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The importance of good bloodstock accounting advice: steps to take and pitfalls to avoid

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Equine business tax and accounting is a multifaceted and complicated business sector. With many rules specific to the industry, it often requires a specialist advisor who understands these intricacies and complexities in order to maximise tax reliefs available and avoid potential pitfalls with HMRC and other agencies.

Stud farming – Tax status

Stud farming, defined as the 'breeding and bringing on of horses' is regarded as farming for tax purposes and is therefore subject to many of the accounting rules governing agriculture, with a few notable exceptions. Ensuring full compliance with the 'farming' definition will therefore mean access to a wide variety of valuable tax reliefs. Failure can mean extra costs and tax liabilities, both in the short and long term. The role of the equine accountant is to have specialist knowledge in those areas and ensure the various entities have full access to the tax reliefs available, from the smaller owner-breeder through to the larger, more-international operations.

Whether or not an equine business qualifies as a commercial farm, and therefore can qualify for the tax reliefs available, depends on a number of factors. To qualify for agricultural property relief (APR) from inheritance tax, and therefore a lower tax liability on passing such businesses on to the next generation, property must be occupied for 'agricultural purposes'. Agriculture is not defined in law [IHTA 1984], but HMRC's own Inheritance Tax Manual provides some useful guidance on land uses that would fall within this category (IHTM 24068) - HMRC therefore accepts that stud farming can be regarded as husbandry and therefore qualifies for the tax reliefs mentioned. The equine accountant plays a key role in ensuring the terms of the definitions of arming to secure the reliefs are complied with and can also provide guidance so as to ensure these are maximised in the form of planning strategies.

If a stud farm or horse breeding operation is being run on commercial lines or with business intent – i.e. the profit making motive - then the trading results will almost certainly be taxable as business income; whereas hobby activities are not normally regarded as a taxable trade and have no tax levied upon them. It is often difficult to tell the difference, which is where specialist advisers will investigate and advise on whether an undertaking is commercial – and therefore taxable - or a hobby, in which cash inflows and outflows fall outside the scope of the tax system. These principles apply whether the activities are run by an individual as a sole trader, through a partnership or a limited company.

If the stud farm or horse breeding entity can be established with HMRC as a taxable trading business, it can obtain some of the benefits of the available reliefs for capital gains tax and inheritance tax, which may, in some cases, cover the stud 'farmhouse' – or the breeder's private residence next to the land occupied for stud farming. These reliefs should not be put at risk as they can prove to be invaluable at later dates but are complicated to determine and usually need specialist experience to identify.

Trading Structures

The choice of which trading structure is to be preferred must be looked at in detail and will depend on the specific objectives of the proprietor and the level of risk involved.

Many stud businesses might look to the protection of limited liability in view of the high-risk nature of the equine industry. Limited Companies are also taxed at a lower rate, in general, than unincorporated entities – especially where strong profits are made. Particular tax problems which may arise here, however, in that trading losses might become 'trapped' in a company setup, and the stud land and buildings will not qualify for business asset disposal relief from capital gains tax. The latter will only apply to stud businesses which own their own land and buildings; however, all equine businesses which own land inside a limited company, will suffer the same problem.

It can therefore be more preferable to set up a cheaper, unincorporated entity, such as a sole trade or partnership, where initial losses can be claimed against other taxable income. On the flip side, this does come with the risk of unlimited liability if things go wrong, something that a Limited Company can help protect against.

In these times of Covid-19, unincorporated entities have also seen more government financial support than their limited company counterparts.

Stud farm losses – 11 year loss rule

As losses from breeding often continue for a number of years, specific legislation was brought in during the 1960s to restrict (define and protect) relief for losses in these circumstances. Guidance is found in section 67 ITA 2007 which states that, "if a tax loss from farming has been made for the past five fiscal years, the sideways loss reliefs against income in the current or prior periods shall not be available for losses sustained in any future year" – in other words, after five years' worth of losses, the business is deemed to be a 'hobby' undertaking and is no longer valid for tax purposes.

This loss period has been extended to 11 years from inception for stud farms within which to make a profit, in recognition of the longer lead time between breeding and sales involved with the horse business. Sporthorse breeding can be an industry with a slow rate of return. Breeders can't hurry the birth of a foal or its training and development.

Accordingly, there are many breeders who think that they just have to make a profit from the trade by the 11th year when starting off in business, and then every sixth year after that. But though allowances are made for the long-term nature of the trade, to achieve the tax relief that is available there has to be proof of commercial motive in the breeding operation, and clear differences to separate a potentially profit-making business from the hallmarks of a hobby undertaking.

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It is worth returning to the 1982 communication from HMRC to the Thoroughbred Breeders' Association (TBA) which stated: 'We have long accepted that the breeding of 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' (but note that the Income and Corporation Taxes Act, ICTA 1988, s 397, is replaced by the Income Tax Act, ITA 2007, s67).

HMRC has been closely reviewing all tax loss claims related to horse breeding, especially when there is no history of profit and the tax relief obtained is against other Income taxed at the higher and additional rates (i.e. above £50,000). These are difficult times for the trade, and before conditions improve, it is essential that breeders and studs have protection in place to preserve these loss relief claims

Impacts of Brexit

The full impacts of Brexit on the equine industry are, at the time of writing, still uncertain and therefore this is a difficult time

for advisors to be issuing any strategic plans for the industry to follow. What is certain is that the present arrangements and agreements will cease, so this must be considered if journeys are already being planned in January 2021.

At this stage, in relation to the permanent exporting horses to the EU, it seems that the following will be required:

1. Blood testing to prove the absence of Equine Infectious Anemia and, for male horses over 180 days, Equine Viral Arteritis to obtain an Export Health Certificate.
2. A horse passport and either an EU-recognised studbook registration or a government-issued supplementary travel ID from APHA.
3. A customs declaration form will also be needed to be prepared prior to the animal arriving at the border
4. The exporter of the horse will need an Economic Operator Register and Identification (EORI) number, available from HMRC
5. The horse will also need to be examined at an EU border control post before entering Europe; not all customs points will have facilities to check equines, so routes should be planned carefully.
6. There is also the possibility of tariff charges being levied, depending on the type of deal struck between the government and the EU.

These additional costs should be factored into the sale price of any sporthorses being sold to Europe or elsewhere beyond the UK from 1 January 2021 onwards.

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In terms of competition horse moving for events on the continent for next season, it is possible that the above rules will need to be adhered to, but this will be confirmed when the UK government concludes negotiations with the EU. Specialist equine accountants and equine transport companies can help with the above, but the general advice remains to check well in advance of travel, and avoid movements in the first two weeks of January as the new rules bed in, if it can be possibly avoided.

Bloodstock accounts together with tax planning are complicated, especially with regard to valuation, VAT, commerciality etc. This editorial looks at a very small area of bloodstock tax. The author, Julie Butler, has published Butler's Equine Tax Planning for more comprehensive understanding.

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