Equine tax issues – Part 1

Julie Butler looks at some of the issues affecting equine clients

With HMRC's current enthusiasm to examine equine activities, especially losses, in an attempt to collect more taxes, the approach of this article, which is set out in two parts, is to highlight tax planning and pitfall points that a tax adviser should look for when taking on a new equine client. It is not surprising that in view of the complexity several cases concerning the eligibility of tax relief on trading loss claims and business property relief have made their way to the First-tier Tribunal (FTT) in recent years.

Equine loss claims

As with all trades, an equine business must be trading on a commercial basis with a view to making a profit (ITA 2007, s. 66) if it wishes to claim tax relief on trading losses. The equine taxpayer has to be able to prove that there is a reasonable expectation of profit from the trading operation and, in due course, pay tax on such profits. Let us examine some of the cases in more detail.

The taxpayer in *R Murray* (TC 3474) was a racehorse breeder and trainer. Mr Murray began the business in 2005 but did not notify HMRC until he submitted his 2007/08 tax return. The problems associated with racehorse breeding include high infrastructure costs and difficulties achieving targets for sales to ensure a profit. HMRC enquired into the taxpayer's 2010/11 return and decided the losses were not allowable because he was not trading on a commercial basis with a view to making a profit (ITA 2007, s. 66).

- The tribunal decided this racehorse business was not commercial and disallowed the claim.
- Business plans should set out how a profit can be achieved in future years.

In order for an equine client to achieve the tax loss claim, it is vital to prepare a well thought-out business plan before questions are raised by HMRC. If loss claims have already been made, now is the time to collect the robust evidence to support them should this be missing and to ensure clients are warned about the potential vulnerability of the claims.

11-year loss rule and studs

HMRC allow a stud the first 11 years to produce a profit. If the income tax loss claim is made when the first 11-year loss period allowed by HMRC has been exceeded, then the loss relief can be denied by HMRC. Likewise, if the next six-year loss period has been reached, or there is little evidence of 'potential profit' being proved to be something that could ever have been achieved, then the loss relief could be removed by HMRC with a reclaim for income tax and penalties. This is an extension of the 'hobby farming' rules that farms enjoy with regard to losses.

It is worth considering the 1982 communication from HMRC to the Thoroughbred Breeders' Association (TBA), which stated:

> 'We have long accepted that the breeding of thoroughbred horses is such a long-term venture, and provided that a stud farming business is potentially profit-making, we would not normally seek to invoke section 397(1) [see now ITA 2007, s. 67] until after 11 years from the start of the business'.

Ownership of racehorses

Following the principle in *Sharkey v Wernher* (1955) 36 TC 215, horseracing, that is to say owning racehorses, is 'outside the scope' of tax. In other words, it is not taxable. This is generally because HMRC regards the prospect of profit from racing to be too remote to be a taxable activity. In response to this state of affairs, HMRC may well attempt to combine breeding and racing activities in its classifications to deny stud losses. The argument in favour of this from the HMRC viewpoint would be that the breeding of horses is itself a hobby, and ancillary to the racing activities.

Action points to consider:

- Keep a portfolio of evidence to show commercial intent, active involvement, lack of hobby status and motive, and how the focus is on profitability.

Such advice applies to sports horse ownership as well as racehorses.

Equine property and agricultural property relief

The HMRC statement on losses refers specifically to a 'stud farm'. This involves land ownership and is different from a 'breeding venture', which does not involve land ownership but generally has mares who are away boarding. The key tax point is that 'stud farming with land' is 'farming' for tax purposes, and therefore can benefit from the various agricultural tax reliefs available to the farming industry.

Breeding horses qualifies as agriculture, as set out in IHTA 1984, s. 115(4), but is the horse livestock for agricultural purposes? *Wheatley (Wheatley Executors v CIR)* (SpC 149) [1988] is the inheritance tax (IHT) case that considers whether the grazing of horses qualifies for agricultural property relief (APR). It concluded that a meadow used for grazing horses failed to qualify for APR. Although the meadow had been owned by the deceased for seven years prior to his death, subject to a grazing agreement during all that time, and as such constituted 'pasture' within IHTA 1984, s. 115(2), the meadow was not 'occupied for the purposes of agriculture' as horses grazed there.

The principal ingredient of the occupation test for APR is in IHTA 1984, s. 117 and is that the agricultural property must be occupied for the purposes of agriculture and that agricultural land is the principal form of 'agricultural property'. So, mirroring the definition of farming, someone has to be in occupation of land and the purpose of the occupation has to be for agriculture. *Wheatley* has been criticised on the ground that the act of growing grass, which can properly be regarded as a 'crop', should be treated as an act of husbandry, irrespective of the way in which the crop is exploited or used, provided the land is occupied for the purposes of those husbandry operations and not mainly for another purpose.

Many would argue that the commercial grazing of horses for livery should now qualify for APR. There is the combination of growing a crop of grass for the horses to eat together with the majority of horses ultimately being used in the food chain, which presents a very strong argument for grazing liveries for horses to qualify as agriculture. Every equine client must be reviewed on a case-by-case basis.

Hay for horses

The continuation of the growing of a crop of grass continues with haymaking. The consensus has always been that a 'farmer who makes hay is a farmer' and, whether they are growing a crop to be consumed by livestock or horses, this does not affect IHT. The potentially negative response to such an assumption might now arrive as a shock to many beneficiaries of farm estates that include 'haymaking for horses' and whose inheritances are under attack from HMRC. If the hay is sold for consumption by horses, HMRC may incorrectly argue that the sale is *not* an agricultural activity under IHTA 1984, s. 115. The department contend that, unless the hay is sold in accordance with IHTA 1984, s. 115(4) for 'the breeding and rearing of horses', it does not qualify for APR.

Equine activities and business property relief

For IHT purposes, the stud should be entitled to a combination of APR and BPR subject to the trading elements of the stud, if BPR is needed in addition to APR or where APR does not apply. One of the current areas of attack by HMRC in their attempt to deny BPR for IHT purposes is to question commerciality. Although in *The Estate of Maureen W Vigne (Deceased) v HMRC* [2017] UKFTT 632 (TC) the focus was mainly on BPR and livery customers, the tribunal also decided that APR under IHTA 1984, s. 115 and s. 116 for the hay field would have failed. This was because no hay crop had been taken by the business in the two years before Maureen Vigne died.

It is a common occurrence in the farming industry for a 'traditional' agricultural farmer to move to letting agricultural buildings, livery and supplying hay to horses as they grow older and become less physically able to undertake other farming activities. With the *Vigne* case being appealed to the Upper Tribunal, BPR on livery operations and APR on haymaking are clearly under attack. For the safe claim of BPR in respect of liveries there should be serviced livery; more than 'enhanced livery' showing that the activity is more than just 'holding investments'.

Part 2 of this article on Equine Tax Issues will be published in the December 2018 issue of *Small Business Tax & Finance*. It considers the VAT position of a number of areas of the equine industry, e.g. teaching, horse dealing, liveries, commerciality etc. There is also the concern of equine stock valuation together with the forensic understanding of the equine operation.

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