# Coversheet: Proposed changes to bloodstock tax rules

|  |  |
| --- | --- |
| Advising agencies | Inland Revenue and the Treasury |
| Decision sought | Final design approvals for Budget 2018 bloodstock initiative  |
| Proposing Ministers | Hon Stuart Nash (Minister of Revenue) |

## Summary: Problem and Proposed Approach

|  |
| --- |
| **Problem Definition****What problem or opportunity does this proposal seek to address? Why is Government intervention required?** |
| The Government wants to encourage investment in the New Zealand racing industry and ensure New Zealand horses can compete with the best in the world. The concern is that the current tax rules for bloodstock breeding do not encourage new investors into this part of the industry.   |

|  |
| --- |
| **Proposed Approach** **How will Government intervention work to bring about the desired change? How is this the best option?** |
| New rules will be introduced that allow new bloodstock investors to claim tax deductions, as though they had a bloodstock breeding business, if they purchase a standout yearling[[1]](#footnote-1) with an intention to breed from the horse in the future. The aim is to incentivise new investors into bloodstock breeding while targeting the best yearling prospects.  |

## Section B: Summary Impacts: Benefits and costs

|  |
| --- |
| **Who are the main expected beneficiaries and what is the nature of the expected benefit?** |
| New investors establishing a breeding business will be able to access deductions earlier and in wider circumstances than they would otherwise. Existing breeders are likely to benefit from an increase in prices for yearlings at the margin. Qualified bloodstock managers may also benefit from additional demand for services in business planning. Finally, the entire racing industry may benefit in the long run from improvements in the quality of New Zealand’s bloodstock.  |

|  |
| --- |
| **Where do the costs fall?**  |
| The monetary costs fall on the Government, which will fund the changes through tax expenditure. Some of the costs may fall on new and existing investors if they need to pay more for quality yearlings, particularly at the threshold. This may include overseas buyers of New Zealand bloodstock. The policy is expected to increase compliance costs for those taking advantage of the policy, as new investors will need to demonstrate an intention to breed by fulfilling a number of requirements, and Inland Revenue will also incur additional administration costs in evaluating these applications.Finally, there is a risk that encouraging investment in one area over others via the tax system may result in reduced tax revenue that needs to be made up elsewhere, and result in resources being captured by interest groups, which can undermine the Government’s overall objectives for the tax system.  |

|  |
| --- |
| **What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?**  |
| There is a risk that this policy may not improve the quality of New Zealand’s racing stock. Limiting the policy to standout yearlings may result in new investors but little improvement in the quality of breeding. The probability that a yearling will be used in a commercial breeding business is reasonably low and is determined in part by how well it performs on the race track, so establishing a breeding business on the future racing performance of a yearling may be a risky approach for investors.Another risk is that investors mainly interested in horse racing will access the rules, when currently the costs and prize money from horse racing are deliberately outside the tax base. We assume the price paid for a yearling may be a good proxy for a yearling that is more likely to be a commercial breeding prospect; therefore the price threshold reduces this risk by preventing investors from claiming an intention to breed with lower-priced horses. However, investors mainly interested in horse racing may be prepared to pay more for yearlings once bidding gets close to the published price threshold. Overall, changes in investor behaviour may result in the costs of this policy being higher than forecast in Budget 2018. The fiscal costs of this policy are based on a certain number of yearlings qualifying as standouts, and their estimated prices. The actual costs could be higher depending on the number of yearlings that are acquired with an intention to breed in the future and the prices paid for these yearlings.Inland Revenue will be able to monitor and report on the notifications it receives of yearlings being acquired with an intention to breed, and we also note that if prices for standout yearlings increase in the future, then the value of the threshold will increase over time. This may help to manage the fiscal risk. However, the increases will always lag behind what happens to prices in any given year. Another consideration is that an increase in yearling prices at the margin may disadvantage race horse investors who would otherwise have acquired yearlings for prices close to the price threshold. Nevertheless, this is an unavoidable risk of having a bright-line price.  |

|  |
| --- |
| **Identify any significant incompatibility with the Government’s ‘Expectations for the design of regulatory systems’.**  |
| Compatible with the Government’s ‘Expectations for the design of regulatory systems’. |

## Section C: Evidence certainty and quality assurance

|  |
| --- |
| **Agency rating of evidence certainty?**  |
| A review of the New Zealand racing industry by Australian racing administrator John Messara has indicated that the thoroughbred racing industry is in serious decline, referencing data such as foal crop numbers and monetary returns to owners. We have not considered whether tax incentives encouraging new investors into bloodstock breeding are the best way to reverse this trend. Further, there is significant uncertainty as to whether a standout yearling will actually be used in a bloodstock breeding business. We consider that a bright-line price is an appropriate way to manage some of the fiscal risk.   |

*To be completed by quality assurers:*

|  |
| --- |
| Quality Assurance Reviewing Agency: |
| Inland Revenue |
| Quality Assurance Assessment: |
| The Quality Assurance reviewer at Inland Revenue has reviewed the ‘Proposed changes to bloodstock tax rules’ RIA prepared by Inland Revenue and considers that the information and analysis summarised in it **partially meets** the quality assurance criteria.  |
| Reviewer Comments and Recommendations: |
| The Regulatory Impact Assessment describes how allowing new bloodstock investors to claim tax deductions if they purchase a standout yearling with an intention to breed in the future will meet the stated objective and also provides excellent coverage of the main uncertainties and risks around its likely impact. The ability to have on-going monitoring may result in any unintended consequences being picked up as part of that process and any remedial action taken as appropriate.The analysis summarised in the RIA is as good as could be expected in light of the constrained range of options considered and the uncertainties over the net impacts of these tax changes on the bloodstock breeding industry.  Even so, the analysis only partially meets the quality assurance criteria primarily because it is not possible to be confident that the stated objective is being met in the best way and with the least unintended consequences. |

# Impact Statement: Proposed changes to bloodstock tax rules

**Section 1: General information**

|  |
| --- |
| **Purpose** |
| Inland Revenue and the Treasury are solely responsible for the analysis and advice set out in this Regulatory Impact Assessment, except as otherwise explicitly indicated.  This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by Cabinet. |

|  |
| --- |
| **Key Limitations or Constraints on Analysis** |
| The Coalition Agreement between the New Zealand Labour Party and New Zealand First commits the Government to supporting New Zealand First’s Racing policy. This policy underscores the need for breeding programmes to re-establish New Zealand as a first tier country in racing.Officials have not assessed the nature and scale of the issues facing the racing industry, nor considered the full range of alternative options. We have not assessed whether the current tax rules are a reason for fewer new investors entering into bloodstock breeding. Prior to the new Government being formed, Inland Revenue officials had been considering racing industry proposals for tax reform. A few options were initially raised to address the problem identified by the industry, including the possibility of direct grants, but these alternatives were not developed further. In early 2018 officials began to focus on an approach that provides tax deductions for up to 30 yearlings per year. The industry advised that in any year, there are up to 20 thoroughbred yearlings and up to 10 standardbred yearlings that have the pedigree and physique and race winning potential to be commercial breeding horses in the future. Price paid for a yearling may be a good proxy for a yearling that is more likely to be a commercial breeding prospect; we assume that final purchase prices must be based on some assessment of a yearling’s qualities that make it more or less likely to be a breeding prospect in the eyes of an investor. However, because a yearling has not yet raced and proven its quality, a higher purchase price will not necessarily translate to a better quality horse. That can only be confirmed after the fact. The price threshold importantly aims to limit the number of horses that qualify for the policy. However, it is difficult to know how industry practices will change in response to these tax amendments. The extent to which investors will bid up horses near the threshold to qualify for tax benefits cannot be accurately predicted. Intention to breed also presents difficulties as a criterion, as it is not possible to know whether the intention an investor claims is genuine until a breeding business is realised. However, the quality of business plans and other information required to support a statement of intention to breed may enable Inland Revenue to identify those investors that do not have a genuine intention to breed from a yearling in the future.  |
| **Responsible Manager (signature and date):** |
| Peter FrawleyPolicy ManagerPolicy and StrategyInland Revenue11 September 2018 |

**Section 2: Problem definition and objectives**

|  |
| --- |
| **2.1 What is the context within which action is proposed?** |
| A high proportion of people engaged in the horse racing and breeding industry are hobbyists. These participants are not entirely motivated by profit, but also by the enjoyment they derive from racing as a hobby and the opportunity to develop a future champion sire or breed the next champion race winner. Bloodstock breeders provide the future horses for the racing industry. Yearlings are typically offered for sale at organised public sales, where they are acquired by a range of purchasers including overseas investors, those buying a horse to race and potentially breed, existing breeding businesses, and investors seeking to start a breeding business. Investors frequently syndicate to share the cost of a horse, and will therefore have an interest in the horse rather than full ownership. The high costs of buying and maintaining a horse for racing, combined with the generally low stake money involved and the multitude of competition, result in it being a loss-making activity in many cases. Racing is exempted from income tax because it is considered to be a hobby. This prevents owners using losses from horse racing to shelter other income. Breeding is in the tax base as it is less likely to be undertaken as a hobby. That said, there are also a large number of hobby breeders. Investors acquiring yearlings face a low chance of breeding them for profit; the probability of an individual yearling colt ever going to a commercial stud in New Zealand is less than 5%, and the probability for a filly around 15%. Whether or not a young horse with good physique and pedigree is used in a commercial stud is contingent on its performance on the race track. The horse racing industry is represented by the New Zealand Thoroughbred Breeders Association, the New Zealand Standardbred Breeders Association, the New Zealand Racing Board, and Thoroughbred Racing New Zealand. The industry works closely with the government to design the rules that will apply to racing and breeding activities and then governs itself under these rules.Industry organisations have expressed concerns that New Zealand is losing top bloodlines to overseas buyers, reducing the quality of New Zealand bloodstock for racing. At the same time however, the industry wants to increase its export potential, which requires a supply of high quality horses to send overseas. These factors combine to create demand for more and better bloodstock, which has contributed to the Government’s proposal to expand incentives for new investors to undertake breeding.John Messara’s review indicates that the thoroughbred racing industry is in a state of serious malaise. It states that returns to New Zealand owners from 2016-17 were 22.9%, compared with 48.1% in New South Wales, and cites a significant decrease in the foal crop.Officials note that since 2004, the number of active breeders has dropped by a third, and the number of foals has dropped by over 40 per cent. In racing, the number of horses in training has dropped by 30 per cent since 2004, and the number of full-time equivalents employed in the racing industry has decreased by around 20 per cent. The general picture is that the industry is not generating as much economic activity as it once was, and is at risk of declining further. Past and current governments have provided support to the racing industry. The New Zealand Racing Board was established by the Racing Act 2003, with the purpose of providing effective governance for the racing industry, running a profitable betting business, promoting and enhancing the industry, and generating long term profit for the benefit of racing.Profits from the TAB, which is run by the New Zealand Racing Board, have for a long time been recycled back into the industry. The Board’s statement of intent for 2018 states that distributions for the racing codes for 2018/19 are budgeted at $151.6 million, a $0.8 million increase on last year. This includes the $12 million of additional funding targeted at increasing stakes across the 2017/18 and 2018/19 seasons that has been approved by the Board. As profitability increases, the expectation is code distributions will also be lifted from $151.6 million to $172.2 million in 2019/20. Code distributions are expected to grow further in 2020/21 to $190.0 million.  |

|  |
| --- |
| **2.2 What regulatory system, or systems, are already in place?** |
| The Racing Act provides governance arrangements for the racing industry, facilitates betting, and promotes the long-term viability of New Zealand racing. The breeding industry is taxed by the bloodstock rules in the Income Tax Act 2007. The current tax rules that apply to bloodstock breeding, last amended in 2006, allow bloodstock owners who have an active breeding business to access accelerated write-downs for bloodstock used in a breeding business: this means that stallions and broodmares receive deductions ahead of their expected decline in value. The accelerated depreciation on bloodstock was intended to make the purchase of bloodstock more attractive and significantly improve the economic potential of the racing industry. The Department of Internal Affairs, which provides advice to the Minister for Racing, has an interest in bloodstock policy. A review of the racing industry, commissioned by the Government, has been completed by Australian racing administrator John Messara. The Government’s goal is to ascertain whether the industry is meeting its full financial potential, and will consider Messara’s recommendations on future directions.  |

|  |
| --- |
| **2.3 What is the policy problem or opportunity?**  |
| The Government considers that the 2006 tax changes are not working as intended. Their view is that the changes favour existing breeders, due to the requirement that an owner must have an existing breeding business to qualify for the accelerated write-downs. The review of the racing industry completed by John Messara is also intended to ascertain how the industry can meet its full financial potential. Data published by the industry shows that horse racing and breeding are in decline and have been for a number of years. The Government’s aim is to encourage new investors to start a breeding business, on the basis that breeding stimulates the industry by increasing the pool of bloodstock, and if there are more breeding businesses then the industry will be more likely to produce a high quality of standout horses that carry economic potential.We have not considered whether an increase in the number of new investors in breeding is the best way to increase the quality of New Zealand bloodstock, or to address the challenges that the racing industry has been facing in recent years. The incentive to start a breeding business with yearlings is not ordinarily very strong, because of the overall uncertainty of this approach. If a horse performs poorly on the track and does not go to stud, then the owner may make a sizeable loss. However we note that, other things being equal, the tax incentives will make such bloodstock breeding a more appealing investment.  |

|  |
| --- |
| **2.4 Are there any constraints on the scope for decision making?**  |
| Ministers have ruled out the status quo, and have also ruled out the use of direct grants to encourage new investors. Officials’ preference was to stay with the status quo, as we see precedential disadvantages in expanding tax incentives in an industry that has a large leisure component. The recommendations included in John Messara’s review of the racing industry will further contribute to Ministers’ decision-making on the racing codes. |

|  |
| --- |
| **2.5 What do stakeholders think?** |
| The stakeholders are the racing industry. They are represented by: the New Zealand Thoroughbred Breeders Association; the New Zealand Standardbred Breeders Association; the New Zealand Racing Board; and Thoroughbred Racing New Zealand. Officials have consulted with all of the stakeholders and the industry is broadly in favour of the proposed changes, although the changes are somewhat narrower than what the industry originally sought. The industry’s initial proposal was for deductions to be available to new bloodstock investors who claimed an intention to breed from a horse in the future. Their proposal was to amend the legislation so that:* A breeding business is treated as commencing on the purchase of a horse, provided there is an intention and plan to breed the horse for profit; and
* The breeding business is only required by the end of the income year (ie does not need to be pre-existing at purchase)

Officials had reservations with this broad proposal because of the number of horses that might qualify, and that all pre-breeding business expenditure could become deductible, even when no contribution to the breeding industry is realised. This could carry significant fiscal risk for the government.The industry later revised its proposal to allow an investor to claim a tax deduction against other income for the accumulated bloodstock holding costs (such as insurance, veterinary costs, and grazing costs), having claimed an intention to breed, at the earlier of:* The date the breeding phase commences;
* The date the investor otherwise comes to have an interest in a bloodstock breeding business; or
* The date they abandon their plans to breed the horse for profit (because the horse is sold, or proves unsuitable or unable to breed)

Officials considered that this updated proposal was similar in substance to the original. The abandonment point allows investors to claim deductions for accumulated costs even when no breeding business eventuates, which officials also regarded as carrying sustainability risks for the government. Instead, officials have proposed a rule allowing write-downs only for the costs of standout horses (the most expensive horses), and proposed that the policy be limited to yearlings. The aim is to limit tax incentives to owners who never end up starting a breeding business by significantly restricting the number of eligible horses and thereby reducing the fiscal impact. It is a second-best option for the industry, and it is also a second-best for Government as it retains the possibility of subsidising some losses where no breeding business has materialised, but it mitigates a large amount of the potential fiscal risk. |

## Section 3: Options identification

|  |
| --- |
| **3.1 What options are available to address the problem?** |
| The four options considered are:* Option 1: Status quo
* Option 2: ‘Carry forward’ to business
* Option 3: Claim to intention (industry’s preferred option)
* Option 4: Claim to intention with high-quality yearling

*Option 1 (Status quo)*Bloodstock breeders must have an existing breeding business to qualify for deductions on the cost of horses. The Government ruled this option out early on.*Option 2*Allow pre-breeding business costs to be carried forward until a breeding business is established, and then deducted. It is a tax incentive as it allows pre-business expenditure to be deductible if a business eventuates, which departs from the general requirement that for costs to be deductible, they must be incurred in the course of carrying on a current business for the purpose of deriving income. Therefore, it provides an incentive for new investors to start a breeding business.This option is closest to the status quo, as no benefit is available until a breeding business is actually started. Due to the fact that it addresses the problem of the uncertainty of new investors’ intentions, officials preferred this option over options 3 and 4. *Option 3*Allow pre-breeding business costs to be deductible when an intention to breed from a thoroughbred or standardbred horse for profit is claimed. Investors can also claim deductions if they abandon the intention to breed the horse for profit. Evidence of an intention to breed for profit in the future would include the pedigree of the horse, contractual arrangements, a detailed business plan, and a skilled manager/trainer. This option departs most substantively from the status quo, as it relaxes the requirements of the longstanding tax policy concept of a ‘business test’, and was the industry’s preferred option. The looser requirements provide an incentive for new investors to buy bloodstock for breeding. *Option 4*Similar to option 3, but limit eligibility for deductions to standout yearlings that command a price above a bright-line threshold determined by previous sales results and published ahead of the next year’s sales by Inland Revenue. This restricts the incentive to horses that, as yearlings, are indicated by the market to be most likely to be genuine commercial breeding prospects, and thus mitigates the negative impact on Crown revenue. It provides an incentive for new investors to start a breeding business while taking steps to manage the fiscal risk. However, it has the same negative precedential effect as option 3. ***Horses acquired at Australian sales***The Government is currently considering whether to include yearlings bought at Australian sales in the proposed policy. The industry has stated that allowing Australian yearlings into the policy would further help to improve New Zealand bloodlines, and has requested that these sales be included.There is a risk that including Australian sales will increase the fiscal cost, particularly given that Australian yearlings are more expensive than New Zealand yearlings overall, and each year more than a couple of standout yearlings may be acquired by new investors at the Australian sales. The industry has argued that there would not be demand for more than a few such Australian yearlings, and that there is therefore room for these horses within the proposed policy. We assume that including Australian horses in options 2 or 3 could also increase fiscal cost.  |

|  |
| --- |
| **3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?** |
| The main objective is to incentivise new bloodstock investors to start a breeding business, in order to promote investment in the New Zealand racing industry and enhance the quality of bloodstock. This has been measured against the following criteria:**Effectiveness:** The option shouldencourage investment in the racing industry by stimulating breeding and improve the quality of New Zealand bloodstock. **Efficiency:** The option should target the best breeding prospects to the greatest extent possible. **Administration & compliance costs:** The option should minimise administrative and compliance costs as much as possible.**Sustainability:** The changes should minimise negative precedential effect, and should fit within the allocated fiscal envelope.Efficiency and effectiveness are the most important criteria; targeting genuine breeding prospects is important for the policy to have a positive effect on the racing industry. We assume that price paid for a yearling may be a good proxy for a yearling that is more likely to be a commercial breeding prospect. As this is not certain, however, it is difficult to assert that the chosen option will be objectively effective, even if purchase price is the most logical metric available. Administration and compliance costs (least important) must also be taken into consideration, and sustainability will be traded off against efficiency and effectiveness, since all of the options involve overriding the traditional ‘business test’ for the racing sector, which inevitably sets negative precedent.  |

|  |
| --- |
| **3.3 What other options have been ruled out of scope, or not considered, and why?** |
| The option to stay with the status quo has been ruled out by Ministers, as have direct grants. The Coalition Agreement supports New Zealand First’s racing policy. Thus, any options put forward have to address the Government’s objective of enhancing incentives to breed bloodstock.  |

**Section 4: Impact Analysis**

**Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?***Add, or subtract, columns and rows as necessary.*

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Option 1 (status quo)** | **Option 2 (carry-forward costs until breeding business is established, then deduct)** | **Option 3 (deductions when intention to breed claimed)** | **Option 4 (deductions when intention to breed claimed; high value yearlings only)** |
| **Effectiveness** | **0** | **+**Likely to encourage some new investors relative to status quo, although incentive is weakest of the three options, and therefore possibly least effective at stimulating bloodstock breeding. There are no deductions if a breeding business does not eventuate. | **++**Strong incentive for new investors to claim that a race horse was acquired with an intention to breed for profit in the future, as the only restriction on eligibility for deductions is the ability to demonstrate an intention to breed. Potentially the most effective at stimulating investment in the racing industry, but perhaps not into bloodstock breeding, as investors may mischaracterise their intent. | **++**May incentivise new investors who have a genuine intention to breed by offering concessions only for higher-priced horses. Therefore, potentially equally effective at stimulating bloodstock breeding and increasing investment in the racing industry.  |
| **Efficiency****(targetedness)** | **0** | **++**Has the benefit of resolving uncertainty surrounding investor intent. Genuine breeders are targeted, as carried-forward losses can only be used when a breeding business is established. | **+**Likely to encourage new investors into the racing industry, but potentially less efficient than option 4 as it doesn’t target standout horses, so may capture a large number of horses that were mainly acquired as horses to race rather than horses that are genuinely commercial breeding prospects. Likely to be reasonably expensive.  | **+**May be more efficient than option 3 because it targets new investors who are buying high-quality yearlings with better commercial breeding potential (presumably reflected by high purchase price).  |
| **Administration & compliance costs** | **0** | **0**Similar to status quo as a breeding business is still required. There may be an increased number of applications, however administration is otherwise the same. | **--**Low compliance costs as taxpayers claim an intention to breed in their tax return by including costs as deductions in the normal way. However, these claims are subject to review by the Commissioner if there is concern whether the intent exists. Potentially more administration costs to review and dispute claims of intention to breed. Typically, proving that an intention does not exist is difficult. Due to lack of restrictions on number of horses, number of cases to review could be large. | **-**More compliance and administration than options 1 or 2, as it is based on intention to breed. Less than option 3, because number of horses is restricted by bright-line price floor. |
| **Sustainability****(precedent & fiscal cost)** | **0** | **-**Slightly less sustainable than status quo, because additional incentives for investors increase differential treatment of sector, which can create precedent for other sectors seeking incentives in the future. However, the option is broadly in line with current policy settings as a breeding business is required. Fiscal cost is significantly lower than option 3 and 4.  | **--**Least sustainable. Offering deductions to any bloodstock investor who can demonstrate intention to breed sets wide precedent if other activities are lobbied to be brought into tax net in future. Potentially very costly fiscally.  |  **-**Less sustainable than option 1 or 2; could set undesirable precedent if other activities are lobbied to be brought into tax net in future. But more limited than option 3, so relatively more sustainable, with a lower fiscal impact. |
| **Overall assessment** | **0** | **+** | **--** | **-** |

**Key: ++** much better than doing nothing/the status quo; **+** better than doing nothing/the status quo; **0** about the same as doing nothing/the status quo; **-** worse than doing nothing/the status quo; **- -** much worse than doing nothing/the status quo

**Section 5: Conclusions**

|  |
| --- |
| **5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?** |
| Option 2 is preferred over the other options considered. Accepting that the Government’s objective carries inherent fiscal and precedential risks, the preferred option is the one that is potentially most effective and efficient in achieving the objective, and least unsustainable, with increased compliance and administration costs as a further trade-off. However, the approach that has been chosen by the Government is option 4. There is a lack of evidence to suggest that high-priced yearlings are more likely to go on to breed than lower-priced yearlings, which makes it somewhat uncertain whether option 3 or option 4 will be more effective or efficient at improving the quality of New Zealand bloodstock. However, the fiscal cost of option 3 is potentially very high, and we consider that this cost is too high to justify the additional effectiveness it might entail.Further, we assume that a higher price paid for a yearling reflects the market’s view that a horse has qualities such as physique and pedigree that make it more likely to be a better racing and commercial breeding prospect. An investor who purchases a high-priced yearling presumably judges the horse to have better prospects than other yearlings, otherwise they would rationally buy the cheapest horse available. Due to officials’ concerns around the sustainability of allowing all horses into the policy, setting a price threshold is considered to be the best solution. This leads us to prefer option 4 over option 3, acknowledging that the Government and the industry did not agree with officials’ preferred approach of option 2.  |

|  |
| --- |
| **5.2 Summary table of costs and benefits of the preferred approach** |

|  |  |  |  |
| --- | --- | --- | --- |
| **Affected parties** *(identify)* | **Comment***: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks* | **Impact***$m present value, for monetised impacts; high, medium or low for non-monetised impacts*  | **Evidence** **certainty** *(High, medium or low)*  |
|  |
| **Additional costs of option 4, compared to taking no action** |
| New investors | New investors (with a horse costing more than the bright-line price) intending to start a breeding business will need to provide evidence of a business plan to the Commissioner. The cost of some horses may also go up.  | Low  | High |
| Existing breeders | Existing breeders may have to pay more for yearlings as a result of yearlings being bid up for the tax incentive (though they will often be selling them, and getting that benefit).Breeders who syndicate yearlings to new investors may have to provide the business plan to the Commissioner themselves. | Low | High |
| Foreign investors | Foreign investors may have to pay more for yearlings as a result of yearlings being bid up for the tax incentive. | Low | High |
| Inland Revenue | The Commissioner will need to evaluate business plans submitted by bloodstock owners claiming an intention to breed, which may be more administratively intensive than simply verifying the existence of a business. | Low  | High |
| **Total Monetised Cost** | Cost allocated to tax expenditure in Budget 2018. | $4.8 million over 4 years | High[[2]](#footnote-2)  |
| **Non-monetised costs**  | Increased administration and compliance costs for regulators and regulated parties. | Low | High |

|  |
| --- |
| **Expected benefits of option 4, compared to taking no action** |
| New investors | New investors would be encouraged to enter into a breeding business because of the concessions for standout horses where an intention to breed can be demonstrated. | Medium | Low |
| Existing breeders | Existing breeders will benefit from any increase in yearling prices as a result of new investors bidding up to get the tax concessions. | Medium | Low |
| Foreign investors | Foreign investors will benefit from any improvements to bloodstock exported from New Zealand (though they will also pay more for it). | Low | Low |
| **Total Monetised Benefit** | Potentially significant monetary benefit for existing bloodstock breeders and new investors. | $4.8 million over 4 years | Medium |
| **Non-monetised benefits** | More level playing field between new investors and current breeders. | Medium | Medium |

|  |
| --- |
| **5.3 What other impacts is this approach likely to have?** |
| The proposed changes involve relaxing eligibility requirements from “existing breeding business” to “intention to breed.” This change removes the requirement for a bloodstock breeding business to exist before an investor can claim tax deductions for the costs of owning bloodstock. The risk is that race horses are characterised as breeding prospects. Further, the success of the racing industry may encourage other sectors to approach the government for their own unique tax rules.  |

|  |
| --- |
| **5.4 Is the preferred option compatible with the Government’s ‘Expectations for the design of regulatory systems’?** |
| There are no identifiable areas of incompatibility with the Government’s ‘Expectations for the design of regulatory systems.’ |

**Section 6: Implementation and operation**

|  |
| --- |
| **6.1 How will the new arrangements work in practice?** |
| The new policy will require amendments to the Income Tax Act 2007. Once implemented, Inland Revenue will be able to enforce and monitor the arrangements. New investors will be required to notify the Commissioner of Inland Revenue of their intention to breed, supported by information including the investor’s details, a business plan, and veterinary reports, which Inland Revenue will evaluate.The Commissioner will publish the bright-line values each year and will be able to monitor how the policy is working overall using the information provided by investors.  |

|  |
| --- |
| **6.2 What are the implementation risks?** |
| During consultation with the industry, concerns were raised about Inland Revenue being too regimented in determining a new investors’ intention to breed from a yearling in the future. The reality is that proving intention is very difficult. The existence of a business plan and other pieces of evidence are only indicators that an intention to breed may exist. Officials acknowledge that establishing a breeding business with a yearling is risky. We agreed that the Tax Information Bulletin would provide examples of the type of information and the level of detail that would be required to support a notification of intention to breed from a standout yearling.  |

**Section 7: Monitoring, evaluation and review**

|  |
| --- |
| **7.1 How will the impact of the new arrangements be monitored?** |
| The information provided to the Commissioner by new investors claiming an intention to breed will give Inland Revenue the ability to monitor how the policy is working, who the new investors are, and whether the horse gets used for bloodstock breeding.  |

|  |
| --- |
| **7.2 When and how will the new arrangements be reviewed?**  |
| The Commissioner will need to annually publish the value thresholds for standout yearlings in light of the previous year’s sales prices, and can review arrangements on an annual basis. Inland Revenue will be able to assess whether the thresholds are allowing the desired number of yearlings into the policy, and whether those yearlings are going on to breed.  |

1. A horse with stud founding qualities, defined under the proposed policy as a horse whose purchase price equals or exceeds a bright-line price floor published by the Commissioner each year. This threshold will be the average minimum value of the top 5% of sales at premier yearling sales for the previous three years, and the top 3% for standardbreds, with colts and fillies treated separately. In this sense it will be a rolling average and require adjustment annually. [↑](#footnote-ref-1)
2. There is a risk that the costs could be higher due to the behavioural effect of investors bidding up yearlings at the margin to qualify for the tax incentive. Nevertheless, data from the previous three years of sales have shown that the number of horses whose prices fall within this sensitive margin is low; therefore, we do not expect there to be a large fiscal blowout. [↑](#footnote-ref-2)