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A Racing Certainty

Julie Butler explains how racehorse owners can arrange their affairs for maximum tax efficiency

A surprisingly wide range of clients take an active interest in the traditional 'Sport of Kings' and many participate as owners or trainers of racehorses, or as members of stallion syndicates. Although blue blood is not required, deep pockets certainly are, so it is important to optimise all aspects of the tax position.

We have found that the following questions are often raised by practitioners unfamiliar with the industry:

(1) Under starter's orders

My client owns racehorses. How can the costs associated therewith be made tax efficient and yet compliant?

Firstly ensure that the input VAT incurred as part of ownership is being claimed back via the 'Racehorse Owners VAT Registration Scheme' and also ensure that the appropriate sponsorship deals are in place (for details see VAT Notice 700/67). Essentially the ownership of racehorses is outside the scope of VAT unless the owner has registered under the Scheme.

For income or corporation tax, structured sponsorship from an associated business (correctly directed through a sponsorship agreement) can produce efficient tax relief. The trading entity must be able to prove *commercial* benefit to its business.

(2) Tax efficient stud farms

My client, who owns racehorses, has moved into Stud activities. What can the tax advantages be?

Stud farming is farming for tax purposes and therefore enjoys all the tax reliefs that are associated with agricultural activities. The five-year loss relief rule associated with farming is extended to eleven years for Studs (see the Inland Revenue *Business Income Manual,* paragraph 55725). There is scope for sideways loss relief via sections 380 and 381, *Income and Corporation Taxes Act 1988*. Watch for section 381(4), which requires proof of commerciality.

If the Stud is run on land and in buildings owned by the client, there is scope for 100% Inheritance Tax (IHT) relief after two years and the 10% rate of CGT (40% top rate less 75% Business Asset Taper Relief) on any disposals. Stud activities can be a good way to 'shelter' development profits as the land and buildings will be a business asset for Taper Relief purposes.

(3) Staff accommodation

My client carries on an equine trading activity and naturally assumes that the staff accommodation qualifies as tax free. Is this always the case?

Staff accommodation will only qualify as tax free if it satisfies the 'customary' and 'proper performance' conditions. Greater emphasis is currently placed on the 'proper performance' angle.

Ensuring that employment contracts record that staff have to live on the premises for the proper performance of their duties will help, as will the fact that staff are required to live close to the animals.

Whilst accommodation can be provided tax free, ancillary costs such as telephone or heating should be paid by the staff. Each case should be judged on its own merits and the facts.

In this Issue

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(4) The professional gambler

A client has left his previous employment to become a 'pro-punter' on the Betting Exchanges. Is this income tax free and, if so, should records still be kept of the profit made?

Gambling by anyone other than a licensed bookmaker is 'tax free' (*Graham v Green [HMIT]* (1925) 9 TC 309) and the Betting Exchanges have not so far changed this position. However, the tax positions of both the Exchanges and the professional gambler ('pro-punter') are still under review. The Exchanges enable some gamblers to establish systems which produce a profit each year. Whilst the profits are currently 'tax free', it is still advisable to notify the Revenue of the source of tax-free income and to keep basic records to prove how the client can afford his lifestyle.

(5) The Irish stallion

My client, who is a United Kingdom resident, owns a share in a stallion in Ireland and considers the income from stud fees to be 'tax free'. What is the correct position? Is it true that the Irish tax concessions are under attack for being a 'State Aid'?

The taxation of Irish stallion fees is a complex issue and whilst stud fee income is 'tax free' for Irish residents it clearly has implications for United Kingdom residents.

From 1 January 2004 the Irish stallion fee income does have to be recorded on the Irish Tax Return. United Kingdom residents will invariably have to pay UK tax on the Irish income stream. Each situation must be assessed on its merits, but clients cannot just forget this income: they must disclose it to their UK tax advisor.

The 'tax free' status of stallion fees in Ireland is currently under attack as a State Aid. However, on 12 May 2005 the Irish Finance Minister (Brian Cowen) and Agriculture Minister (Mary Coughlan) met the EU Agriculture Commissioner (Mariann Fischer Boel) in Brussels. The European Commission has agreed to work with the Irish Government to find a way to continue support, but which does not break State Aid rules.

(6) Capital allowance claims

My client has invested in a 'horsewalker' and an 'all-weather gallop'. Do these qualify for capital allowances or are they improvements to premises?

These items of expenditure can be described as a very debatable area of tax treatment. The horsewalker should be capable of qualifying as 'plant' and the normal criteria of 'function v setting' come into play. The horsewalker must be capable of being moved and must not be set into the ground in order to qualify as 'plant'.

The tax treatment of the all-weather gallop is directed by two tax cases. In *Shove [HMIT] v Lingfield Park 1991 Ltd* [2003] STC 1003 the taxpayer company had spent nearly £3 million on the installation of an all-weather racetrack (AWT) at Lingfield Park racecourse – this included equitrack surfacing, drainage and safety fencing – and made a claim under section 24, *Capital Allowances Act 1990* for this to qualify as plant and machinery. The claim was originally allowed by the General Commissioners but then rejected by the High Court.

However, in *Anchor International Ltd v Inland Revenue Commissioners* [2003] STC (SCD) 115 a five-a-side football surface 'green carpet' was allowed as plant and machinery. Every new all-weather surface must therefore be assessed on its merits and perhaps the *Anchor* case will lead the way to overriding the *Lingfield Park* position where the facts allow.

Key questions will be: 'Can your client's all-weather gallop be moved?' and 'Is the expenditure on "setting" or "function"?'

(7) One business or two?

My client has for some years merged his racehorse training activity with his very profitable retail business. The training business has suffered some knocks over the last few years and traded at loss. The total business is under enquiry and the Inspector says that the two businesses must be separated. What are the key problems to watch for?

Many racehorse training establishments sadly trade at a loss. The trainer must try to avoid his activities being classified as a 'hobby' or non-commercial and therefore having his losses restricted to carry-forward under section 385 as opposed to offset 'sideways' under section 380 (section 381 for the early years). There has been a 'trend' or fashion over the years to merge businesses and hide the possible non-profitability of the racehorse trainer.

Tax Inspectors are having a lot of success insisting that the business should be split and that the trader is out of time to claim that the losses of one activity should be offset against the profits of the other. As a result Inspectors are collecting lots of extra tax, because the losses are carried forward and not offset sideways against other income. The key is to separate out the businesses before the Inspector insists upon it and to try to make sure that a sponsorship agreement is in place, which helps to ensure that the racing business is profitable and commercial.

Racing is a wonderful vehicle for marketing and PR and therefore can add commercial advantages to an associated business, which are best established via a formal sponsorship arrangement as opposed to an unstructured merging of the two businesses.

(8) Antrobus 2

I have heard that the recent referral to the Lands Tribunal of the original Antrobus case could have an interesting impact on the stud farm. Is this correct?

The key initial impact of the *Antrobus* Lands Tribunal case is that of interpreting the existing agricultural property relief legislation in such a way as to restrict inheritance tax relief on the stud house to the 'agricultural value' of the property.

More broadly, there are also concerns that a restriction of relief to the 'working farmer' could be reintroduced. We await the appeal with interest.

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A short report of the Lands Tribunal decision in 'Antrobus 2' (written by our own editorial staff) appears on page 69.