INCENTIVES FOR NEW BREEDERS
BROODMARES OR YEARLINGS?

The official encouragement – if that is the correct word – to date has been centred around purchasing "standout yearlings". Only yearlings purchased from a select list of premier New Zealand thoroughbred and standardbred yearling sales qualified with an effective prohibition on quality yearlings from offshore, notably Australia. Also, mature breeding stock did not fall within the scope of the new legislation.

The problems that new investors face with purchasing yearlings under the "superior yearling" scheme are threefold:

- There is far more risk with yearlings than mature broodmares,
- The monetary threshold chosen was too high and beyond the reach of most potential new investors, and
- Too much emphasis on "integrity measures" rather than concentrating on the actual requirements of the breeding industry.

If readers think carefully about the existing "stand-out yearling" scheme it will be apparent that the requirement to purchase at only the New Zealand yearling sales does not really help the local industry. It is clear that the vendors of these "stand-out yearlings" would normally be existing New Zealand breeders. These quality fillies would always be a saleable product and a new investor buying these fillies would simply replace a "normal" sale. The only benefit would be the one last bid to clinch the purchase.

The *Tax Circular* of June 2019 spelt out all that was wrong with the "standout yearling" proposals. The problems facing the breeding industry are immense, particularly the lack of confidence in the future. The economic contribution of the breeding and racing industry to the country is said to be in the vicinity of $1.6 billion per annum. This is too great a sum to have the breeding industry wither and die.

Comparative statistics provided by the NZ Thoroughbred Breeders Association in their Stallion Registers show a very disturbing trend:

	1984/85	**2008/09**	**2013/14**	**2018/19**
Mares served	10,509	6,498	5,596	5,311
Foal crops	5,879	4,557	3,535	3,535 (est)
Stallions*	283	96	84	74

*served 10 or more mares.

TIMING:
There is the question of timing. Take a yearling purchased in January 2019 and destined for a breeding career on retirement to stud at, say, age 5:

- Decision to form breeding business, say, July 2018;
- Purchase yearling January 2019;
- 1 August 2019, yearling is now age 2;
- Races as 2YO, say January/April 2020;
- 1 August 2020 now age 3;
- Races as 3YO, 1,000 Guineas*, November 2020;
- Races as 3YO, NZ Oaks*, March 2021;
- 1 August 2021, now age 4;
- Races as 4YO, say, October 2021 – April 2022;
- Decision to retire to stud, say, July 2022;
- 1 August 2022, now age 5;
- At stud, first served, say, September 2022;
- Foal born, say, August 2023;
- Yearling sold January 2025.

*classic races for fillies aspiring to be top class.

Contrast this 6 1/2 year period with the purchase of mature breeding bloodstock:

- Where a maiden mare is purchased, say, in July 2022 date above, it is only 2 ½ years until there is a return.
- Purchase a mare with a foal at foot and the time gap from purchase until sale of the yearling is only a matter of months. Still using the above time frame, purchase the mare and foal in, say, May 2024, yearling sale is still January 2025.

BEST OPTION:
In the opinion of this author there is no doubt as to the best course of action – buying mature bloodstock for the start of a breeding business is by far the best move. Purchasing yearlings puts back matters by four or five years – time the industry can ill afford.

It is a simple matter to buy yearlings after the breeding business has been established.

Bloodstock agents advising potential new investors would surely recommend their client purchase mature bloodstock for the start of a breeding business; but are unlikely to recommend yearlings as the opening investment.

The Minister's 2018 Budget announcement dated 17 May 2018 initially referred to "high-quality horses" but later in the press release noted - "To qualify, the horse must be a stand-out yearling". The Minister's plan was to encourage new investment in bloodstock but, with respect, the purchase of yearlings takes far too long for the yearlings to be mated and produce progeny of their own, unless, of course, there has been an accident, or similar, and the yearling is unraced.

The proposal was never discussed with the "industry", represented by the NZ Thoroughbred Breeders Association. The industry participants at the subsequent discussions with the Revenue were, effectively, presented with a "fait accompli".

A SUGGESTED BROODMARE INCENTIVE SCHEME:
New Zealand is not alone in facing a deteriorating position in the market place. The Irish Thoroughbred Breeders' Association in its forthcoming 2020 submissions for taxation relief stated:
"…we have seen a decline in the quality of our broodmare band along with the number of new stallions standing in Ireland in recent years which is a key concern for the industry. Assistance is vital to incentivise breeders to maintain a stock of high quality broodmares and ensure we retain our global reputation as one of the leading producers of quality breeding and racing stock. The thoroughbred breeding industry needs support now to ensure it remains competitive and assist with market pressures that it is currently facing."

Exactly the same position as in New Zealand.

A proposal that needs to be worked through concerns an expansion of the section in the Income Tax Act 2007 (s. EC48) that provides for the profit or "net gain" on the sale of breeding stock to be offset against the cost of replacement breeding stock. This little used provision effectively defers the taxation on any profits on the sale of mature breeding bloodstock, up to the amount of the replacement bloodstock.

Conversely, as the cost of the replacement bloodstock is usually reduced to Nil there are no customary write-offs to take in the years subsequent to purchase of the replacement bloodstock.

Currently, yearlings fall outside the provision as they are not bloodstock that have been used for breeding purposes.

THE PROPOSAL:
The proposal is for new investors in the bloodstock breeding industry:
1. Offset the profit on sale of yearlings against the cost price of broodmare(s) purchased subsequently;
2. Applies only to new investors;
3. Applies to broodmares purchased for a minimum of $30,000, say;
4. Limited to only, say, three broodmares per year;
5. Sunset clause - concession for each breeder ceases, say,10 years after purchase of first broodmare introduced into the scheme;
6. Does not apply to corporates, only the new personal investor;
7. Applies to only parties that are not associated;
8. Reinvestment made within 12 months of sale of the yearling;
9. No geographic restriction on purchases, in fact, quality broodmares from overseas should be encouraged;

10. Suitable legislation passed to ensure that the new investor commences business as a bloodstock breeder as from the date of purchase of the first broodmare;
11. Ensure that all new investors may claim all customary expenses and tax write-downs in all respects treated as for an existing breeder; no additional reporting or information requirements;
12. Also applies where there is a payment of insurance, indemnity or compensation where the yearling has died or suffered permanent injury.

It is important that any new provisions be practical and not make excessive demands on the Revenue. The Irish submissions for €5,000 Tax Credits and notional expense claims for €10,000 just would not be acceptable to the New Zealand Revenue.

Obviously some points may require negotiation, the $30,000 threshold for example, but nothing in the proposal is insurmountable.

REVENUE COST:

There is an immediate revenue loss because the profits on sale of the yearlings are not taxed in the year of sale. However, there are no tax write-downs on those yearlings purchased for breeding purposes, over the seven years from age 2 to age 8, inclusive.

Thus, any loss to the Revenue is only one of timing and over the course of the next seven years the revenue cost is expected to be neutral.

APPLICATION TO THE COMMISSIONER:

It is notable in the provisions for the "stand-out yearling" that the Revenue required an immense amount of paperwork including formal application to the Commissioner. It is believed the additional paperwork was mainly for integrity reasons but these concerns have been rejected by the industry.

The requirement to make application under the section, EC 48(8), is sufficient notice to the Revenue if they need to keep track of those taking advantage of the new measure.

It is important that additional paperwork be kept to an absolute minimum otherwise this scheme will also be rejected by potential investors.

SUBMISSION:

These details have not been discussed with the NZTBA. The Association needs to meet formally to approve this scheme, or any variation arising from their own research. After that one would assume there would be a formal submission to the Minister.

It is important that any new proposal to the Minister be made in the next month or two and, if successful, be included in the annual omnibus tax bill. Next year is election year and nothing new happens.

MOST IMPORTANTLY:

1. **The proposal outlined above means that – in general terms – 100% of the yearling proceeds is available for reinvestment in breeding stock. If Terminal Tax is allowed only 67% is available and if Provisional Tax is included in the equation the sum available could be as low as 34% of the sale proceeds.**
2. **If there is no yearling sale it follows that there is no incentive.**
3. **In recent days Government have announced two new tax measures to assist industry – a tax break for feasibility studies and when a business is sold new rules for carrying losses over when there is a change to the ownership threshold. Hardly a week goes by without money being tossed out to all sorts of businesses and organisations. Compare this with the paltry $4.8 million "incentive" spread over 4 years for the "stand-out yearling" scheme.**
4. **There is no doubt that the industry has to come up with a better scheme than that for "stand-out yearlings". Time is of the essence.**

John Aubrey
30 September 2019.