half-share of a horse is being sold and the other half is being retained, the supply being made is deemed by HMRC to be a service. If the sale is made to an Irish VAT-registered company that deals in horses in the normal course of its trade, the transaction will be deemed to have originated in Ireland, and no UK VAT should be charged because this transaction is 'outside the scope' of UK VAT.

However, if the other party was an individual resident in Ireland, but who had no business interests in horses, the transaction would be deemed to be B2C and will originate in the UK with VAT chargeable on the transaction.

Margin scheme

HMRC's *Notice 700/67* at paragraph 5.4 states that the margin scheme is available to a person who is chargeable to VAT – in other words, in business and trading commercially – on the sale of a horse if they did not recover input tax on the original purchase, subject to the various conditions of that scheme as set out in *Notice 718: The Margin and Global Accounting Scheme*. So, if the transaction is within the scope of VAT, the output tax will be restricted to the margin made on the animal in question, rather than the proceeds.

Sale of a share in a partnership

If a horse is being sold by a partnership, when one joint owner is selling a share to a third party, the VAT treatment will again need to be considered. Such action is akin to an individual partner selling a share in a business partnership. It is considered, particularly given HMRC's stated policy on shares of less than 50% in the notice, that this should be treated as an investment transaction (outside the scope of VAT) rather than an economic activity. VAT should therefore not be charged on such transactions.

Summary

The sale of private horses and horses used in a business can be easily confused and the different VAT approaches can complicate the determination of the correct treatment by advisers. As well as identifying when VAT should be applied to an equine transaction, advisers should have an understanding of both the racehorse owners' scheme and the margin scheme, while remaining aware of the complications involved with the sales of part shares in a horse. 'Any eye should also be kept on the final Brexit position. The *McMorris* case gave guidance on the complexity of the commerciality question.

The key is to consider all horse sale transactions on their merits and plan ahead. Nothing is straightforward in such transactions and where appropriate seek specialist advice. ●

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