

Equine tax planning – tax planning for a passion

Julie Butler looks at tax planning for horse breeders.



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year of trading and section 397(3) [ICTA 1970] provides for loss relief to be continued after the fifth year where the claimant is engaged in a particular farming activity of an intrinsically long-term profit making nature 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) until after 11 years from the start of the business.

This statement is found in paragraph 2350g in the Inspector's Manual and is available on the Revenue's website at www.inlandrevenue.gov.uk/manuals/immanual/im2250/im2350g.htm

However, this does not mean that all stud farming losses are relievable against other income up to 11 years from commencement. The requirement that the business should be potentially profitable (in other words, the question of whether section 397(3)(a) is satisfied) is important and should be checked. Nor should the letter be interpreted as meaning that the five-year period is extended in cases where a run of losses arises in periods after a year in which a profit has been made, or in cases where a business is taken over as a going concern. Where the enterprise is clearly not being carried on on a commercial basis and with a view to the realisation of profits, the Revenue is likely to seek to disallow the losses on the basis of commerciality.

So with farming in collapse, the tax breaks for a stud farm can be enjoyed by diversifying farmers, new entrants and those who are effectively trading as a stud but do not realise the tax

Equine tax has recently been given high profile in both the tabloids and broadsheets due to the beneficial Irish tax rules and a certain 'Premiership' manager enjoying the rewards from the potential stud fees of his horse 'Rock of Gibraltar' tax free.

Under the Irish system, stud fees are tax free and do not have to be recorded on a tax return. While there has been suggestions that these rules might change, this appears unlikely because these Irish tax reliefs support a great Irish industry and the risks to the economy are too great.

The UK Thoroughbred Breeders Association (TBA) have fought to try and have UK benefits equal to the Irish. However, many of the beneficial Irish tax rules shadow the current UK benefits, both for capital gains tax and inheritance tax on land used for business. In addition, UK stud owners are able to offset losses for up to 11 years (see below).

For stud farms there are some important tax planning points in the advantages of business status with regard to the eligibility to capital gains tax business asset taper relief and the ability to roll over the gain into another business asset. With business asset taper relief resulting in 10 per cent tax rates the emphasis on capital gains is important. However, it is not just the capital gains tax reliefs that are beneficial: there is also the inheritance tax reliefs for agricultural and business property relief.

It is important to remember that a stud farm is a farm for tax purposes. It receives all the tax reliefs associated with farming. The establishment of business status can be achieved with a relatively small number of horses. The average number of mares owned

by TBA member-breeders is just two. Although many breeders are farmers, there is steady recruitment of breeders from those who progress from race-going to owning or part-owning a horse, then to breeding one, two or more to race and/or sell.

So what do the tax manuals say?

Stud farming, which in these paragraphs is taken to mean the occupation of land for the purpose of breeding thoroughbred horses, is a very expensive and high-risk activity. In some cases it may be carried on by wealthy individuals essentially as an adjunct to their racing activities. Nevertheless, for tax purposes it is treated as farming and thus as the carrying on of a trade regardless of its commercial viability.

Horse racing however is not a taxable activity. Where, as is often the case, a stud farmer also races horses, considerable care may therefore be needed to ensure that the division between the two activities has been correctly made. In particular, attention should be given to any transfers of animals from the stud farm to training (that is, being kept for the purpose of racing) or vice versa.

One crucial advantage of stud farming is in relation to the beneficial treatment of losses for tax purposes. A loss from a stud can be offset against total income, yes that includes property income, earnings from employment, and stock market dividends (are there any left?) for up to 11 years. This treatment has been accepted for many years and was confirmed in a letter to the TBA from the Inland Revenue in 1982, as follows:

It has always been recognised that some ventures are by their nature unlikely to show a profit by the sixth

breaks available. Perhaps it is time for the hobby stud to 'come out' as a business, face the problems of greater paperwork but enjoy generous tax reliefs which include not only income tax but also capital gains tax, inheritance tax and VAT. So what questions do stud owners raise? A few examples are set out below.

Question

Is there a minimum number of horses to qualify as a business to achieve the reliefs?

Answer

No. The criteria is view to profit and to be able to prove there is possibility for future profitability. The Customs and Excise give the following direction on acceptance for VAT registration which helps emphasise the business intentions.

Breeding is a long-term activity. A mare will not produce a foal every year, and the average may not be better than one year in two. A breeder therefore will normally need to own several mares before supplies (sale of offspring) can be made with any degree of regularity. However, there will be exceptions to this, eg it is becoming more common to acquire one or two well bred mares, cover them by an expensive stallion and sell the offspring for considerable amounts of money. In these circumstances we would accept there was a business activity and registration may be permitted. In cases of doubt the trader should be requested to submit written details of their business intentions. Where subsequently a trader is registered it should be as an intending trader.

Question

Are there problems with converting a previous stud hobby into a business?

Answer

In practice for income tax and VAT there is more scope for challenge by the authorities if there is a change from non-commercial to business. However, each case will be assessed on its merits and proof of a view to a profit will be essential. For CGT purposes, the move from private to business use will enable business asset taper relief to become available but it

will also bring into play the rules for 'tainted' business taper relief. For inheritance tax business property relief the stud property must have had business status for two years.

Question

What proof will the Inspector require that there is a genuine trade? Will the Inland Revenue check 'sudden' profits in year 11 or year six after that?

Answer

The stud must be run on a commercial basis with a view to realisation of profit. The key factor is *potentially profit making*. The Revenue will look for 'fudged' or 'convenient' profit.

The Inland Revenue will look to:

- restricting business expenses in the year that needs to be profitable;
- recognising sales/expenses in the wrong year;
- manipulating stock valuations.

Question

Once the first loss period of 11 years has been taken advantage of and a profit achieved, can a further loss period of 11 years be allowed by the Inland Revenue?

Answer

No. The 11-year period is to allow for the intrinsically long-term profit making nature of a stud farm. Once recognition of the long 'lead' in period has been provided the farming rule of 'a profit every six years' applies.

Question

The claim for VAT relief, especially input VAT on repairs to improvements of stud premises is valuable to the stud owner. What criteria will Customs and Excise impose to allow registration and to allow input VAT claims? How does this differ from the registration rules for race horse owners introduced in 1993 Budget?

Answer

In order to achieve registration there must again be the intention of making a profit. *It must be a business*. The *Lord Fisher* case made the principal that an activity pursued for

pleasure and social enjoyment is not business even if undertaken in an efficient and businesslike manner. The *Premm* case favours the breeder as it ruled that regular taxable supplies are not necessary as breeding horses is a long term activity. The *Turnbull* case ruled that although there was an element of hobby there was the simple commercial objective of achieving a good bloodline which could produce profit issue which was a business.

In order to claim the input VAT the goods or services would have to have been purchased in the course or furtherance of the business of stud farming.

Question

If the stud business continues but there is a change of stud premises are the inheritance tax reliefs (IHT) kept intact?

Answer

In principle yes. The replacement property provisions apply. Problems could arise with a temporary move to rented accommodation as these will obviously not be eligible for IHT. If death occurred in this transitional situation then all inheritance tax reliefs would be lost.

The tax reliefs are potentially very beneficial in income tax, CGT, inheritance tax and VAT, but tax planning cannot be looked at with any one of these taxes in isolation or aspect. Every case must be reviewed 'in the round' and tailor made for the taxpayer according to the facts of their case and what they ultimately want to achieve.

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