



**A world leader of the  
accountancy and finance profession**

## **Commerciality - combined businesses and smoke screen**

 You have exclusive access to this article as a Farming and Rural Business SIG subscriber.

**HMRC has been paying a lot of attention to the offset of losses sideways (Income Tax Act 2007 s 64 and s 72) and, in so doing, the question of commerciality is raised.**

Particular attention has been paid to studs, hobby farming and racehorse trainers who also combine their main trade with a farming operation.

Rather than have tax losses disallowed, some businesses (either consciously or by default) have merged profitable businesses with unprofitable businesses that they do not want to relinquish. The proprietors want to achieve the tax relief. The overall benefit of sideways tax loss relief being offset against total income is achieved indirectly or (please excuse the pun) through the side door.

### **Sponsorship**

It can be argued that sponsorships by a profitable business of a non-profitable business are effectively this type of merging and smoke screen, putting in monies from profitable business into a non-profitable business so that commerciality can be achieved. An example of such sponsorship is shown in the 1996 Special Commissioners case *Executive Network (Consultants) Ltd v O'Connor (SpC 56)*. In *Executive Network* a company made payments to a riding school business (the wife of the controlling shareholder) and claimed deduction of these payments on the basis that they were sponsorship payments. The sponsorship payments were disallowed for corporation tax purposes on the basis that they could not be proved to be wholly and exclusively for the purpose of a company's trade.

In looking at *Executive Network* the Special Commissioners did consider the fact that 'personal benefit played a part in the decision to make the sponsorship payments'. The payment by the company was strongly influenced by the deficit of the wife's business.

More direct approaches to offsetting losses can be taken where an unprofitable legal entity was actually used by another family member to incorporate another business activity. The overall result is a net profit from the two businesses and the possibility that tax losses which may not pass the commerciality test have been utilised incorrectly.

## **Offset of losses - training**

HMRC do try to review in detail business accounts which include a number of activities, one of which, for example, is loss making and is being propped up by the other profitable activities. A clear example of a profit being offset against an un-commercial loss is farming and the racehorse trainer (where he is often just training his own horses). HMRC has mounted a number of enquiries into farmers registered as trainers who have included the expenses from training their horses in the accounts of the farming business.

Confusion can arise when a trainer is training for himself as opposed to somebody else, ie, there is no external commerciality. However, the trainer would argue that the reason he owns the horses is that he is simply waiting to find the right owner and the arrangement is commercial. There must be clear evidence of trying to find an owner, selling the horse at a profit and showing that it was commercial.

Any costs incurred by a trainer in connection with training horses he owns, (unless it can be shown that he is going to find an owner for the horse) should not be deductible for tax purposes. If a trainer only owns part of a horse then a portion of the associated costs would be allowed for tax, provided that the other owners actually pay a training fee for their share. If the other party merely paid for part of the purchase cost of the horse and does not pay a training fee, HMRC takes the view that none of the costs will be allowable for tax purposes.

These can clearly be very “muddy waters” and advisers must take the necessary steps to protect their position, eg, in their fact find about the commercial activity and ideally enterprise accounts should be produced wherever different trades are included.

## **Offset of losses - farming**

In farming there can often be some element of the farm which is non-profitable but for some reason (perhaps sentimentality, history etc) the farmer does not want to cease the unprofitable element and it is actually being supported by the other activities.

Some accountants have been quite surprised when HMRC have launched an attack into a set of business accounts which cover more than one activity to find that one element is loss making (no matter how many clever arguments are presented for the overheads being offset against other activities to make the unprofitable activity profitable). This can be in innocent good faith with the client actually “lying to themselves” about the profitability of one element of the activity or at the other extreme it can be just incorrect planning on the part of the taxpayer!

## **Practical steps to protect correct tax loss claims**

The practical steps to consider are:

1. Carry out a good “fact find” when taking on a client in the first instance and continuing to understand the nature of the activity and whether more than one trade exists within the business.
2. Identify the activities contained within one set of books and records delivered into the accountant’s office.
3. Produce enterprise accounts where there are separate trades or activities, especially when there is a worry that there is a propping up of a loss-making operation.

**Julie Butler, FCA, Butler & Co.**

**Farming and Rural Business Group, April 2012**

Julie Butler FCA is the author of Tax Planning for Farm and Land Diversification, Equine Tax Planning, and Stanley: Taxation of Farmers and Landowners.

**Please note:**

Views expressed in this article are those of the author and may not represent ICAEW policy. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the publisher or authors.

---

**BUSINESS WITH CONFIDENCE**

Copyright 2012 © ICAEW