TC03474

Appeal number: TC/2013/05208

INCOME TAX – Loss Relief – Trade – Race Horse Bloodstock Breeding and Training – whether a taxable activity – Yes in part – whether on a commercial basis with a view to the realisation of profits – No – Appeal dismissed. Income Tax Act 2007 Sections 64 and 66.

FIRST-TIER TRIBUNAL
TAX CHAMBER

RICHARD MURRAY **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE W RUTHVEN GEMMELL, WS
MS EILEEN A SUMPTER, WS

Sitting in public at George House, 126 George Street, Edinburgh on 26 March 2014

No appearance for the Appellant

Mr Matthew Mason and Mr William Kelly, Officers of HMRC, for the Respondents

DECISION

1. This is an appeal against a decision by the Commissioners for HM Revenue & Customs ("HMRC") by Richard Murray ("RM") against a Closure Notice issued by HMRC on 13 December 2012 withdrawing losses totalling £28,407 for the tax year 2010-2011 with the consequence of RM paying an additional tax of £2,788.25.

Cases

The Earl of Jersey's Executors v Bassom [1926] 10 TC 357

The Earl of Derby v Bassom [1926] 10 TC 357

Lord Glanely v Wightman [1932] 17 TC 634

Lady Zia Wernher v Commissioners of Inland Revenue [1942] 29 TC 20

John Cree Locke Agnew v Commissioners of Inland Revenue TC/2009/13343

Legislation

Income Tax Act 2007

Section 64 Deduction of losses from general income -

(1) A person may make a claim for trade loss relief against general income if the person -

(a) carries on a trade in a tax year, and

(b) makes a loss in the trade in the tax year ("the loss-making year")……..

(8) This section needs to be read with -

(a) Section 65 (how relief works),

(b) Sections 66 to 70 (restrictions on the relief),

Section 66 Restriction on relief unless trade is commercial

(1) Trade loss relief against general income for a loss made in a trade in a tax year is not available unless the trade is commercial.

(2) The trade is commercial if it is carried on throughout the basis period for the tax year -

(a) on a commercial basis, and

(b) with a view to the realisation of profits of the trade.

Evidence and Findings of Fact

2. RM operated as a race horse bloodstock breeding and trainer in 2005 but only notified HMRC of this fact when he submitted his 2007-2008 self assessment tax return claiming cumulative losses in that year of £51,378.

3. In the subsequent tax years 2008-09, 2009-10 and in the year under consideration before the Tribunal, 2010-11, he had losses respectively of £25,565, £27,434 and £28,407.

4. In total, therefore, in the tax years 2007-2008, 2008-2009, 2009-2010 and 2010-2011, losses were claimed of £132,784.

5. In February 2011, HMRC opened an enquiry in to RM's 2009-2010 self assessment tax return and issued a Closure Notice withdrawing losses of £27,434 on the basis that the race horse bloodstock breeding and racing business was not a commercial activity being pursued with any reasonable expectation of profit.

6. No appeal was made to HMRC in respect of this year and HMRC considered the matter to be final, conclusive and settled under Section 54 of the Taxes Management Act 1970.

7. A further enquiry was opened into RM's 2010-2011 self assessment return into RM's business which was in that year described as "Racehorse Bloodstock Breeding and Training" and it is this matter that was before the Tribunal.

8. The relevant Closure Notice of 13 September 2012, followed on from previous correspondence and telephone conversations and a letter from a HMRC Shares, Assets and Valuation employee, Mr Goodrich, written on 25 April 2012.

9. In essence, HMRC contended that RM was not entitled to claim losses arising from his race horse bloodstock breeding and training businesses against other earnings for the 2010-11 tax year because he was not trading on a commercial basis with a view to raising profits.

10. Reference was made to RM's self assessment tax return for 2010-11 where he had entered the description of business as "race horse bloodstock breeding and training" and had declared a nil turnover. "The Cost of Goods for Resale or Goods Used" box had been completed in an amount of £28,407.

11. In addition, the return noted a net business loss for tax purposes at £28,407 and "loss from this tax year set off against other income for 2010-11", also £28,407.

12. RM says that HMRC East Kilbride had told him he could write off losses in the Racehorse Bloodstock Business against other profits without time limit and that if RM rehabilitated an animal he would be given allowances for this during its lifetime. No other evidence of this advice was produced to the Tribunal.

13. Reference was made to Section 64 of the Income Tax Act 2007 (ITA07) which states that "a person may make a claim for trade loss relief against general income if the person (a) carries on a trade in the tax year and (b) makes a loss in the trade in the tax year subject to the caveat at Section 66 of ITA07".

14. Section 66 ITA07 states that loss relief against general income for a loss made in a trade in a tax year is not available "unless the trade is commercial"; and continues that "The trade is commercial if the trade is carried on throughout the basis period for the tax year (a) on a commercial basis, and (b) with the view to a realisation of profits of the trade".

15. HMRC put forward the dictionary definition of commercial as being "connected with or engaged in commerce, having profit as its main aim and commerce is activity embracing all forms of purchase and sale of goods and services".

16. On 8 March 2011, RM confirmed that he did not prepare accounts and only worked with self assessment but provided a number of invoices to HMRC.

17. In the absence of RM to provide evidence, the Tribunal considered the correspondence between RM and HMRC and, in particular, a letter by RM to HMRC dated 30 May 2011 which indicated that in the tax year 2010-11, RM owned four horses, Gunner Marc, a brood mare which had been purchased on 7 February 2005 and which it was stated on 30 May 2011 had been "ill for some time and is now in a rehabilitation home, due to this illness its value is NIL, but it could not be used as a brood mare".

18. The remaining three horses, Santiago Boy, Braehead Lad and Mr Pagan, were all geldings and, therefore, not capable of breeding/procreating.

19. HMRC wrote on 27 July 2011 to state that they did not believe that horse racing itself was a taxable activity based on the case of *Lord Glanely v Wightman* where the Special Commissioner held that "racing itself is not an enterprise of a commercial nature" and went on to make a distinction between horse breeding activities and those of racing.

20. HMRC state that they could not accept that RM was trading as a recognised horse breeder, given that he only had a single brood mare, basing much of their justification on an article written by Penelope Lang regarding commerciality when breeding horses which stated that "very broadly two mares are enough for a business but it would be difficult to demonstrate profitability at this level so realistically you need more mares for a trade".

21. At the heart of HMRC's concerns was their perceived lack of evidence that a trade existed and if there was one that it was not run on a commercial basis with a view to a realisation of profits.

22. HMRC's view was that once a horse goes out to training it can no longer be part of a breeding business which included Santiago Boy with effect from 17 June 2009.

23. As Gunner Marc had been ill, HMRC questioned whether a breeding business still existed.

24. RM replied on 17 August 2011 stating that he did not accept that the circumstances in the case of *Lord Glanely v Wightman* were similar and, in any event, the world economic downturn had badly affected the value of horses.

25. RM made the point that when breeding and rearing thoroughbreds at the medium end of the sales market it is not possible to know until the horses are mature and ready for the sales whether they will have made a profit and that this is the same as any other livestock breeder.

26. RM stated that a trade exists and that all foaling, rearing and stabling were carried out in a professional manner in an attempt to produce a profitable race horse. RM confirmed that he had never produced a business plan but had been involved in various businesses over 54 years and had business experience.

27. RM clarified that his comment that Gunner Marc could no longer be used as a brood mare was slightly inaccurate and that, at some date, whilst preparing for the breeding season of 2009, was treated twice to improve fertility, albeit unsuccessfully, before it was decided not to spend any further amounts on treatment.

28. RM stated that he had taken on Gunner Marc, "a neglected mare and her filly with no financial help and tried to give her a new use in life".

29. HMRC's, Mr Goodrich, in his letter to RM of 25 April 2012, reiterated his view that HMRC generally do not regard racing as a taxable activity and further put forward his view that the costs of production prior to racing are generally accepted to be around £15,000 to £20,000 plus a nomination stud fee per horse.

30. This letter raised the issue of whether RM was carrying out the trade on a commercial basis with a view to a profit or whether instead profitability was an intention or just a hope.

31. HMRC stated, "if the realistic prospect of profit is slim then any view must in reality be no more than a remote hope. The test is not in the hope of profits but with the view to a realisation of profits and it is, therefore, open for the stated view to be replaced with a view that is more realistic".

32. The letter continued with the quotation from Penelope Lang in the guise of the "Thoroughbred Breeders Association Taxation Advisers".

33. The letter continued, "whereas HMRC is of the view that trade is a concept so rooted in commerce that it cannot really be separated from it and it fully accepts that the purchase and sale of horses can be by way of trade, it does not accept that every purchase and sale of bloodstock will constitute a sale in this regard. Buying and selling horses is a function of owning horses".

34. Mr Goodrich continued "breeding and owning race horses is full of ups and downs. Will the mare actually produce a foal every year? Will she carry it to full term? Will it be healthy and correct?".

35. Mr Goodrich then stated that RM was not carrying on a commercial activity as RM was an office bearer for the club which owned the mare and that RM then took on what were a neglected mare and her filly, "presumably because she was regarded as an uncommercial breeding prospect and tried to give her a purpose. Gunner Marc was not chosen but was looked upon as an Old Friend. The recuperation and breeding gave you some satisfaction. You were seeking to enhance the value of horses by winning races and thus enhancing their values. Unfortunately that was more of a hope than an expectation and cannot be deemed to be a commercial activity".

36. Mr Goodridge was not called as a witness and it was not possible to ascertain the basis on which he made these somewhat sweeping assumptions.

37. On 12 January 2013, RM wrote to HMRC saying that "the economics of a business greatly depended on the contribution from my tax rebates and I was not in the business where I could close the door. The animals had to be looked after until they could be disposed of".

Submissions for RM

38. RM does not accept the reasons for disallowing the loss claims and states that HMRC are putting too much emphasis on the opinions of Mr Goodrich.

39. RM further states that no consideration was given to the possible success of the venture and no consideration was given to his assertions of seeking advice from other HMRC offices.

Submissions by HMRC

40. HMRC say that RM is not entitled to claim losses arising from the race horse, bloodstock breeding and training business against other earnings for the 2010-2011 tax year because he was either not carrying out a taxable activity or, if he was, he was not trading on a commercial basis with a view to the realisation of profits.

41. HMRC say that the burden of proof is on RM to bring evidence and facts to support his appeal and that the Closure Notice and assessment stand good unless RM is able to produce evidence to show that he has been overcharged by such assessments.

42. HMRC refer to the case of *Lord Glanely v Wightman.* This related to profits from stallions owned by a racing establishment and a stud farm comprising of arable land stud paddocks and pasture land on which the taxpayer maintained a stock of selected horses and carried on breeding operations.

43. Horses bred from the taxpayer's stock were sent to his training stables and raced and those which were considered satisfactory were subsequently sent to the stud.

Additions to the stock of horses at the stud farm were made by purchases from time to time and unsatisfactory horses were sold.

44. In consideration of this case, the House of Lords held that the taxpayer was clearly not breeding horses for sale as in the main he only sold those which were used for his own stud. It held "racing in itself is not an enterprise of a commercial nature".

45. HMRC referred to the *Earl of Jersey's Executors v Bassom* and *the Earl of Derby v Bassom*. In these cases, each taxpayer owned, bred and raced thoroughbred horses but bred no horses for sale (though in fact a few were sold) all for the purpose of earning stallion fees.

46. The taxpayers' contention that the entire activity should be considered as a whole was rejected. Stud fee income was held to be a taxable source, whilst owning and racing horses was not and held to be a hobby and not trading.

47. Mr Justice Rowlatt stated "I do not see that there is – certainly there is not at all necessarily – a connection between racing and the breeding. Counsel's argument has been 'you cannot have breeding stock unless the stock itself has not only been bred but has been tested and its performance ascertained on the race course'. That is very true but not necessarily tested by the owner of the breeding establishment. The two things are really quite separate".

48. HMRC referred to the *Agnew v HMRC* case where the taxpayer claimed relief against other income for losses incurred in the trade of manicure/pedicure make-up largely carried on by his wife.

49. In looking at the trade carried on, Tribunal Judge Poole, stated "but if one is looking at the putative trade carried on by the appellant with the extra overhead of wages paid to his wife, then it is clear that the trade is structured in such a way that it is never likely to make a profit. It had never made a profit in its ten years or more of operation. The Tribunal finds that any person running such a basis on a commercial basis would take steps to reduce the losses and the appellant has refrained from taking the obvious step of doing so by reducing the payments to his wife which are clearly out of all proportion to the sales achieved. It would be difficult to escape the conclusion that the Appellant has run the business in this way specifically in order to generate trading losses to set against his other income year on year whilst taking advantage of his wife's personal allowance. Vague and unsubstantiated plans to expand the business and make it profitable when he retires would not in the Tribunal's view constitute a commercial basis for running a business at a continuing loss for many years beforehand".

50. HMRC say that RM continued to make losses for a considerable period of time and took no steps to reduce those losses and, therefore, by refraining to do so raises the conclusion that the business was run in such a way in order to generate trading losses.

51. HMRC refer to RM's comment that "the economics of the business greatly depended on the contribution from my tax rebates" as an acknowledgement that his

business was not operating on a commercial basis in the sense that profit was not the main aim of the business.

52. HMRC also refer to the fact that RM declared no income whatsoever in the tax year 2010-2011, not even a small or minor amount.

53. HMRC say that in order to have a reasonable expectation of profit, RM had to have a reasonable expectation of meeting the costs of production. HMRC say that he failed to do so, given the condition of the only mare and the probability that the breeding may not be successful.

54. HMRC say that RM could only hope to enhance the value of horses by entering them into races. This was a hope and not an expectation and little more than a gamble. HMRC draw an analogy with an expectation to win the National Lottery and the hope to win the National Lottery with the latter being no more than a gamble and similar to the predicted outcome of a horse race.

55. HMRC say that a business plan would have allowed RM to show his expected profit and to support his contention that he was running the business on a commercial basis but RM did not provide a business plan.

56. HMRC say that by taking on Gunner Marc, a neglected mare, RM was taking on a philanthropic rather than a commercial enterprise and referred to *Lady Wernher v the Inland Revenue* in which, in a case in relation to income tax from profits from a stallion, the High Court drew a distinction between a breeder of rare horses, selling them to new owners which was a commercial activity and keeping others, training them and entering them into races which was treated as a recreation and not a taxable activity.

57. HMRC say RM's owning race horses and training them for racing was recreational and not a taxable activity and that there was no breeding as there was no viable stock with which to breed.

58. HMRC say that RM became accustomed to obtaining tax losses and claimed them against other income as a *modus operandi* allowing him to continue his activities with horses and that, in effect the rebates entirely supported this business. This, they say, is not commercial.

Decision

59. The Tribunal considered that RM's horse owning and training activities were not taxable activities in terms of case law.

60. The issue, therefore, was whether of the activities in relation to RM's ownership of Gunner Marc, a mare purchased on 7 February 2005, Santiago Boy bred and born on 20 March 2006, Braehead Lad bred and born on 9 April 2007 and Mr Pagan bred and born 20 April 2008 amounted to a trade which was carried on (a) on a commercial basis and (b) with a view to the realisation of profits.

61. The information provided by RM was not complete and, accordingly, as the Tribunal were unable to seek further information from RM at the hearing, considered his letter written on 30 May 2011.

62. In this letter it was stated that Santiago Boy was bought for £2,500 and that RM had been trying to organise a sale but, during this time, had raced it at Ayr and it had come in last on 2 September 2010.

63. Throughout the tax year 2010-2011, RM earned no income from horses and incurred costs and, therefore, a loss of £28,407.

64. In relation to the taxable activities, RM had to establish that under Section 64 of ITA07 he was carrying on a trade in order to make a valid claim for a trade loss relief against general income and, in doing so, had to prove the loss was made in a trade which was "commercial". Section 66(2) of ITA07 states that "the trade is commercial if it is carried on throughout the basis period for the tax year (a) on a commercial basis and (b) with the view to the realisation of profits of the trade".

65. The Tribunal considered whether the activities carried out by RM were on a commercial basis.

66. The Tribunal considered the fact that none of the horses had been sold which might mean that RM had not intended to sell them and had simply been unlucky in his attempt to do so and was motivated to finally sell them as a means of "winding up" his business.

67. The Tribunal were not entirely persuaded by HMRC's distinction between an expectation to realise a profit and a hope to realise a profit and the Shorter Oxford English Dictionary defines "hope" as "expectation and desire combined".

68. RM, by his own admissions, had become accustomed, at the very least, to accepting that his race horse bloodstock breeding and training activities would be sustainable if the losses were allowable and showed some surprise when HMRC advised him that this was not going to be the case on a continuing basis.

69. HMRC stated in their evidence that a reasonably long period of time of taking no action on losses is given for activities, such as breeding horses, given the number of factors such as the relatively long gestation period of a mare, the probability of having a successful foal or foals and the consequent period to test the foals to ascertain their value.

70. The Tribunal considered that at the outset of his business RM did have a reasonable expectation of profit but, by the tax year 2010-11, following the economic downturn, the apparently continuing high annual costs, resulting in almost consistent losses in 2008-09, 2009-10, 2010-11, that that hope or expectation must have evaporated and that the fact that there was no income whatsoever reinforced this view.

71. The Tribunal considered that RM may have been unfortunate in this regard with his clear wish to look after the animals in a responsible manner coupled with the

difficulties of selling them at perhaps short notice but nonetheless there was no evidence, as Tribunal Judge Poole would say, of RM taking steps to reduce the losses or even to have any evidence to quantify what the losses might be or how they might be reduced by producing a business plan.

72. The Tribunal considered that RM's comment that "the economics of the business greatly depended on the contributions from my tax rebates" whilst being a statement of fact also informed a view that was less than commercial to the extent that it conceded that there might not be a profit but that notwithstanding the business could continue as economically viable, albeit by reducing tax on other income.

73. The Tribunal accordingly considered that whereas they were sympathetic to the predicament RM found himself in the tax year 2010-11, by that time his purpose and attitude did not demonstrate sufficiently that his activities were carried out on a commercial basis with a view to the realisation of profit of a trade.

74. The Tribunal considered that RM would need to have done more to satisfy the test but understood the difficult circumstances of dealing with animals in the method and disposal of his business.

75. In the absence of any evidence the Tribunal could not consider RM's contention that he had, in effect, been misinformed by HMRC offices as to the correct rules and practices to follow.

76. The appeal is dismissed.

77. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

W RUTHVEN GEMMELL
TRIBUNAL JUDGE

RELEASE DATE: 10 April 2014