

The sale of a horse for VAT

Julie Butler FCA considers the VAT implications when selling a racehorse from shared ownership to applying the business economic activity test, particularly in light of the McMorris case

15 Aug 2019

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If a horse is sold by a sole trader who is in business with another activity, there may be a worry that VAT will have to be charged as the sole trader VAT registration could be seen as relevant to all business activities of the sole trader, including horse ownership.

If it is not clear that the horse activity is a business activity or a hobby, then the business tests must be applied to help decide on the VAT and tax position. However, there is a further complication – if the sale is of a part share in a horse, the supply is deemed to be of services rather than goods; unless all the shares are transferred simultaneously (see HMRC’s VAT Manual at [VATSC71600](#)) in which case it will be the sale of goods.

The case of McMorris

In [McMorris](#) [2015] TC4204, the First Tier Tribunal (FTT) found that Mr Ewan McMorris was not carrying on a trade while involved in the activity of horse ownership.

The primary issue involved in the case was whether he should be permitted to set losses from a ‘racehorse activity’ against other income of the same tax year. To prove the eligibility of the losses, McMorris had to prove that they were the result of a commercial trade. He had bought a half-share in a racehorse in February 2010 and agreed to meet half the training and racing costs. Initially, the racing results for the horse were positive and the owners refused an offer of £50,000 to buy the horse.

The racing success did not last and in summer 2011 the owners sold the horse for £1,000, of which McMorris received half. In his 2010/11 tax return, he claimed loss relief in respect of a trade, which he described as ‘racehorse’. HMRC refused the claim for income tax loss relief on the ground that owning a racehorse was a hobby, not a trade.

The FTT referred to the badges of trade as explained in *Marson v Morton* [1986] STC 463. The tribunal decided that the deal was a one-off transaction. Further, because the taxpayer had not borrowed any money for the venture, there was no long-term plan for the operation and he ‘clearly derived pleasure’ from the project, all of which pointed away from the badges of trade.

Overall, the tribunal decided that the activities did not amount to a trade. The judge added that, given the informality of the arrangements between the co-owners, Income Tax Act (ITA 2007), s66 was not satisfied because the activities were not carried out on a commercial basis. The taxpayer’s claim for loss relief failed.

Racehorses – no business economic activity

As demonstrated by the *McMorris* case, if the activity is not a business, the sale of a horse should be outside the scope of VAT.

If, by contrast, a situation meets the badges of trade and qualifies as a business activity, the taxpayer would be able to recover VAT on relevant costs.

If the income of the operation consists of occasional prize money and the possibility of a profit when the horse is sold, HMRC may challenge the recovery of VAT on costs relating to it on the basis that a commercial trade is not being undertaken. The only reason to deny registration to someone owning, or part owning a share of, a horse would be that it is not regarded as an economic activity.

While one must consider the general rule, that all economic activities of the same person falls under a single registration, which could lead to the conclusion that output tax is due on the sale, it is important to note the commercial and trading definitions prior to this charge being levied or VAT expenditure being reclaimed.

VAT registration for racehorse owners

The VAT Registration Scheme for Racehorse Owners commenced on 16 March 1993, allowing VAT refunds from this date to be claimed on racehorses in full training, providing some output tax was recorded against these inputs.

In HMRC Notice 700/67, HMRC states that output tax is due on prize money if a racehorse owner is registered for VAT. However, the Court of Justice of the European Union (CJEU) ruled in *Pavlina Bastova* [2016] (Case C-432/15) that providing a horse for a race was not a supply for consideration if payment was entirely dependent on the horse winning (or achieving a high ranking).

Therefore, in order to circumnavigate this point, HMRC insist that a level sponsorship is received by the horse’s owner that has output VAT charged upon it, in order to claim back input VAT under the scheme. HMRC normally expects to be satisfied that there is at

least the prospect of regular income from sponsorship before agreeing to a VAT registration under the scheme.

Sale of part share of a horse

It has been confirmed that, per VAT Act 1994 (VATA 1994), [Schedule 4, para 1\(1\)](#), the transfer of any undivided share of the property is a supply of services. Thus, as a horse is deemed undivided property, then the sale of a 50% share is deemed to be a potential supply of services; assuming the business holds a valid VAT registration, has passed the various badges of trade tests and is trading in the sale of horses.

The only variance to this rule is where all shareholders dispose of their shares simultaneously; in such a scenario, the entire horse is being disposed of and therefore this counts as a supply of goods.

Treating a horse share sale as a service opens further complications involved with the place of supply, which again can determine whether a VAT charge should be levied. The result is that in such a scenario, advisers must follow place of supply rules and HMRC [VAT Notice 741A](#):

1. if the transaction undertaken is business to business (B2B) with a company or business dealing in horses in the normal course of their trade, then the service is deemed to have originated in the place where the customer belongs. If this is outside the UK, no UK VAT should be charged, although the transaction may be subject to local taxes in that other country.
2. if the transaction undertaken is business to consumer (B2C), ie, a private individual or a company that does not deal in horses in the normal course of trade, then the service is deemed to have originated where the supplier is based, ie, the UK, and therefore full UK VAT should be charged.

For example, where 50% of a horse is being sold and the other 50% is being retained, the supply being made is deemed by HMRC a service.

If the sale is made to an Irish VAT-registered company that deals in horses in the normal course of its trade, then the transaction will be deemed to have originated in Ireland, and no UK VAT should be charged as this transaction is 'outside the scope' of UK VAT.

If, however, the other party was an individual resident in Ireland but had no business interests in horses, then the transaction would be deemed to B2C and will originate in the UK with VAT chargeable on the transaction.

Margin scheme

HMRC Notice 700/76 states that the margin scheme is available to a person who is chargeable to VAT, ie, in business and commercially trading, on the sale of a horse on whose original purchase they did not recover input tax, subject to the various conditions

of that scheme as set out in HMRC Notice 718: The Margin and Global Accounting Scheme (see HMRC Notice 700/67, para 5.4). So, if the transaction is within the scope of VAT, the output tax will be restricted to the margin made on the animal in question, rather than the proceeds.

Sale of a share in a partnership

Where there is a situation in which the horse is being sold by a partnership, where one joint owner is selling a share to someone else, VAT treatment will again need to be considered. Such action is akin to an individual partner selling a share in a business partnership.

It is considered, particularly given HMRC's stated policy on minority shares in the notice, that this should be treated as an investment transaction (outside the scope of VAT) rather than an economic activity. VAT should therefore not be charged on such transactions.

Summary

The sale of private horses and horses used in a business can be easily confused and the various different VAT approaches can make the correct treatment by advisers extremely complicated to determine.

In addition to identifying when VAT should be applied to an equine transaction, advisers should have an understanding of both the Racehorse Owners Scheme and the Margin Scheme, as well as being aware of the complication involved with part share sales.

The *McMorris* case gave guidance on the complexity of the commerciality question. The key is to consider all transactions of horse sales on their merits and plan ahead. Nothing is straightforward on the sale of horses.

About the author

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