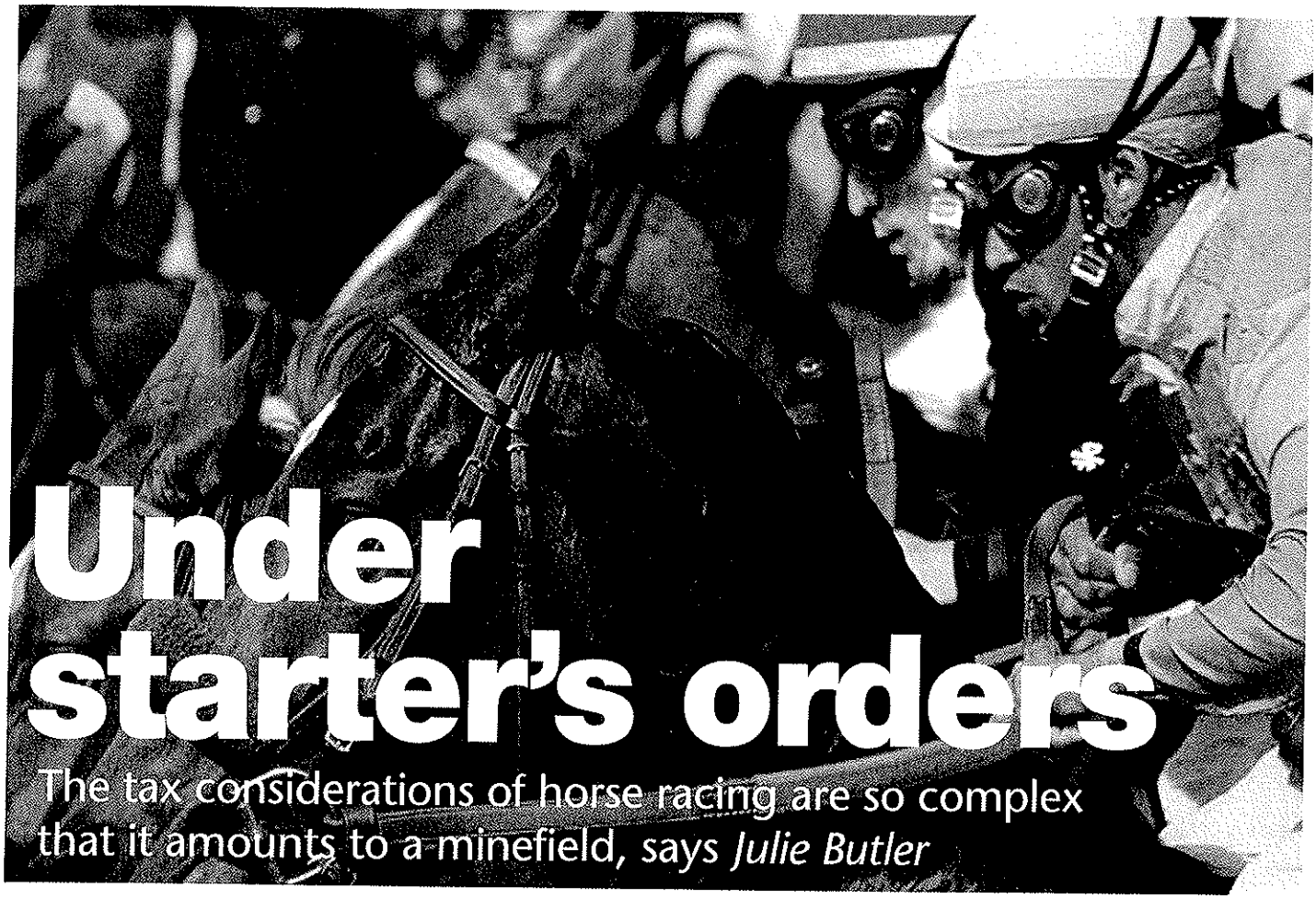

Under starter's orders

The tax considerations of horse racing are so complex that it amounts to a minefield, says *Julie Butler*

The 'sport of Kings' has wide-ranging implications for tax advisers and their client base.

What are the client tax needs? The owner, the trainer, the jockey, the breeder and gambler all have complex tax considerations. The equine industry expands into the whole world of the 'horsey culture' from the sports horse to the happy hacker. A tax minefield.

Racing is tax free

Guidance is given in Inspector's Manual BIM55701 Farming Stud Farms: Overview. It states:

'Horse racing, however, is not a taxable activity. Where, as is often the case, a stud farmer also races horses, considerable care may therefore be needed to ensure that the division between the two articles 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.'

If a breeder transfers an 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 while it was 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.

There is a strong tendency for accountants and tax advisers to totally or partially ignore any of their client involvement with racing on the basis that horse racing is tax free. Likewise, gambling is totally tax free (*Graham v Green* [1925] 9 TC 309).

Profitable racehorse owners and gamblers are so rare that HMRC would not want to disturb the tax-free position and open floodgates to loss claims. But what are the tax pitfalls of racing that are often overlooked, and what are the practical tax planning points that can be used to help clients?

Racehorse owners' VAT scheme

The 2006 Budget confirmed that the VAT registration scheme for racehorse owners will continue for the lifetime of the current parliament.

Tax advisers should try to ensure that VAT claims are maximised. The key emphasis is on sponsorship and/or appearance money to show commercial compliance with the 'code of conduct' in order to qualify for the claim.

This area of tax planning can be taken a stage further to corporate income tax or corporation tax relief from racehorse sponsorship with emphasis on marketing, advertising and PR.

When looking at sponsorship, the March 2007 case of *McQueen v Revenue & Customs* (2007) UKSPC SPC00601 has given great hope to those contemplating and reviewing sponsorship arrangements.

The stud farm

The UK stud farms do have distinct tax advantages, which should not be overlooked.

- A stud farm is farming (*ICTA* 1988, s. 31(1), and has all the associated reliefs of farming, agricultural property relief on land, stables and possibly the stud house (but note recent cases of *Antrobus* and *Amader*).
- Eleven-year loss rules (improvement on the five-year rule).
- Business reliefs for capital gains tax, especially business asset taper relief and rollover.
- Potential business property relief on cottages and outbuildings, see *Farmer (Exors of Farmer dec'd) v I R Commrs* (1999) STC 321.
- But note that stud farming has problems on qualifying for enterprise investment

scheme relief – other equine activities might qualify.

The HMRC Manual at paragraph BIM55701 sets out the overview as follows:

'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, by virtue of section 53(1), Taxes Act 1988, as the carrying on of a trade regardless of its commercial viability.'

It is worth quoting the HMRC Manual at paragraph BIM55725:

'Following discussions with the Thoroughbred Breeders' Association in 1982, Policy Division wrote to the association as follows:

"It has always been recognized that some ventures are by their nature unlikely to show a profit by the sixth year of trading and section 397(3) provides for loss relief to be continued after the fifth year where the claimant is engaged in a particular farming activity of an intrinsically long term profit making nature. We have long accepted that 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." '

Ownership via EIS schemes are very fashionable, and investment in racing clubs and 'pin hooking' syndicates, and breeding syndicates with EIS relief are readily available.

Stallion fees

Stallion fees are taxable in the UK under Sch D case VI (*Benson v Counsel (Inspector of Taxes)* 1942 24 TC 178). This nomination income (Inspector's Manual BIM55730) must be included on the tax return even if the costs of racehorse ownership far exceed the nominations.

So how can the tax bill on stallion fees be minimised? The stallion fees can be included in a Sch D Case 1 stud farm provided the stallion share is used on the stud's own mare.

Jockeys, trainers, stable staff

The racing industry is riddled with non-cash benefits that can cause practical problems for advisers. Presents to successful jockeys and trainers by owners are taxable – *Wing v O'Connell* Supreme Court (IFS) 1926 IR84.

Living accommodation provided to stable staff can be tax free provided the conditions are met (Inspector's Manual SE68502). This can include accommodation being provided by third parties (Extra-statutory Concession C60), which means that double tax relief can be achieved through the rent-a-room scheme.

It is standard practice for trainers, jockeys and sometimes other interested parties to receive free shares or nominations on the syndication of a stallion when it retires to stud. For the self-employed, the current value of the nomination should be shown as trading income. The employed should be taxed on the value of the 'cost to the provider'. Ironically it was Alex Ferguson who brought this benefit to the eye of the public in the form of the potential stud income from the horse 'Rock of Gibraltar'.

Staff accommodation will only qualify as tax free if it satisfies the 'customary' and 'proper performance conditions'.

Accounting treatment of racing and stud interaction

It is important to recognise the difference between racing and stud farms. The racing adjustment is fairly complex from the angle of accounting and tax treatment.

If the occupier of a stud farm races animals bred by him:

- The stud farm accounts should be credited when animals are transferred to training with the then market value of the transferred animals, as if they had been sold at that value (*Sharkey v Wernher* 36 TC 275).
- When animals return to the stud farm after racing, the stud farm accounts should be debited with their market value, at the time of return, as if they had been purchased at that value.
- If an animal purchased and not bred on the stud farm is brought into the stud after racing by the occupier, the stud farm accounts should similarly be debited with the then market value of the animal, as if it had then been purchased at value.

VAT and liveries

The Customs & Excise Business Brief 21/2001 issued on 21 December 2001 (Business Brief 21/2001) gave apparent clarity to the John Window Tribunal decision.

Where the supply of stabling and livery services are put together as a single supply, then it can be exempt from VAT, subject to the definition of livery services.

It is important to review what is included in livery services. These are services provided for horses in a stable that go beyond the right to occupy the stable. They may include feeding and watering, mucking out, turning out, worming, clipping, plaiting, exercising, cleaning tack, grooming, breaking in, schooling and arranging for vets. It does not include clearly identifiable separate supplies such as vets' services.

Moving away into the more basic world of the horsey culture, one of the key problem areas is the charging of VAT.

The business brief is considered to be misleading by many, and the fact that 'full liveries' are being treated as an exempt supply seems a contradiction to the basic VAT principle of the supply of land. The equine industry has suffered from looking at the short-term VAT advantages of exempt liveries without considering the more important considerations of the business CGT and IHT reliefs that would be lost through the treatment of liveries as essentially non-trading income.

Trainers and combined business

Many racehorse training establishments sadly trade at a loss. The trainer must try to avoid his activities being classified as a 'hobby' or non-commercial, and therefore having his losses restricted to carry-forward under section 385 as opposed to offset 'sideways' under section 380 (section 381 for the early years). There has been a trend or fashion over the years to merge businesses and hide the possible non-profitability of the racehorse trainer.

Tax inspectors are having a lot of success insisting that the business should be split and that the trader is out of time to claim that the losses of one activity should be offset against the profits of the other. As a result inspectors are collecting lots of extra tax, because the losses are carried forward and not offset sideways against other income. The key is to separate out the businesses before the inspector insists on it and to try to make sure that a sponsorship agreement is in place, which helps to ensure that the racing business is profitable and commercial.

Racing is a wonderful vehicle for marketing and PR and can add commercial advantages to an associated business, which is best established via a formal sponsorship arrangement as opposed to an unstructured merging of the two businesses.

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