

April 2019

A special report from
Policy and Strategy, Inland Revenue

Taxation of bloodstock

Sections CG 8B, CG 8C, EC 39, EC 39B, EC 39C, EC 47B to EC 47E, EZ 6B, YA 1, and schedules 18B and 18C of the Income Tax Act 2007

Section 225AB of the Tax Administration Act 1994

The Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 made changes to the taxation of bloodstock.

This special report provides early information on the new rules and precedes full coverage of the new legislation in the May 2019 edition of the *Tax Information Bulletin*.

Background

In Budget 2018, the Government announced its intention to amend the tax treatment of expenditure incurred on high quality yearlings when an investor has an intention to breed for profit in the future.

The Government's expectation is that, on average, 20 thoroughbred and 10 standardbred yearlings will qualify each year. The policy objective is to encourage new investment in the New Zealand racing industry.

Key features

Generally, a person must have a bloodstock breeding business to qualify for tax deductions in relation to owning bloodstock.

These amendments allow investors that do not currently have a bloodstock breeding business to qualify for tax deductions in relation to owning bloodstock if they acquire "high priced yearlings" with an intention to breed in the future for profit.

High-priced yearling refers to bloodstock acquired, either directly or indirectly, from a premier yearling sale for an amount above the relevant price threshold set for that calendar year. Each year the thresholds are set by the Commissioner, taking into account the last year's sales results.

To qualify for tax deductions, investors must also:

- notify the Commissioner of Inland Revenue of their intention to use the bloodstock for breeding for profit in the future; and
- provide the information required by the Commissioner.

The sale of a high-priced yearling by a prospective bloodstock breeder is assessable income in accordance with the existing bloodstock rules. There are also recovery rules where a high-priced yearling is sold to a non-resident or exported without first racing or being used for breeding in New Zealand.

Application date

Most of the amendments apply from 1 January 2019. The amendments requiring the Commissioner to set and publish the national minimum price thresholds each calendar year apply from 1 January 2020.

Detailed analysis

Prospective bloodstock breeders treated as being in breeding business

New section EC 47C treats a prospective bloodstock breeder as having a bloodstock breeding business from the day that they acquire stud-founding bloodstock.

Stud-founding bloodstock means high-priced bloodstock acquired by a prospective bloodstock breeder before the yearling turns two years of age and where the notification requirements are met. This rule allows the syndication of a yearling that is high-priced bloodstock prior to the yearling turning two.

High-priced bloodstock is bloodstock that has been acquired at a premier yearling sale (these sales are defined in schedule 18B) for an amount greater than the relevant national minimum price threshold. For 2019, these thresholds are in the new section EZ 6B.

For the 2020 calendar year and beyond, the Commissioner must set and publish the national minimum price thresholds before the first premier yearling sale in the relevant calendar year. Where the Commissioner fails to do this, the most recently published thresholds will apply to sales occurring until the Commissioner sets and publishes thresholds for that calendar year.

A prospective bloodstock breeder means a person who acquires bloodstock when they do not have an existing bloodstock breeding business but intend to first race the bloodstock in New Zealand and use the bloodstock for breeding in New Zealand for profit.

Notification requirements of an intention to breed

Under the notification requirements the owner(s) must, within four months of acquiring the high-priced bloodstock, provide the Commissioner with the following:

1. Notification of intention to breed.

2. Sale and purchase documentation (and, if not included in documentation, lot number/sale name/horse identification (colt/filly, dam/sire etc)).
3. IRD/GST number of the owner. If multiple owners (syndicate/partnership) details of the entity, including all owners.
4. Contact details of all owners: physical address, phone number, e-mail address.
5. Balance date.
6. Owner's founding documents (syndicate/partnership agreement).
7. Breeding business plan that includes:
 - a. A description of the business.
 - b. The research undertaken on the yearling's breeding pedigree and future commercial breeding prospects.
 - c. Location of activity.
 - d. Racing programme designed to prove the horse's breeding value (how is horse to be raced/racing management?).
 - e. Where and when is horse to commence breeding and who/how is this to be managed?
 - f. Financial forecasts.
 - g. Involvement of racing/breeding/syndicate manager (overall management of horse).
8. Veterinarian reports:
 - a. For syndicates required to operate in accordance with the "Bloodstock Syndication Code of Practice", a copy of the veterinarian certificate obtained; and
 - b. For all other syndicates, confirmation that an external physical examination was carried out by a veterinarian prior to purchase together with the details of the veterinarian who performed the examination.
9. Any other relevant communication within the syndicate prior to filing the application for a deduction for the cost of the high-priced bloodstock.

Meeting these requirements entitles a prospective bloodstock breeder to claim tax deductions for the write-down in the horse's value and other expenses, just like the owner of an existing bloodstock breeding business.

Notification requirements on change of intention to breed

There is significant uncertainty whether a particular high-priced yearling will be used in a breeding business. This is because many yearlings never get to be used in a bloodstock breeding business due to injury, being gelded and/or poor racing performance.

New section EC 47D applies when a prospective breeder has been allowed deductions in relation to their high-priced bloodstock and change their intention or the horse is no longer expected to be used for future breeding. The owner is treated as having disposed of the high-priced bloodstock at the bloodstock's market value on the day their expectation or intention changes.

When the owner(s) of high-priced bloodstock changes their intention to breed from the bloodstock in the future for profit, the Commissioner requires them to provide the following information:

1. If horse is gelded or deceased, a copy of the invoice noting the date of gelding or death.
2. If exported, a copy of the export documentation.
3. Copies of any change of ownership forms.
4. All communication relating to any change of intention to breed.
5. Financial statements (or financial statements summary IR10 form, where no other financial statements have been prepared) tax reconciliations and bloodstock schedules.

Other bloodstock owned by a prospective bloodstock breeder

New section EC 47C also has rules relating to other bloodstock owned by a prospective bloodstock breeder. If a prospective bloodstock breeder concurrently owns bloodstock that is not stud-founding bloodstock, that bloodstock is not treated as part of the prospective bloodstock breeder's bloodstock breeding business.

Bloodstock breeding business commences

When a bloodstock breeding business commences with the stud-founding bloodstock, the existing bloodstock rules apply.

Where a prospective breeder commences breeding using bloodstock that is not stud-founding bloodstock section EC 47E applies. The breeding business owner can apply to the Commissioner to have the stud-founding bloodstock treated as being used in the existing bloodstock breeding business. The application must be made within one month after the day that the bloodstock business commences. If the application is approved, then the recovery rules that apply to stud-founding bloodstock removed from New Zealand or sold to non-residents no longer apply.

Recovery rules

If stud-founding bloodstock is removed from New Zealand before first being raced in New Zealand or used for breeding in New Zealand, the owner can make deductions in relation to that bloodstock, and the bloodstock is expected to be able to be used for future breeding, then the owner is treated as having disposed of the high-priced bloodstock. New sections CG 8B and CG 8C apply as appropriate in these circumstances.

These sections recover the greater of the amount of the consideration received for the sale of the high-priced bloodstock or the total deductions that have been allowed in relation to that bloodstock.