FarmTaxBrief

Practical guidance on effective tax planning and the law relating to agricultural land

Briefing

Valuing horseflesh: stock valuations and the equine business

As horse businesses appear to gradually replace traditional farms, the practitioner is faced with problems of understanding and treatment.

The most common problems for the practitioner when dealing with equine accounts are stock valuations combined with the definition of the stud activity (farming) and other equine activities. Is it or is it not a farming activity? BEN 19 does not necessarily come to the rescue.

Breeding can be agriculture – but there must be occupation of land

For the breeding operation to be treated as agriculture, the stud must be carried out in conjunction with the occupation of land. This can either be through owning the land or through having a tenancy.

Where the mares are boarded at stud in return for a keep fee, the mare owner is not carrying out an agricultural activity as he is not occupying land. This activity can then be considered as qualifying as an EIS. Although the stud is agriculture, BEN 19 does not apply.

Horses used for a trade must be treated as stock

An accurate valuation is crucial for the stud accounts and for the accounts to survive scrutiny by HMRC. Stock is essentially valued at the lower of cost and net realisable value.

Section 30 ITTOIA 2005 states that the horses must be treated as stock unless they are kept on herd basis, which is not generally appropriate for horses.

S30 Animals kept for trade purposes

Animals or other living creatures kept for the purposes of a trade are treated as trading stock if they are not kept wholly or mainly:

- For the work they do in connection with the carrying on of the trade;
- For public exhibition; or,
- For racing or other competitive purposes.

But they are not treated as trading stock if they are part of a herd in relation to which a herd basis election has effect.

(3) This section applies to shares in animals or other living creatures as it applies to the creatures themselves.

(4) This section does not apply to professions or vocations.

Competition animals – fixed assets

Where the animals are kept purely for competing, they can be included as fixed assets. However, this is very unusual as most animals are kept in a business either for breeding or for sale. Most animals kept purely for competing are owned privately and would not therefore be included in the business accounts.

If competition horses were to be included as fixed assets it is more difficult to argue associated expenses would be allowed for tax purposes.

The whole issue of sponsorship and duality is a subject of much debate.

Cost of production – deemed cost must not apply

The HMRC internal guidance at BIM55420 states that the deemed cost method of stock valuation described in Para 7 BEN 19 should not be used for horses. (BEN 19 is a long-standing revenue business economics note concerning farming stock valuation).

Instead the cost of production needs to be used. This is described very clearly in BIM55710 as set out below.

Stock Valuation

Except where the herd basis has been adopted, both stallions and mares should be dealt with as stock in trade and valued individually at the beginning and end of each year on the usual basis of cost or net realisable value (see BIM55705), whichever is the lower. Stock valuations should also include any foals and, where appropriate, stud fees paid (see below).

In the case of stallions (but not mares), we accept a rule of thumb method of valuation, whereby the cost of the animal is written off by equal annual instalments until it reaches the age of 10 (15 for valuations as at dates up to and including 31 December 2000). This rule of thumb method is an attempt to arrive at an acceptable figure for net realisable value where this is less than cost. It is not appropriate:

- Where a better figure is available because the animal is valued at the balance sheet date; or,
- Where it would give an unreasonable result. For example, in those exceptional cases where the value of an animal increases or drops at a rate significantly slower than that used in the rule of thumb because, for example, of very successful progeny, the figure computed using the rule of thumb should be increased to an amount not exceeding cost.

This is the overriding rule of the lower of cost and net realisable value. Shoeing fees and vets fees are written off to profit and loss.

Stud fees paid – the nomination

This is again made clear in BIM55710. The stud fee or 'nomination' fee paid by the owner of a mare for the services of a particular stallion can be a substantial sum. Unless:

- The mare has already given birth to the foal, or is known not to have conceived, or has aborted, by the accounting date; or,
- An 'adjusting event' (see BIM33140) occurs – for example, the discovery between the balance sheet date and the date the accounts were finalised of a congenital defect rendering the foal valueless.

The fee paid should be reflected in the balance sheet by one of the following methods:

- Including the fee in a stock valuation of the embryo or foetus of the foal;
- Increasing the value of the mare while she is carrying the foal by the amount of the fee; or,
- Carrying forward the fee as a prepayment.

Foals

When the foal is born the stud fee becomes part of its cost. foals should normally be included in the stock valuation at cost, ie the nominal fee, depreciation of the mare and keep to the date of the year end.

Breeding stock

The value should be increased each year by the cost of the keep. Industry standards have been agreed at figures such as £75 per week. Net realisable value must be considered so that if the cost of production is greater than net realisable value it must be reduced.

When young stock are 'broken' for work

When the stock is 'broken' for work, strictly it should come out of the agricultural business at its then market value and be transferred into the breaking or dealing business. There can be complications with the sports horses, which are dealt with below. In the racing industry it is quite straightforward; once the horse goes into training, it ceases to be agricultural until the horse comes back to the stud, when it re-enters the agricultural environment. The transfers to and from racing are at market value.

Stallions

The income from stallions is assessable as 'other income' (formerly Sched D Case VI income) unless the stallion is integrated into the stud.

The racing industry, through the Thoroughbred Breeders Association (TBA), agreed with HMRC that stallions can be written off up to the age of 10 in equal instalments.

This agreement was negotiated to encourage the owners of flat racing stallions to stand them in the UK. The flat racing industry does not consider the popularity of a flat bred stallion as a National Hunt sire to be a success, hence the expectation of a short useful life for these horses.

If the horse is growing in value, then the depreciation is unlikely to be agreed. Sports horse stallions are likely to grow in popularity as their progeny become successful. Where horses do not become visible to the public until they are eight or 10, the time lag will be significant. It can be inappropriate to write off in 10 instalments and the policy must be reviewed and, if changed, this must be documented.

Sports horses v race horses ('bloodstock')

The rules of racing prohibit using artificial insemination (AI) or embryo transfer. In other areas of equine sport, AI is routinely used meaning that stallions compete at the same time as being used at stud. Even stallions used for natural covering on mares frequently compete.

Embryo transfers are used for good performance mares in showjumping, eventing and polo, where the mare continues to compete while her genetic offspring is developing in another mare via *in vitro* fertilisation.

Assuming the stud is a trade where sports horses are competing at the same time as their breeding activities, competing expenses should be treated as wholly and exclusively incurred for the purpose of the business. The number of mares being sent to a sports horse stallion depends more on its current performance than its breeding. Once a horse has been established as a successful stallion, which may take up to 10 years from the date it is first used as a stallion (say at four years of age), current competition records become less important. This is an issue particularly in the UK as opposed to Germany, Holland or Belgium where the sports horse breeding industry is some 30 years ahead of the UK.

Understand the business

The key for the practitioner is to understand the equine client, eg 'bloodstock' v 'sports horses', competition v stud, and ensure the ground rules for accounting and tax treatment are established and consistency is in place.

Article supplied by Julie Butler F.C.A. Butler & Co, Bowland House, West Street, Alresford, Hampshire, SO24 9AT. Tel: 01962 735544. Email; j.butler@butler-co.co.uk, Website; www.butler-co.co.uk

Julie Butler FCA is the author of Tax Planning for Farm and Land Diversification ISBN: 0754517691 (1st edition) and ISBN: 0754522180 (2nd edition) and Equine Tax Planning ISBN: 0406966540.

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Editorial contact: Laura Brown • 020 7017 5652 • email: laura.brown@informa.com
Desk editor: Jessica Hills • 020 7017 5161 • email: jessica.hills@informa.com
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