

Have Fun - And Save Tax at the Same Time

For the Summer, we thought it might be fun to have a quick run down of the various ways in which leisure and enjoyment can impact on tax – and provide opportunities for saving it!

Hobby or Business?

There are very few hobbies which are absolutely free, and it would be nice, wouldn't it, if we could somehow get tax relief for what we spend on our leisure time activities? That might just be possible in some cases, because there are a lot of situations where a hobby merges into a business activity.

Take the example of someone whose hobby is restoring old furniture. It may start off being purely done for his own benefit, so as to be able to fill his house with beautiful things. But it can develop into something more, if a friend asks him to do something and insists on paying him for it. Immediately the cost of the tools, lathe etc in the garage, the purchase of French polish, even repairs to the workshop itself, become allowable expenses.

The most common example of the "grey area" between a hobby and a business, of course, is farming. So much so, that there is a whole set of rules devised by the Revenue to prevent individuals getting loss relief for "hobby farming", which inevitably, of course, tends to show a loss every year.

But the fact that these rules are necessary for farming shows that it is by no means impossible for an activity that shows regular losses to be treated as a trade within the scope of taxation, and therefore available for relief. What you have to show is that there is a "reasonable expectation of profit", but the Revenue's own internal manuals make it clear that this

need not be an expectation of profit this year: merely an expectation that a profit will be made in the future.

With global warming, more and more people are planting vines in their gardens. How about turning this from a hobby to (eventually) a wine making business?

Cars

And now, let's turn that principle exactly on its head! From looking at a case where you are likely to make losses, and were trying to get tax relief for those losses against other income, what about a situation where we expect to make money, indeed perhaps substantial money, from a leisure time activity, but want to avoid paying tax on that money?

If your hobby is buying, doing up, and selling veteran or vintage classic cars, this could precisely be the situation you could contrive for yourself. Such cars are collectors items, and it is likely, if this is your hobby, that you are a collector yourself. That old Morris Traveller which has been mouldering away in the back of your garage under tarpaulin for the last ten years, you know you could sell for a considerable profit if you could only find the time to get round to doing it up properly.

Well, why don't you? A beautifully restored Traveller, of the right vintage, can fetch a king's ransom in the collectors' market, and is likely to net you a substantial book profit compared with what you originally paid for it and the costs of doing it up.

What is the tax treatment of the book profit? This is the nub. If you originally bought the car for your own pleasure rather than as part of a trade of buying and selling cars, and assuming, as we have done, that you have held on to it for quite a long time as well, there probably isn't much argument that this would be treated in tax terms as a capital gain rather than a trading profit. And, very satisfactorily, capital gains on cars are tax free.

The same applies to some other assets, of which clocks are an example, being eligible for a special capital gains tax exemption as “machinery”.

Holidays

You may think there’s no link up at all between holidays and tax. If they let you have tax relief for your holidays, what could they charge tax on? Well, there is a way of achieving just that.

If you are an employee and either your employer or a good customer of your employer sends you on holiday, this unfortunately won’t work. There is a special set of rules relating to employee perks which will charge you to income tax on an amount equal to what the holiday costs to provide. But for self-employed people, there’s no equivalent benefit in kind code. So if a favourite client or customer of yours decides that you have done a particularly good job for him this year and sends you out to his villa in the Algarve, there doesn’t seem to be any mechanism to declare this as taxable income.

Second Homes

What are the tax angles on second homes?

Well, first of all, here’s something not to do. Don’t hold your holiday home through a limited company. Despite recent relaxations on situations where, to save local taxes in foreign countries, a property is held through a locally incorporated company, there is still an issue in the situation where your trading company buys a second home and makes it available to you for occupation.

But probably the aspect of second homes that it is most sensible to concentrate on is the capital gains aspect. By owning the home direct, you have a chance of engineering at least some exemption from tax on the ultimate sale on the

basis of electing the property to be your “main residence” for at least part of your period of ownership. The second home, of course, by definition is not actually your main residence, but that doesn’t stop the election being made and saving potentially a huge amount, or even all, of the tax on the gain.

Entertaining

Despite the Revenue’s pathological hatred for entertaining expenditure, which results in this type of expenditure being wholly disallowable for almost all tax purposes even though it may be a valid and indeed necessary item of expenditure to advance the trade, surprisingly there is a tax angle on entertaining expenditure and it is this.

If you are operating through a limited company, one of the classic tax problems is how to use the company’s money for your own personal lifestyle but minimise the tax effects of doing so. The solution to this straight forward problem is usually to juggle dividends and remuneration, which are taxable, but depending on the circumstances a different mix will give rise to a lower liability. Benefits in kind are another ingredient that you can put into the mix, whereby the company, instead of paying you money which you then use to buy things, buys the things for you and allows you to make use of them.

This is still a taxable event, however, based on the cost to the company of providing the benefit.

An exception, though, is entertaining expenditure where the entertaining is business related. So, if you and your spouse take out some important customers (who may also be good friends) and have a superb time at the best restaurant in town, the reimbursement by the company to you of this expenditure is not taxable.

Boat and Planes

Did you know that, if you have made a capital gain on disposing of a business asset (as defined – basically, an asset you have used for the purposes of a trade) that you can avoid paying tax on the gain by “rolling over” the gain into a number of other assets, including boats and planes?

The important condition to meet in order to get the relief is the boat or plane concerned is then taken into use for the purposes of a trade, which in the case of these items is, of course, likely to be a trade of chartering, although some sorts of trade may also make the use of a private plane, for example, a valid trading use.

There are two approaches you can take to the (almost inevitable) private use of the boat or plane.

If the vehicle of your business is a sole tradership or partnership, you would disallow a proportion of the total expenses to allow for private use as compared to business use.

If it is a limited company that owns the asset, you’ll either have a benefit in kind charge for the periods for which the asset is “available”, or you can have a rule that you pay the company a fair market rate for your individual charter.

The VAT advantages of having business use of boats and planes are also fairly mouth watering. If you consider the amount of VAT there will be on the purchase, the ability to reclaim this is obviously very important, and if you arrange things properly, the private use element can be accounted for by a corresponding repayment of a fairly small proportion of the total VAT reclaimed based on the actual cost referred to your use. HM Revenue & Customs have been known to agree the basis of calculation of this small claw-back in advance.

Betting

Gambling is normally regarded as an activity as outside the scope of tax (unless you are a bookmaker).

On the authority of what is now a very old case, gambling winnings are tax free even if you are so good at it that overall you make a regular profit, or indeed even make your living from gambling.

This principle, which was established in the context of horse racing, obviously applies in all other areas of gambling as well. One particular type which has become very popular recently is “spread betting”. This works as follows.

You put down a deposit with one of the many spread betting brokers who advertise and provide an online service. You can then bet on sporting or financial events, including the results of matches and the movement of currency and shares etc. In the case of financial spread betting, the broker very often lays off your bet on the market, in other words effectively you are trading in the market yourself through an intermediary. Those who are good enough at, say, currency trading without actually setting themselves up as professional currency traders with a trading platform in the City etc can make very nice profits indeed, all of them tax free.

Of course, the converse applies that no tax inspector is going to allow you loss relief if you end up in the red!

Bonnes Vacances!

So taxation and relaxation are not necessarily so far apart as most people think. And, of course, the idea of a repayment from the taxman makes whatever your particular interest is potentially even more fun!

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