Horse sense

A main residence may have an adjoining meadow or paddock and owners and their advisers should be aware of the related tax issues, say Julie Butler and Fred Butler.

It could be argued that it is the dream of a large number of people to own a paddock next to their house, however there are many tax considerations to take into account before making the dream a reality.

Only 'half a hectare' of character appropriate grounds will qualify for only or main residence relief under TCGA 1992, s 222. When buying a house with a paddock(s) it is essential to have a split in value between the house and the land for the future calculation of this relief. When selling the property, the split will be needed because capital gains tax will be payable on the paddocks, stables, barn and the like; in other words, any area that is not the house and garden and therefore does not qualify for main residence relief. The potential gain will be relevant to the disclosures on the new residential capital gains tax return (tinyurl.com/y7ta9ybw) that has been required since 6 April 2020 and which must be submitted within 30 days of the completion of the disposal. Details of the original purchase and improvements to the paddocks and barns need to be kept to calculate the gain.

Tax on disposal of paddocks

The current rate of capital gains tax on any possible gain on paddocks and buildings will be 20% unless the land and the newly purchased asset were used for a business. In that case rollover relief can be claimed on both the purchase and disposal under TCGA 1992, s 162. From a tax perspective, the disposal of bare land can be linked with a grand farmhouse and let cottages. The eligibility of the farmhouse as an asset against which a claim can be made for rollover relief is the subject of much debate. It has been known for tax advisers to claim full rollover relief on the purchase of the farmhouse, however there should be restrictions to defer only the business elements of the working farmhouse. Alternatively, business asset disposal relief (BADR) can be claimed if the conditions are met and 10% capital gains tax paid. Many UK residents have a misapprehension with regard to their homes and capital gains tax and assume 'it is where I live so no tax to pay', not realising that gains on 'pony paddocks' are potentially taxable.

Key points

- Only half a hectare of grounds will qualify for only or main residence relief.
- Land used for a business may be eligible for rollover relief.
- Grazing income from livestock can mean that land qualifies for agricultural property relief.
- The *Hyman* case shows HMRC may contest claims for the mixed-use rates of stamp duty land tax.
- Arguments for mixed use are easier if the house and grounds are divided clearly.
- HMRC may highlight any failure to bring the newly acquired land into immediate commercial use.

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Many UK property owners also think that the new capital gains tax returns apply only to those taxpayers with more than one residential property, overlooking the fact that property which does not qualify for main residence relief in full must be included on the return. This could catch many taxpayers who are not currently within the self-assessment system. Examples include those residences with big gardens (outside the normal half hectare/reasonable enjoyment rules), pony paddocks included as part of the residence and garden, and individuals with a lack of evidenced quality occupation which could lead to a liability.

Recent tribunal decisions have shown HMRC's enthusiasm to hunt down non-compliance with main residence relief. Farmers could possibly be caught by the need to sell let cottages to reduce the investment element of the farm trading operation for business property relief (BPR) for inheritance tax purposes.

In practical terms, some estate agents and solicitors may take a 'not my problem' approach to the new capital gains tax return, so responsibility appears to fall firmly with tax advisers and accountants. The new returns are likely to create some new problems.

Income tax on pony paddock income

The income sources could be horse liveries, a grazing licence or the paddock could be let for events such as parties, weddings, local festivities and the like. All such income should be declared on the self-assessment tax return. The importance of the declaration of this income to the tax authorities can be seen above as support for claims to beneficial capital gains tax rates. But the importance of correct disclosure was also illustrated by the self-employed income support scheme (SEISS), enabling claims to be made when income was lost due to Covid-19 disruption.

The negative cost of production potentially exceeding sales and evidence to show a profit can be produced is key. There is a difference between breeders who board out their mares and stud farms that have their own land. The latter is farming for tax purposes and the former is not. The stud farm can take advantage of the 'hobby farming' rules, but there must still be evidence that the stud operation is trading commercially with a view to a profit. At the top end of all equine sports (such as racing, show jumping, dressage and the like) there are strong profits, but problems can arise at the lower end due to margins and, sometimes, inexperience. Equine profits can be achieved – there must be full allowance for private usage and a full understanding of the weak areas and rectification action.

Inheritance tax

Many pony paddocks have business income. The declaration of such income can also have an advantage for inheritance tax. Grazing income from livestock can qualify for agricultural property relief (APR) and assets used in a business can qualify for BPR. Some advisers forget that small paddocks do qualify for inheritance tax reliefs.

The case of *HMRC v The Personal Representative of Maureen Vigne (Deceased)* [2018] UKUT 0357 turned on whether the operation of livery stables was a business (thus qualifying for BPR) or consisted 'wholly or mainly of … making or holding investments' (IHTA 1984, s 105(3)) and serves as welcome pony paddock guidance.

HMRC was of the view that Mrs Vigne's livery business was nothing more than the letting or licensing of land for the use of others and was therefore an investment business. However, the taxpayer had convinced the First-tier Tribunal (TC6068) that no properly informed observer could have concluded that the livery business was wholly or mainly a business of holding investments. The Upper Tribunal confirmed that the correct test had been applied to the case by the lower tribunal and emphasised that HMRC's view – that there was a presumption that land constituted an investment unless it was proved otherwise – was incorrect. The open-minded starting point advocated by the First-tier Tribunal in its decision was held to be correct. Further, the intention of the business owner was deemed to be useful as an indicator if cases fall within the grey area on the 'spectrum of holding investments' or trading and therefore qualifying for BPR.

The case highlighted the nature of the extra services, as well as the intention of the business owner or landowner. However, many argue that the decision has not made satisfying the BPR test of s105(3) any clearer. There is a spectrum of land exploitation with clear investment and clear trade at either end, and this is referred to by the tribunals.

In both *Vigne* and *Graham* the business owners have jumped over the 'investment line' successfully and won BPR as a result of the hard work of both providing the services and the dedication in presenting this to the tribunals.

The details to be included on pony paddock probate valuations are of particular importance to successfully achieve APR and BPR – see 'Hold your horses' (*Taxation*, 16 August 2018, page 15). Any land and property valuations are surrounded by uncertainty with the unusual Covid-19 market conditions and the proposed changes to the Town and Country Planning Act 1947 promising more development opportunities.

Stamp duty land tax

The pony paddock attached to the house and used for business could ensure that the purchaser can apply the mixed-use rate of stamp duty land tax (SDLT). Such use has come under attack by HMRC in a number of tribunal cases; for example, *David Hyman and another* (TC7271), *Pensfold* (TC7609) and *Myles-Till* (TC7633). It is important to show that the pony paddock had a business use at the time of purchase *or* that business plans were in place from the time of purchase.

Many consider that the recent *Hyman* case presents another potential tax problem for the world of pony paddocks. It again shows how HMRC is being increasingly strong over the eligibility of the mixed-use SDLT rate.

The facts were that Mr and Mrs Hyman bought a farmhouse with about 3.5 acres of land. For farmers restructuring that is an ideal size to increase the value of the cottage. The property comprised two gardens, a duck pond, a barn and a meadow. The couple paid SDLT at the residential rate when they bought it. The problem arose when they then sought to reclaim what they considered to be an overpayment of SDLT on the grounds that the property should have been classed as mixed use due to the 'non-residential' element, and that they therefore should have paid SDLT at the lower commercial rate for mixed use. The case is being appealed to the Upper Tribunal by Dr Hyman which also shows the taxpayer's desire to take advantage of the rate.

HMRC argued: 'The acquisition of a farmhouse and the surrounding land was found to be subject to the residential rates of SDLT because the land fell within the definition of "garden and grounds". A meadow, bridleway and barn were held to be available to the owners for use, even though they were physically separated from the house and the public had rights over the bridleway.'

Mr and Mrs Hyman argued that the meadow and public bridleway were not residential land, and nor was a derelict barn that had been classified as non-residential by the local authority. Further arguments were that the barn, meadow and bridleway were separated by hedges, and the bridleway was used by the public and so could not be used for recreation or private purposes. They also argued that the barn was a non-residential building and that the meadow and barn were not integral parts of the property. The First-tier Tribunal found against Mr and Mrs Hyman and held that they had correctly paid SDLT at the residential rate. Thus, no refund due to them in respect of the potential mixed rate. It is generally considered that, to be 'extra sure' of eligibility for the mixed rate, the land has to be put to strong commercial use. Ideally, such strong business use should be documented by way of the self-assessment tax return.

The reality is that it can be difficult to prove non-residential use on such a small amount of land as was the case here. Obviously, a significant amount of non-residential land and evidence of commercial use are ideal arguments to prove eligibility for mixed-use rate.

The decision in the *Hyman* case

The tribunal's view was that the brochure for the sale of the farmhouse explained that the property was marketed to buyers as an integral whole. 'Grounds' has and is intended to have a wide interpretation and its ordinary meaning is land attached or surrounding a house which is occupied with the house or available to the owners of the house to use. For SDLT purposes, it is understood that the grounds do not need to be used for any particular purpose as long as that use is non-residential. The tribunal considered that it was not relevant that the grounds were separated by hedges or fences and it does not matter that there is a right of way over the grounds. However, arguments to achieve the mixed-use rate are easier if the house and grounds are clearly divided.

HMRC updated its guidance on the meaning of 'garden or grounds' just a few weeks before the *Hyman* case, though this was not referred to in the case and fails to provide more clarity. For example, while reference to the traditional 'reasonable enjoyment' test in SDLTM30030 has been removed, when it comes to the extent of land in question and how that plays a part the department SDLTM00470 states: 'A small country cottage is unlikely to command dozens of acres of grounds but a stately home may do. Large tracts of fells/moorland, etc. (even if purchased with a dwelling) are unlikely to be residential in nature. The test is not simply whether the land comprises gardens and grounds, but whether it comprises the gardens and grounds of a dwelling…'

Arguments for a mixed-rate approach

Non-residential use of grounds that generate income which is, for example, declared on the owner's tax return as business income has proved to be a strong argument for the mixed rate. Agricultural use that does not attract business rates and should have the advantage of inheritance tax APR are ideal combinations with the residential property to achieve an SDLT reduction. In the *Hyman* case, the judge noted that the land used for a commercial purpose would be land on which a business is conducted and not therefore part of the grounds of the house, hence the suggestion of the declaration on the tax return.

The need to have to record business income at an early stage to achieve mixed-use rate will be an important point for tax planners in future. This is key for advisers trying to help their clients on upcoming sales and purchases. Both land agents and estate agents presenting the brochures must be aware of the technical detail required for the advantage of the mixed-use rate and the potential negatives of an incorrect brochure and incorrect advice. However, this should not be actioned in a single-minded way without a view to other taxes as mentioned above.

Planning point

If mixed-use rates of stamp duty land tax are being claimed, it is important that any business income is recorded at an early stage and that, for example, supporting sales brochures include technical information to support such arguments.

Commercial activity

One common pitfall when property with pony paddocks is acquired is the lack of any commercial activity before acquisition. For example, despite the intention to create a business from the newly acquired property, with clear business plans and a registered partnership in place, the lack of previous commercial activity on the land is an argument HMRC could still make.

Another area HMRC may try to attack is any failure to bring the newly acquired land into immediate commercial use, even if there are reasonable grounds for not doing so, such as delays in acquiring planning permission. This issue is less of a problem for farmers acquiring more land than for taxpayers such as the Hymans with, say ten acres with a cottage or farmhouse, because a farmer is more likely to be able to bring such new land into business usage immediately.

Ensuring the commercial activity is entered into straight away is also important to be able to provide HMRC with the evidence it requires to allow for a successful mixed-use SDLT claim. The business plan and HMRC business registration mentioned above is additional evidence of commercial use of the land.

Review time

The recent summer statement on stamp duty land tax reductions means that mixed-rate SDLT on some pony paddock property purchases is now less attractive than the residential rate. Will this result in having to make arguments to HMRC that the properties with pony paddocks are residential rather than mixed rate? This is therefore an ideal time to review all tax planning around pony paddocks.

It is very easy for the taxpayer to forget the paddock when they sell and for other professionals to omit to provide warnings of the tax advantages, disadvantages and compliances. The task generally falls to the tax adviser.

Author details

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