



NEW ZEALAND BLOODSTOCK TAXATION UPDATE: the new write-downs & the business test by John Aubrey

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*John is a chartered accountant based in Hamilton, and was previously a senior partner in Coopers & Lybrand. He served for eight years on the NZTBA Council, including a term as president, and gave a total of 30 years' service to the Council and the Waikato branch committee. The author of **Bloodstock Taxation in New Zealand** (2002), John's work in this field with successive governments has been of immense benefit to New Zealand owners and breeders.*

The following is based on a presentation John made to the NZTBA branch representatives' meeting on 19 July 2006 and has been approved for publication by him. He welcomes professional inquiries from accountants on Ph: (64 7) 838 1014.

THE NEW BLOODSTOCK WRITE-DOWNS: AN OVERVIEW

On 10 March 2006 the Minister of Racing, Rt Hon Winston Peters, announced major legislative changes for the racing industry, including:

- **A decrease in the write-down period for stallions from 4 years to 2 years.**
- **A decrease in the maximum write-down period for broodmares from 8 years to 5 years (or 6 years for those few broodmares that commence breeding at age 2). Broodmares that commence breeding at age 8 and over will be written-off in full in the first year of breeding.**

These changes, along with a reduction in totalisator duty from 20% to 4% of gambling profits, have subsequently been confirmed by legislation, and take effect from 1 August 2006.

These rules, old and new, apply only to New Zealand taxpayers.

NEW STALLION WRITE-DOWN RATES

- **Calculated on the cost price – 50% write-down for two years**
- **Alternatively, on reducing value – 75% on reducing value each year. This is a very significant change from 37.5% on reducing value.**

The above rates apply only to stallions bought or brought into breeding on or after 1 August 2006 that have not previously been used for breeding in New Zealand. Otherwise, the basic write-down is 20% for five years.

Examples:

A yearling colt purchased as a stallion prospect in February 2006 does not qualify for the new rates.

A yearling colt purchased as a stallion prospect in February 2007 will qualify for the new write-down rates, from the age of two. If he subsequently fails to establish himself as a viable stallion prospect by performing well as a racehorse, and is gelded he should, in my view, be transferred out of the financial books at the market value on the day he ceased to be a stud animal. Income tax will be assessed on the market value less the current written-down value. The "market value" is clearly the sale price. In respect of GST, the position is complex, but the writer and the majority of practitioners prefer to pay the GST, and thereby completely remove the horse from all business sets of books.

A stallion that has previously stood at stud overseas, but not in New Zealand, does qualify for the new write-down rates, provided it is purchased or brought into breeding on or after 1 August 2006.

Note that the key phrase in the legislation is: **"was not used for breeding in New Zealand by any other person."**

Two "real-life" examples:

A September 2006 sale of a share in champion stallion Zabeel, who first commenced stud duties in 1991, would not qualify the new owner to use the new write-down rates. Black Minnaloushe is a shuttle stallion that has previously stood in New Zealand and has now been sold by his Irish owners to South African interests. If Black Minnaloushe had been purchased or syndicated by New Zealand interests, on the face of it, having been used for breeding by any other person he would not qualify for the new rates.

However, if the stallion was purchased on or after 1 August 2006 by the same stud/owners that stood him as a shuttle stallion in New Zealand there is an argument, *prima facie*, that he would qualify for the new rates because he had not been used by "any other person." *This is highly technical and expert advice is necessary before acting on this example.*

Editor's Note: *The IRD advises that this argument would not be accepted. John Aubrey replies that space does not permit a detailed treatise on the topic, but the example is exactly what years of submissions to government set out to achieve: encouragement to purchase, rather than lease, a stallion.*

Southern Hemisphere breeding rights

These are not specifically covered in any legislation but are probably caught by the accrual rules.

NEW BROODMARE WRITE-DOWN RATES

Effective from 1 August 2006.

- **Applies – across the board - to any mares purchased or retired to stud: imported mares, maiden mares, or mares that have previously been to stud.**
- **Mares will now be fully written-off by age 9.**
- **Mares aged 8 or over qualify for a 100% write-down.**
- The 25% loading still applies for eligible mares - basically, **mares not [previously] used for breeding in New Zealand by any other person.** This includes maiden mares and mares imported to New Zealand for the first time. The write-down formula for this is:

1.25 x cost of broodmare

9 – age of broodmare

where:

the age of the broodmare is: - 8 years of age, or

:- the actual age in years, if the mare is 7 years or less at balance date

$$\frac{1.25 \times \$40,000 \text{ (say)}}{9 - 5 \text{ years (say)}} = \frac{\$50,000}{4} = \$12,500$$

Where the loading is not applicable the "multiplier" is 1.00.

Example:

$$\frac{1.00 \times \$40,000}{9 - 5 \text{ years}} = \frac{\$40,000}{4} = \$10,000 \text{ write-down}$$

The position with leased mares is different. Lease fees are 100% deductible. Write-downs apply to the residual value paid at the end of the lease.

Examples:

A nine-year-old mare purchased on 6 August 2006 qualifies for a 100% write-down. If she's re-sold, say in 2008, that second purchase also qualifies for a 100% write-down. Note that the first owner will pay income tax on the full sale price. The only deduction will be the book value of \$1.

A six-year-old mare purchased in the UK for \$100,000 and imported to New Zealand for the first time qualifies for a 33.3% write-down; plus the 25% loading:

$$\frac{1.25 \times \$100,000}{9 - 6 = 3} = \frac{\$125,000}{3} = \$41,666.67 \text{ writedown}$$

Important Note: Bloodstock previously written down at the "old" pre-1 August 2006 rates cannot change to the "new" rates. These horses are locked in at the "old" rates.

BUSINESS TEST VS. RECREATIONAL PURSUIT

- Basic test is the case of Grieve v C of IR (1984)
- An ability and intention to make a profit must be demonstrated.
- Note must be taken of:
 - **Scale of the operation**
 - **Commitment of time, money & effort**
 - **Pattern of activity**
 - **Financial results**
 - **If activity is carried out in a business-like manner**
 - **If activity is characteristic of breeding businesses in general**
- **Bloodstock Tax Cases:**
 Edgcombe v C of IR (1991)
 TRA Case K40 (1988)
 TRA Case U10 (1999)
 et al
- Unlike the Australian Tax Office, the **New Zealand IRD does not apply fixed criteria for numbers of mares, commercial pedigrees etc, to establish whether or not a breeding operation is a business or a recreational pursuit.** For those in the business of breeding bloodstock in New Zealand, racing a filly or a colt is considered to be part of the breeding operation.
- However, **it is possible to claim only the costs of care and maintenance (eg feed, vet) for a racing filly or colt** – not the cost of preparation (eg trainer's costs, track, nomination & acceptance fees) for racing.
- **Be careful about the tax treatment of geldings.** A gelding may remain in a breeder's accounts if he was gelded to improve his sale prospects. Otherwise he must exit the accounts when he ceases to be a "stud" horse, at a market value on the day he ceased to be a stud animal. This will usually create an income tax and GST liability for the owner (see comments for the second example under New Stallion Write-Down Rates, above.) It is recommended that a competent bloodstock valuer values the horse after inspecting it personally.

The above information is intended to provide a general guide only to the new legislation and its application to various hypothetical situations; and a review of how business and recreational breeding operations may be defined for tax purposes. Businesses and individuals are strongly advised to seek specific advice on their transactions and decisions from their own taxation & accounting specialists.

The NZTBA and John Aubrey expressly disclaim all and any liability and responsibility to any person in respect of anything done or omitted to be done in reliance on these notes on new taxation write-downs and the business test for thoroughbred breeding in New Zealand.

Accountants & advisers wishing to clarify aspects of bloodstock taxation with the Inland Revenue Department can contact:

Kevin Bradfield
Technical Adviser
Technical and Legal Support Group
Hamilton
Ph: (07) 834 7428
Email: kevin.bradfield@ird.govt.nz

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