The Tax Problems Of Land Held For Personal Enjoyment

Julie Butler points out a recent tribunal case which highlights the importance of demonstrating that land and property was used in a commercial business, when it comes to claiming certain tax reliefs.

HMRC's continued attacks on the commerciality of equine activities have had an adverse impact on tax reliefs available on property.

A recent First-tier Tribunal case has enforced HMRC's stance on qualifying under the 'badges of trade' in order to be able to claim business tax reliefs. For example, this is the situation with regard to equine activities. It is a very easy trap for taxpayers to fall into with general farmland and potential development land to involve horses as a business that have an element of 'personal enjoyment' and are not a robust trading arrangement.

In the recent case of Blaney v Revenue & Customs [2014] UKFTT 1001 (TC) the taxpayer was denied business asset taper relief (BATR) for capital gains tax (CGT) on the sale of land in County Down. In order to claim this CGT relief – from which entrepreneurs' relief (ER) has evolved, there was a need to show that the land was an asset used in a commercial business. A lot of farmers enjoy the land from every angle but the operation also makes a profit. This case was followed swiftly by tightening of the ER conditions in the 2015 Budget (ER having replaced taper relief in 2008).

Whether the taxpayer's horse breeding business was a trade

The question that had to be considered by the First-tier Tribunal (FTT) was the matter of whether Mr Blaney's horse breeding business amounted to a trade. Whilst the breeding of horses is a trade in the correct circumstances, in Mr Blaney's case the FTT deemed that the operation was carried out for 'personal enjoyment' and was too small to constitute a trade. The judge considered that the 'principal motivation was his love of horses and horse racing'.

In Blaney the judge referred to the badges of trade in Marson v Morton [1986] STC 463. It is interesting to note that Marson v Morton was again quoted in the recent FTT case of McMorris v HMRC [2014] UK FTT 1116 (TC). McMorris was again a question of claiming tax reliefs (in this case income tax loss relief) on an equine activity. The Blaney case is a reminder that HMRC's current attacks on the question of commerciality are not restricted to sideways income tax loss claims.

Owning a racehorse

In the case of McMorris, the owning of a racehorse was deemed not to be a trade by the tribunal. It was considered that the arrangement was a one-off transaction. In addition, it was noted that the taxpayer had not borrowed any money for the venture. There was no long-term plan and Mr McMorris 'clearly derived pleasure' from the project, all of which failed to prove badges of trade. Overall, the tribunal had no hesitation in deciding Mr McMorris' activities did not amount to a trade.

It was also decided, given the informality of the arrangements between the co-owners, that ITA 2007, s 66 ('Restriction on relief in case of farming or market gardening') was not satisfied, because the activities were not carried out on a commercial basis. Whilst the courts continue to acknowledge that horse racing is not a taxable activity, in Benson v Counsell, KB 1942, 24 TC 178 it was held that sending a horse to a trainer to be raced and sold was a taxable business. However Sharkey v Wernher [1955] 36 TC 275 takes the view that the ownership of racehorses is not taxable.

A tribunal pattern

The decision on Mr McMorris' lack of badges of trade in his operation to support his income tax loss claims follows closely upon another tribunal case which examined the question of commerciality and losses associated with horses, Murray v Revenue & Customs [2014] UKFTT 338 (TC) with a focus on stud farming and racing. With the continued enthusiasm shown by HMRC to scrutinise equine activities, it is not surprising that the eligibility of tax relief on a trading loss claim has again been taken all the way to the FTT.

This was again shown in the case of Thorne v Revenue & Customs [2014] UKFTT 730 (TC), where Ms Thorne included a self-employment income page in her 2008/09 tax return for her trade as an 'equestrian breeder and farmer', showing a substantial loss. HMRC considered Ms Thorne was not seriously interested in profit but was 'just an amateur', participating in what could be considered a hobby and such an operation was therefore beyond the scope of the UK taxation system and the tax losses not allowable. These loss claim cases help give guidance when trying to claim ER and inheritance tax reliefs in the event of a future disposal or death and that there is a need for property owners and their advisers to ensure that the assets are used in a real trade not just an enjoyment, but that they are of commercial design.

A timely warning

The recent tribunal decisions prove a timely warning to all those involved in property ownership that might at some time be developed for housing to ensure that there is a real business that passes the badges of trade tests. The tax reliefs that need protecting through positive badges of trade are:

- sideways income tax loss relief;
- entrepreneurs' relief for CGT; and
- inheritance tax (IHT) relief – agricultural property relief (APR) and business property relief (BPR)

With farmland increasing in value and housing development potential returning at a very strong pace there is a lot of potential tax relief to protect. The HMRC approach of trying to deny BPR on 'do-it-yourself' horse liveries on the basis there is not a trading activity is another worry for property owners where there is potential development value, the 'hope value', will need the protection of BPR.

Commerciality needed at every level

The Blaney case shows the importance of protecting CGT relief, e.g. if land that is used in a trade is to be sold at a 10% rate of CGT through ER, as opposed to 28%.

There is also the need to consider IHT reliefs. When the deceased owns a parcel of land it will be key to try and achieve APR and/or BPR as appropriate. However, sometimes the IHT relief is denied by HMRC. Firstly, there can be a lack of awareness of the tax reliefs available on small parcels of land by executors and probate solicitors. Secondly, there can be a lack of action in the years before death to ensure that the criteria that need to be met are actioned in order to achieve the relief. For APR the land simply has to be used for agriculture. This could be farmed by the owner of the land for the last two years or by a third party for the last seven years. The stronger choice is obviously a trade that qualifies, if appropriate, for loss relief, ER and BPR.

However, as shown by Blaney, it is not enough for the land just to be used for 'personal enjoyment' – there must be evidence of a trade with a view to a profit.

Practical Tips :

- review redundant and under-used areas of land to consider how they can achieve reliefs as required;
- ensure there is a business with the correct badges of trade;
- always have a business plan to show that a profit can be achieved;
- ensure that the correct IHT reliefs are claimed during the probate process;
- consider future requirements from land with regard to tax relief; and
- ensure that where there is a business there is also a trade that would survive HMRC scrutiny for commerciality.