Tax ahoy!

Julie Butler looks at the outcomes of two recent cases involving loss claims by yacht chartering businesses

PROFILE

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Profile Julie Butler is a farm and equine tax specialist. Her articles are published in the national accountancy and tax press and she is the author of *Tax Planning for Farm and Land Diversification*, *Equine Tax Planning* and *Stanley: Taxation of Farmers and Landowners*.

There have been two recent cases of yacht chartering that have recently made tax loss claims and then come under HMRC attack, with mixed results. In *Adrian Salmon v HMRC* (TC3789), the taxpayer lost over the question of 'active involvement' in ITA 2007; whereas in *Beacon Estates (Chepstow) Ltd v HMRC* (TC3808), the taxpayer won, having demonstrated the realistic possibility of recording a profit.

In the *Salmon* case, the taxpayer bought a yacht which he chartered (hired) to customers. In his tax return, he said he was in the yacht chartering and skippering business and claimed tax losses arising from capital allowances against his other income. He was unaware that ITA 2007 s 75 precluded such losses being used in this way, unless he spent at least half his time carrying on the trade.

Active involvement: Salmon

In *Salmon*, HMRC raised discovery assessments (TMA 1970 s 29) to recover the tax when they realised that the taxpayer did not meet the requirements of s 75. The taxpayer appealed, saying the return had contained sufficient information for HMRC to have realised the incorrect claim in due time.

Mr Salmon argued that his description of his business as chartering and skippering made it clear that there were two separate activities. This should have led HMRC to note that one activity, chartering, involved the mainly passive letting out of a yacht on a bareboat basis, which could not have satisfied the conditions in s 75.

Ambiguous description

The First-tier Tribunal (FTT) disagreed that the description should automatically have indicated the business was bareboat chartering. It was considered not unreasonable for HMRC, from the business description, to have assumed that the taxpayer met the active involvement test. An inspector would have had to ask for more information to know there was an underpayment.

Furthermore, s 75 was 'of fairly limited relevance', used mainly in the context of 'hobby farming', and it was 'unrealistic to assume that the average inspector should be assumed to have been aware of it'.

HMRC were entitled to raise a discovery assessment and the taxpayer's appeal was dismissed, and therefore the tax losses were disallowed.

Carried on commercially: Beacon Estates

In the second case, *Beacon Estates*, the FTT was asked to consider whether a business was being carried on commercially.

The company carried on a yacht chartering business, experiencing a number of difficulties that gave rise to losses. In considering whether those losses were eligible for relief, it was necessary to determine whether ICTA 1988 s 393A (now CTA 2010 s 44) applied – both expressing the same test that the trade must be carried on 'on a commercial basis and with a view to the making of a profit in the trade or so as to afford a reasonable expectation of making such a profit'. The need to satisfy such a test is often being questioned by HMRC.

A view to making a profit

The FTT said in *Beacon Estates* that 'with a view to the making of a profit' should be interpreted to mean 'allow a realistic possibility of making a profit', thereby importing an objective element directly into the test.

Applying this test to the facts of the case, the tribunal decided there was a realistic possibility, or reasonable expectation, of the company making a profit from its chartering activities. The losses were thus allowed.

Action plan

Shown in conjunction with other recent cases, including *Glapwell Football Club Ltd* (TC2904), *Richard Murray* (TC3474) and *Judith Thorne* (TC3851), the key element has been the ability to provide evidence that a profit motive existed, usually via a business plan.

It is fair to say that it must be assumed that all tax loss claims will be questioned by HMRC with answers being at the ready if required. It is essential that there is evidence of both active involvement and commerciality. Ideally, there must be both diaries and business plans.