Horses for courses

Despite current 'in-fighting' within the racing industry regarding the OFT report, mobile phones and prize money, attendance figures are up and the mood is good. Television coverage is currently excellent and it is a wonderful time to own a racehorse – so why not let the taxman try and help your fun? Equine tax specialist Julie Butler looks at the potential benefits and effects of businesses owning racehorses.

THE BUSINESS RELATIONSHIP

IN GENERAL, an individual or a company cannot obtain tax relief for racing expenses, and conversely will not have to pay tax on race winnings. The exception to this rule is where the Inland Revenue accepts that a racehorse is maintained for the purpose of advertising, marketing, or business development, in which case the owner can claim the cost of keeping and racing the horse as a business expense. The disadvantage of this approach is that prize money becomes taxable, however relatively few racehorses generate enough money to cover the cost of keeping them so this is sadly not normally the first concern. The vast majority of owners who keep racehorses for marketing purposes will be companies, although the rules also apply for individuals.

CAN A COMPANY PURSUE A HOBBY?

IN PRINCIPLE, it makes no difference whether an individual or a company owns a racehorse, since corporation tax is largely based on income tax rules. Inevitably there are minor differences due to the legal distinction between a company and an individual.

For example, whereas the Inland Revenue regards racing as a hobby when carried on by an individual, it cannot be said that a company owning a racehorse is carrying on a hobby. It is either carrying on a taxable or a non-taxable activity, but what of benefits in kind for directors?

It is an interesting tax fact that it is the individuals behind a company - the members and/or directors - who pursue hobbies, not the company itself.

It could be argued that the company is merely carrying on a non-taxable activity at the directors' instigation. From the company's point of view, the distinction is academic since the effect is still to deny tax relief in most cases on losses. The position of director's benefits in kind and the requirements of form P11D must be considered by the company's management and the tax advisors.

THE RACEHORSE OWNERS' VAT SCHEME

GUIDANCE TO the sponsorship angle can be found in the "The Racehorse Owners VAT Scheme".

The VAT scheme agreed between HM Customs and Excise and the racing industries means that owning racehorses can become significantly less expensive.

There were doubts about the scheme continuing but it was agreed in December 2002 for the scheme to continue with a review in 2005. It will depend on the owners complying with the code of conduct rules for proven sponsorship agreements. Information can be obtained on the Weatherbys' website www.weatherbys-group.com/services/vatservices.html.

At the time of writing, the Weatherbys VAT services guide says that as a 'rule of thumb', keeping a horse in training costs around £16,000 a year. Weatherbys estimates that the scheme could mean a saving of around £2,800 a year per horse, quite apart from recovering VAT in the purchase price. Sponsorship agreements must be registered and must have minimum values to be attained. The minimum value is £300 per horse per year. For those horses intended to compete in class A races, the minimum value is £750 per horse per year. Where the agreement extends to sponsorship of a group of 10 or more horses, the minimum is £100 per horse.

It is a known fact that companies cannot survive without sales revenue and that customer and supplier goodwill is essential. The advertising world of the 1960s and 1970s has moved into the whole new industry of marketing and PR. The travelling salesman is almost a 'rare beast' replaced by a marketing and PR team. How does the ownership of a racehorse fit into the 21st century businesses life?

In today's world one of the ultimate aims of the taxpayer and tax adviser alike is to try to obtain tax relief for expenses that the taxpayer "enjoys". This does not mean trying to hopelessly claim relief for a hobby but to ensure that the business relationship between racehorse ownership and the taxpayers' business is commercially sound, well structured and tax efficient.

ACHIEVING TAX EFFICIENCY

THE GOVERNMENT'S decision to keep the Racehorse Owner's VAT Scheme is a wonderful opportunity for tax advisers, racehorse owners and racing authorities to work together and look at the maximisation of the commercial structure and tax efficiency of the industry of owning racehorses.

Racecourses are ideal locations for the entertainment of business contacts and, although the entertainment element of the exercise is disallowable for tax purposes, the rest is commercially viable and tax allowable if structured correctly.

THE BUSINESS MOTIVE OF OWNERSHIP

MOST DIRECTORS whose companies own racehorses would claim that they do so for advertising, marketing or PR purposes. Tax inspectors will obviously look very closely at such claims, as they have to satisfy themselves that they are granting tax relief for legitimate business expenses and not merely subsidising a hobby of one of the directors. The key issue here is MOTIVE. The following points will be taken into consideration:

- Is there an entertaining motive behind the acquisition of the racehorse? If so, the claim is likely to fail or at least fail in part.
- Is this a form of advertising in keeping with the company's size, structure and image? A company who has not previously had a substantial advertising budget is unlikely to succeed in a claim. The same applies to a company which would not otherwise advertise to the public.
- Is there any evidence that the horse is being used for advertising purposes? If a horse is named after the company which owns it, there is a stronger argument in favour of treating it as a business expense.
- It might be wise to try and carry out an analysis of sales and to prove that there is a direct benefit. Alternatively an independent marketing or PR bureau could carry out a report. This might keep fellow directors and the Tax inspector happy at the same time.

OBTAINING AGREEMENT WITH THE LOCAL TAX INSPECTOR

ULTIMATELY, A company's ability to succeed in obtaining tax relief on a racehorse depends largely on the facts of the case and on the relative powers of negotiation possessed by the company's directors and advisers and by the company's local tax inspector. In practice, it should be relatively easy for a large company to claim relief if it has a substantial advertising budget and if the racehorse is named after the company's product.

Conversely, a small company, which is unlikely to generate much business from this form of advertising, is unlikely to succeed in its claim for tax relief for the expenses, especially if its advertising budget would otherwise be a modest one.

The practical point for the tax adviser and the owner is to plan in advance the purchase of the racehorse looking at budgets, opportunities and possibly marketing reports of the benefit. Full consideration must be given to the previous references to sponsorship, entertaining, marketing, advertising and PR.

FORM P11D RESPONSIBILITIES

FOR ALL directors who pay UK income tax, and whose companies own racehorses, there is a danger that the Inland Revenue will regard the company's financing of the horse as a benefit in kind for the director, especially in cases where the director has a keen interest in horse racing and has enough influence to bring a racehorse into the company. The benefit in kind will have to be declared on the form P11D if appropriate.

PERSONAL OWNERSHIP FUNDED BY THE COMPANY

ALTHOUGH MANY bloodstock breeders and owners of racehorses may be optimistic about the likely future profitability from these activities, more often than not racing and bloodstock breeding will produce losses. It may be necessary to borrow to fund these activities and any interest payable on loans relating to the trading activities should be allowable for tax purposes. However if an individual wishes to embark on bloodstock activities but is not able to fund these personally or by bank borrowings without providing generous personal guarantees, then he may wish to fund the activities by withdrawing funds from one of his trading companies. If that company owes him money, possibly by way of loans, which he has previously made to the company or credit balances on his director's current account, then these funds can be withdrawn without any adverse tax consequences.

The tax legislation ensures that the withdrawal of funds from any company (whether to purchase a racehorse or not) ensures that tax in some form is payable, whether it be by dividend, director's remuneration or director's loan (s.419). Taking profits/funds from a company is a complex subject, which warrants its own article or book.

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