

# THE TAXMAN AND THE STUD FARM

## How to let one assist the other

Racing, so aptly named the sport of kings, is an integral part of country life. Likewise, the breeding of racehorses and it is therefore very encouraging to know that indulgence of this passion can be tax efficient. This article will try to set out the tax advantages and tax breaks.

With the collapse of the farming industry there are many alternative land uses being considered. What about a stud farm? What are the criteria for being able to claim tax losses on a stud? Does there have to be a stallion? Does there have to be a certain class of thoroughbred? The answers to these last two questions are no and no. In order to obtain the reliefs for VAT, income tax, inheritance tax and capital gains tax the stud must simply be run "commercially" with a "view to a profit." Although there is a quote in the Inspector's Manual "regardless of commercial viability" it is still suggested that every possible step towards profit is made.

The other distinct advantage of the stud farm is that the tax losses that can arise are extended from the normal "five year" rule for a farm to "eleven years". Losses that arise from a farming business can be offset against total income. However, there must be a profit every six years, i.e. there can only be five years of losses. For stud farms there must be a profit every twelve years, i.e. there can only be eleven years of losses. *So the stud farm is free of "death duties" and tax losses can continue being offset against the other income for eleven years.*

What if a stud farm never generates a profit? What happens if the losses last for more than eleven years? The simple answer is that in this case the losses can only be carried forward against future profits and not set against other income. As with

any business enterprise it will be essential that a stud farm venture has a business plan, a cashflow forecast and a profit motive. It could be advisable to try and borrow money from the bank to fund part of the venture. This will ensure the forecasts are carefully reviewed by a bank manager.

So racing is tax free? Why it might be asked? Clearly racing has in the past been a luxury passion that can absorb money as opposed to generating it. The ability to 'eat money' is similar to yachts or country homes that are not available for let. Racing can generate income and there are some horses who pay for themselves (and more) and some owners who manage their horses in training very efficiently.

The Tax Inspector's logic behind the "tax free" element of racing must be that if you do not have to pay tax on the profits you cannot claim tax on losses — a smart gamble by the

Inland Revenue. However, the positions concerning studs and race sponsorship present a different situation which can be used very tax efficiently by the racing fraternity.

For those racehorse owners who do not enjoy a stud farm with their racing activities the tax efficiency of financing the racing activity through a business interest such as sponsorship should never be overlooked. Likewise, the VAT benefits of this option need careful review.

### So what about tax benefits for the stud farm? The Tax Inspectors Manual helps give direction:

"Stud farming, which in these paragraphs is taken to mean the occupation of land for the purpose of breeding thoroughbred horses, is a very expensive and high-risk activity. In some cases it may be carried on by wealthy individuals essentially as an adjunct to their racing activities. Nevertheless, for tax purposes it is treated as farming and thus as the carrying on of a trade regardless of its commercial viability."

Horse racing, however, is not a taxable activity. It is, as mentioned above, "tax free". Where, as is often the case, a stud farmer also races horses, considerable care may be needed to ensure that the division between the two activities has been correctly made. In particular, attention should be given to any transfers of animals from the stud farm to training (that is, being kept for the purpose of racing) or vice versa."

The very significant point with regard to stud farms is that they do qualify as an agricultural property for agricultural property relief for inheritance tax purposes. If a claim for agricultural property relief failed a business property relief claim could



be made. In simple terms this means that a well planned stud farm can escape death duties (inheritance tax).

So what is the tax treatment of the other angles of the stud farm?

If a breeder transfers any animal to training and it is then returned to stud at a higher value after a successful racing career then the uplift in the market value whilst it is in training is tax free. Furthermore the value at which the animal is returned to stud is relieved over the rest of its life. The valuations of animals at the dates of transfer to or from training are, therefore, significant.

A form of income can be the stallion syndicates and tax position on the sale of the share in a stallion together with the sales of nominations must be considered.

Since the cost of buying a successful stallion outright is prohibitive for some bloodstock breeders, ownership may be shared in a syndicate. The proceeds of any sales of nominations are treated as trading receipts. Any contribution by the stud farmer towards syndicate expenses will be an allowable trading expense.

So where does this leave the participants in the sport of kings? Any profits are tax free and it can be argued any expenses could be underpinned by sponsorship. When racing moves to a stud farm it can result in the whole of the farm escaping death duties. But is there more? What of the good news of the Finance Act 2002 and the very favourable capital gains tax rules?

Since 6 April 2002 provided that a business asset such as a stud farm has been owned for a minimum of two years and used for a business purpose (which a stud is) then the rate of capital gains tax is 10% (or better known as 75% business asset taper relief). The serial entrepreneur could possibly take advantage of these business rules by aiming to ensure that land due for development would obtain business status whilst having the pleasure of enjoying a stud farm.

There must be many landowning studs that are very mindful of Mr Prescott's statement for the need for more houses. Where will these be built? For example, if a piece of land could be developed to "grow houses" at a future stage and the land



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needs business status there is scope to achieve "business" status through the medium of the stud farm. Enter "stage right" the reluctant stud farmer, i.e. the entrepreneur who wants to use (abuse) the business tax advantages of stud farming to try and mitigate future tax liabilities on land that might be developed.

It might be that the stud farmer would like to take advantage of limited liability and trade through a company. This has the disadvantage of no business asset taper relief and trapping the tax losses in the company. It is not advisable to own stud land in the limited company. It is through the limited company that a further tax relief might be available – EIS (Enterprise Investment Scheme). Strictly farming is an excluded trade to qualify for EIS and as stud farms are deemed to be farming for agricultural property relief for inheritance tax it should not qualify for EIS. A stud farm is deemed to be "agriculture" and "farming" but sections of the stud farming activity could escape the definition of farming for EIS.

#### **So what could the advantages of EIS be?**

- ◆ Immediate income tax relief of 20%.
- ◆ Deferral of capital gains.
- ◆ If the investment is held for more than three years the gain will be tax free.

With the move away from farm subsidies by Europe and the apparent

direction of the revival of the rural economy there should be scope to convert traditional farms to stud farms. The planning permission angles to provide accommodation for staff and to convert traditional farm buildings to stud buildings should be received favourably by the planning authorities. The reality is of course more difficult than the theory but good planning consultants should help greatly.

The CLA (Country Landowners and Business Association) are currently lobbying the Government about tax reforms – "Reform to Perform". It will be important for the stud farms to be represented in this lobbying. Stud farms provide rural employment, serve as a useful alternative to traditional farming and have a tax voice that needs to be heard.

The reader may be totally confused by the abundance of tax reliefs available. Nevertheless, the potential is almost limitless and it is hoped that this article highlights the value of enlisting good tax advisers.

*Article supplied by Julie Butler  
FCA, Butler & Co, Bowland House,  
West Street, Alresford, Hampshire,  
SO24 9AT. Tel: 01962 735544  
Email: j.butler@butler-co.co.uk*

*Julie M Butler FCA is the author of  
a forthcoming Butterworths Tolley  
title 'Tax Planning for Farm and  
Land Diversification'  
ISBN: 0754517691*