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Horse power

The very use of the words 'investment' and 'passion' could instantly mean not allowing business property relief (BPR) for inheritance tax (IHT).

This statement implies first that the activity is an investment, not a business (s105, ss3 *Inheritance Tax Act 1984*), and 'passion' can state that the reason behind the investment is not commerciality but a hobby or an activity that does not have all the necessary badges of trade and therefore is not a business and not eligible for BPR. If any investment in an equine activity is to take place it would be financially reassuring if there was the potential availability of BPR and APR (agricultural property relief).

One of the fundamental attacks by HMRC on equine businesses is that of commerciality. While HMRC is often prepared to accept that there was actually a business, it is not prepared to accept that it was a business carried on for gain, and therefore argues that BPR does not apply. Many entrepreneurial businesspeople, when they sell off their business interests at what they consider an appropriate retirement age, want to roll that gain over into an investment of passion to take the advantages of the capital gains tax relief on the disposal. Their choice is often the equine or the racing business.

A prime example can be a stud farm, which is farming for tax purposes and therefore has the advantage of APR as it involves land investment. The stud farm can present a hugely satisfying lifestyle choice. Land prices showed a large increase between 2005 and 2010 and, while there have been problems with profitability and showing a good return on the monies invested in that commercial passion, the value of the underlying assets has increased dramatically. It is therefore important to 'frank' that investment with IHT reliefs where appropriate and where they can be justified to HMRC, and this is mirrored by the fact that HMRC seems to have decided it is open season against such IHT claims.

Much is documented about the HMRC approach in the IHT manuals, advising inspectors to look out for the 'rich man's hobby'. The root of HMRC's attack will be checking business plans and identifying the fundamental motive for the business decision - is this business or private? Is this a commercial activity or a hobby?

In this HMRC attack on the world of all things equine, many genuine equine activities are suffering. A lot of the racing and breeding operations have suffered from the recent problems in racing and have been blown off course (see the income tax case *Walls v Livesey*) when they are potentially and fundamentally profit making.

There are two ways to prove whether potential profit exists: either by achieving an actual profit, or by showing that a profit can and will be made through accurate, well-thought-out business plans

It is worth returning to the 1982 communication from HMRC to the Thoroughbred Breeders' Association, which stated: 'We have long accepted that the breeding of thoroughbred horses is... a long-term venture, and provided that a stud farming business is potentially profit making, we would not normally seek to invoke s397(1) until after 11 years from the start of the business.' (But note: the *Income and Corporation Taxes Act 1988* s397 is replaced by the *Income Tax Act 2007* s67.)

There are a number of clear directions outlined in HMRC's statement. The business must be 'potentially profit making'. A recent relevant case, *John Agnew* (TC566), was actually about a beautician's business, but the key factor was whether, within the existing structure, the business was capable of making a profit. There are two ways to prove whether potential profit exists: either by achieving an actual profit, or by showing that a profit can and will be made through accurate, well-thought-out business plans. There has to be a financial road map for the equine operation, showing how the business has learnt from its own specific mistakes, as well as from generic mistakes common in the trade and any problems arising in the bloodstock industry.

It is also important not to muddle breeding of horses on the stud (which is agriculture) with other equine activities. This is essential so the tax advisor can undertake the correct fact-find as to the nature and commerciality of the investment of passion.

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