

MEDIA RELEASE

ATO ISSUE DRAFT OF NEW HORSE INDUSTRY RULING – TR 2007/D9

After extensive industry consultation, the ATO finally released a new draft ruling addressing major thoroughbred industry taxation issues on 22 August 2007.

It has been 14 years since the ATO last issued a specific tax ruling relating to the thoroughbred industry (TR 93/26) and this current ruling seeks to clarify many aspects of this ruling as well as addressing many horse income tax issues that have arisen subsequent. The major catalyst for this ruling is the current ATO audit of the industry that commenced in late October 2003 and which continues to escalate.

Major issues addressed

The major areas addressed by this draft ruling are:

- What is a business of “racing” horses?;
- What is a business of “breeding” horses?;
- When “racing” activities can form part of a “breeding” activity;
- The proper treatment of racing and breeding stock for tax purposes, i.e. is it trading stock, plant or a CGT asset?;
- The deductibility of service fees; and
- When racehorses can be subject to depreciation.

Amongst the areas the ruling did not comment on were foal share arrangements, “one-off” profit transactions involving horses and leasing arrangements relating to the breeding of horses and syndications generally.

ATO submissions for comment due by 10 October 2007

It must be emphasised that this is only a draft ruling and the ATO are inviting submissions to be lodged by 10 October 2007 for parties wishing to make relevant comments. *Carrazzo Consulting CPAs*, as a leading provider of tax services to the industry, will not only forward its own submission relating to specific tax issues, but has also been invited to participate in the general industry submission of Thoroughbred Breeders Australia (TBA).

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Major ruling highlights

After proper consultation with the ATO, we comment below on some of the significant specific issues addressed (or not addressed) within the ruling:

1. ATO still “hard line” on horse racing activities

Regrettably, little has changed in this area. A “stand-alone” racing activity would, in the words of the ATO, “rarely amount to the carrying on of a business”.

It did restate that determining any business is a “question of fact”, so there is still hope for major racehorse owners.

This rigid ATO position seems to have little regard to the general indicators that the AAT and courts refer to when deciding whether an activity is a tax business. It appears as though only wins by racing taxpayers at the AAT or courts will change this ATO position and our office (and the industry as a whole) must ensure that the ATO has full knowledge of these at the time this ruling is finalised.

2. “Racing” activities can form part of “breeding” activities

Where the ATO will relax their “hard line” racing position is where the racing of horses is an “integral” part of a horse training or breeding activity. This ATO administrative position has been out for at least 6 months and it is comforting to see that it now forms its public opinion.

If the taxpayer can prove “integration” between the racing and breeding activities, e.g. fillies retained for racing to be used in future breeding, then the racing activity forms *part* of the breeding activity. Again, this question relies heavily on the facts of the case and a breeding business **must** be in existence before this test can be applied to the racing activity.

3. ATO relief for “breeding” business indicators

As flagged in a consultation meeting I attended at the ATO in October 2006, the ruling no longer states that a tax breeder needs “at least six quality or commercial brood mares”. I welcome the removal of this indicator as it very much reflects decisions of the AAT and courts in this area where many breeders have been held to be in business with less than six mares.

We also note that the ATO have not included as business indicators the need for mares to have “black-type” in pedigrees or that they should be bred to stallions with “market appeal”. Throughout the audit process, this has been a strong ATO administrative position.

4. Deductibility of Stallion Fees

Though a little ambiguous within the ruling, the ATO indicate that stallion fees paid pursuant to a positive pregnancy test, i.e. upon issue of a final invoice, are deductible in the year incurred.

However, the ruling also indicates that where stallion fees are prepaid, they are subject to the new special prepayment rules in terms of timing of deductibility.

This area should indicate that breeders within the STS are not bound by the prepayment rules noted above and the ATO acknowledge that it is likely that the final ruling will discuss this.

5. Stock in a breeding business is treated as trading stock

This ruling makes it quite clear that stock within a breeding business, including racehorses, must be held as trading stock, e.g. fillies retained for racing and future breeding or home-bred geldings retained for the purpose of racing.

This differs to their position in the 1993 ruling where it did give the taxpayer the option to hold racehorses as depreciable plant where their major purpose is to derive prizemonies from racing.

The ATO have effectively closed off the depreciation of racehorses in a breeding business by clarifying the original 1993 ruling.

The ruling also restated the trading stock provision that horses acquired by natural increase cannot be subject to the general mare and stallion write-down provisions. It appears that there must be a degree of confusion amongst tax advisers when advising in this area.

6. Depreciation for racehorses starts from birth

The 1993 ruling stated that a racehorse can only be depreciated from two years of age.

Where a racehorse is held in a racing business, the new ruling now states that such horse can be depreciated from the time it is born. This reflects a change in the general depreciation rules since the release of the original ruling.

7. Hobby racehorses still considered "Personal Use Assets"

The ATO have not overturned their 1990 ruling which stated that racehorses (or interests therein) held by hobbyists are designated as "Personal Use Assets" under the Capital Gains Tax rules.

Assets in this category are tax exempt if acquired for \$10,000 or less. The industry believes that this threshold is too low and should be increased to a level commensurate with the increase in average yearling prices over the past ten years.

End of release.

DISCLAIMER

Any reader intending to apply the information in this article to practical circumstances should independently verify their interpretation and the information's applicability to their particular circumstances with an accountant specialising in this area.

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