TR 2008/2 - Income tax: various income tax issues relating to the horse industry; including whether racing, training and breeding activities (carried out as stand-alone activities or in combination) amount to the carrying on of a business

This document has changed over time. This is a consolidated version of the ruling which was published on *14 May 2008*

Taxation Ruling

Income tax: various income tax issues relating to the horse industry; including whether racing, training and breeding activities (carried out as stand-alone activities or in combination) amount to the carrying on of a business

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If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling identifies, and provides guidance on, certain important income tax issues relating to activities undertaken in the horse industry with a focus on racing, training and breeding activities.

2. The Ruling does not attempt a comprehensive examination of every income tax issue that may potentially be relevant in this area. Rather, it attempts to highlight certain key income tax issues that frequently arise in practice and to provide the Commissioner's views on them.

3. The Ruling considers the question of whether horse-related activities amount to the carrying on of a business. In considering this question, racing, training or breeding activities may be carried out as stand-alone activities or in combination. While observing that whether a business is carried on is always a question of fact in any particular case, this Ruling addresses this issue and related issues under the following parts:

- Part A of the Ruling provides general guidance on whether horse-related activities amount to the carrying on of a business. Part A also outlines some of the key implications that will arise if the activities constitute a business and those that will arise if they do not;
- Part B of the Ruling provides further guidance on whether horse racing activities can, on their own, constitute the carrying on of a business. Part B also deals with situations when horse racing activities can be considered an integral part of the carrying on of a business of horse training and/or horse breeding;
- Part C of the Ruling considers certain specific matters relating to horse breeding activities; and
- Part D of the Ruling makes some general observations about horse training activities.

What this Ruling does not deal with

4. The Ruling does not deal specifically with the following situations:

- cases where horse-related activities are carried out in combination with non-horse related activities, whether as a business or not. However, some of the general discussion in the Ruling may still assist in resolving income tax issues in this area;[1]
- leasing arrangements relating to the breeding of horses or syndicate arrangements generally;
- foal share arrangements;
- isolated profit-making transactions involving horses; and
- cases where a horse is used in the course of deriving assessable income otherwise than in a business or a comparable commercial activity. For example, the use of a horse by a stockman to earn personal exertion income.

[1] See also *MR & SL Block v. Federal Commissioner of Taxation* [2007] AATA 1897; 2007 ATC 2735; where a business of horse and sheep breeding was being carried on.

Class of entities

5. The class of entities to which this Ruling applies are taxpayers whose activities include any of the following, whether or not as a business activity:

- the racing of horses;
- the training of horses; or
- the breeding of horses.

Relevant provision(s)

6. The relevant provisions dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);[2]
- section 8-1;
- Division 35;
- Division 40;
- Division 70;
- Division 392;
- Parts 3-1 and 3-3;
- subsection 995-1(1); and
- Subdivision H of Division 3 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).

Ruling

Part A: horse-related activities – when are they carried on as a business and what are the general implications if they are or if they are not?

7. Relevant horse-related activities can comprise the racing of horses, the training of horses, the breeding of horses or any combination of these activities.

8. Whether these activities amount to the carrying on of a business (or more than one business) in any particular case is always a question of fact. Each case turns on its own particular circumstances.

[2] All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise stated.

9. The courts have, however, identified certain indicators that are relevant in determining whether a taxpayer's activities amount to the carrying on of a business. These indicators are outlined in Taxation Ruling TR 97/11: am I carrying on a primary production business?[3] and include:

- whether the activity has a significant commercial purpose or character – this indicator comprises many aspects of the other indicators set out below;
- whether the taxpayer has more than just an intention to engage in business or to commence in the future – an intention alone without commencement of activities is insufficient;
- whether the taxpayer has a purpose of profit as well as a prospect of profit from the activity;
- whether there is repetition and regularity of the activity;
- whether the activity is of the same kind and carried out in a similar manner to that of the ordinary trade in that line of business;
- whether the activity is planned, organised and carried on in a businesslike manner such that it is directed at making a profit;
- the size, scale and permanency of the activity; and
- whether the activity is better described as a hobby, a form of recreation or a sporting activity.

10. In deciding whether a business is being carried on, regard should be had to all of the above indicators and no single indicator will be determinative in any particular case.

11. The most important point is that a determination of whether a taxpayer's activities amount to the carrying on of a business is based on the overall impression gained after examining the activities as a whole and the intention of the taxpayer undertaking it. If a taxpayer's activities do not amount to the carrying on of a business in one income year, that will not prevent them doing so in a later income year. That change may also occur before profits begin to be made.

[3] The indicators of carrying on a business are outlined in paragraph 13 of TR 97/11, summarised at paragraph 18 and explained in detail in paragraphs 23 to 103 of that Ruling.

Activities not a business – some implications

12. If a taxpayer's horse-related activities do not amount to the carrying on of a business, the following five important consequences follow:

- the gross proceeds derived from the activities will not be assessable income under section 6-5;
- the non-capital outlays and other expenses will not be deductible under section 8-1;
- the horses will not be trading stock of any business of the taxpayer;
- the horses (or interests in them) are depreciating assets but no deductions for decline in value under Division 40 will usually be available to the taxpayer in relation to them; and
- CGT event K7[4] may need to be considered if a balancing adjustment event occurs for the horse, such as a disposal, and the horse has been used for a purpose other than a taxable purpose.

Activities are a business – some implications

13. If the taxpayer's horse-related activities do amount to the carrying on of a business, the following two important consequences follow:

- the gross proceeds derived from the activities will be assessable income under section 6-5; and
- the non-capital outlays and other expenses will be deductible under section 8-1 subject to the tests set out in that section.

The application of particular asset regimes to a taxpayer's horse or an interest in a horse

14. The ITAA 1997 contains rules relating to CGT assets, trading stock and depreciating assets. These are referred to below as 'asset regimes'.

15. A horse (or an interest in a horse) is a CGT asset regardless of whether or not it is also a depreciating asset or trading stock.

[4] CGT event K7 happens if a balancing adjustment event occurs for a depreciating asset held by the taxpayer and, at some time the asset was held, it was used or installed ready for use for a purpose other than a taxable purpose – see section 104-235.

16. A horse (or an interest in a horse) will be a taxpayer's trading stock only if it is live stock used in the taxpayer's primary production business (for example, a horse breeding business), or if the taxpayer is in the business of actually buying and selling horses (that is, as a trader in horses). This is further explained in paragraphs 122 to 137 of this Ruling. As trading stock, a horse (or an interest in a horse) cannot be a depreciating asset.[5] Although it remains a CGT asset, any capital gain or capital loss, if a CGT event happens to it as a CGT asset, is disregarded.[6]

17. A horse (or an interest in it) is a depreciating asset, unless the horse (or an interest in it) is trading stock of a taxpayer's business. A horse (or an interest in it) is a depreciating asset notwithstanding the horse (or an interest in it) may not be used for the purposes of producing assessable income.[7]

18. Whether a particular asset regime applies to a taxpayer is summarised in Table 1.

Table 1

	Horse (or an interest in the horse) is not used in carrying on a business	**Horse (or an interest in the horse) is not live stock of a primary production business and not traded**	**Horse (or an interest in the horse) is live stock of a primary production business or traded**
Asset regime			
Is the horse (or an interest in the horse) the taxpayer's CGT asset?	Yes.	Yes.	Yes.
Is the horse (or an interest in the horse) the taxpayer's trading stock?	No.	No.	Yes.
Is the horse (or an interest in the horse) the taxpayer's depreciating asset?	Yes.	Yes.	No.

Implications where a horse or an interest in the horse is both a CGT asset and a depreciating asset

19. The taxpayer can deduct an amount for the decline in value of a horse (or an interest in it) under Division 40 if it (or an interest in it) is used for a taxable purpose. (A taxable purpose in this context is the purpose of producing assessable income.)

[5] See paragraph 40-30(1)(b).
[6] See section 118-25.
[7] See paragraph 59 of this Ruling.

20. The balancing adjustment provisions in Division 40 will also apply if the horse (or an interest in it) is both used for a taxable purpose and a balancing adjustment event occurs for the horse (or an interest in it). For example, if there is a disposal of the horse (or an interest in it).

21. Importantly, where there is a balancing adjustment event that occurs for the horse (or an interest in it), the capital gains tax (CGT) provisions will *not* apply unless the horse (or an interest in it) is used for a purpose other than a taxable purpose.[8]

22. Where this occurs, CGT event K7 applies. Any capital gain or loss worked out under CGT event K7 is calculated using the concepts of *cost* and *termination value* under Division 40 and not those found in the CGT provisions (that is, cost base and capital proceeds).[9]

23. However, any CGT event K7 capital gain or capital loss may be disregarded if the horse (or an interest in it) is a personal use asset. A personal use asset is, in broad terms, one that is used or kept mainly for personal use or enjoyment.[10] In broad terms, a capital loss from a personal use asset is disregarded[11] and a capital gain is disregarded if the asset cost $10,000[12] or less.[13]

24. Whether the depreciating asset regime or the CGT asset regime applies to a taxpayer when a balancing adjustment event occurs for a horse (or an interest in it) is summarised in Table 2.

Table 2

Use of the asset	Asset regime applying
Where the use of the asset is *wholly* for a taxable purpose	Depreciating asset regime.
Where the use of the asset is *wholly* for a purpose other than a taxable purpose	CGT asset regime using depreciating asset regime concepts.
Where the use of the asset is *both* for a taxable purpose and for a purpose other than a taxable purpose	Both the depreciating asset regime and the CGT asset regime using depreciating asset regime concepts.

[8] See section 118-24.
[9] See section 104-240 as to how to work out a capital gain or loss under CGT event K7.
[10] See paragraph 108-20(2)(a).
[11] See section 108-20.
[12] Note: where the horse is co-owned and is not a partnership asset, then each co-owner must treat their depreciating asset (their interest in the horse) in accordance with their own tax profile. See paragraph 99 of this Ruling. Consequently, whether or not the capital gain is disregarded, will be based on the taxpayer's cost of their interest in the horse.
[13] See section 118-10.

25. Table 3 sets out in more detail the application and interaction of the depreciating asset and CGT asset regimes – that is, where the taxpayer's horse (or an interest in it) is not trading stock.

Table 3

	Horse (or an interest in the horse) of a taxpayer is not used in carrying on a business	**Horse (or an interest in the horse) of a taxpayer is used in carrying on a business otherwise than as trading stock**
Depreciating assets (Division 40)		
If a horse is co-owned, how is the interest treated?	It is treated under section 40-35 as if the interest were itself the underlying asset, that is, as a separate depreciating asset.	It is treated under section 40-35 as if the interest were itself the underlying asset, that is, as a separate depreciating asset.
Is there a deduction for the decline in value of each horse or interest in each horse held?	No.	Yes but only to the extent the horse or interest in the horse is used or installed ready for use[14] for a taxable purpose.
May any amount be included in assessable income or deducted under section 40-285 if a balancing adjustment event occurs for the horse (or an interest in the horse)?	No.	Yes.
Capital gains and losses (Parts 3-1 and 3-3)		
Does a CGT event happen on disposal of a horse (or an interest in a horse)? (see notes 1 and 2)	Yes.	Yes.
Is CGT event K7 the relevant event? (see notes 3 and 4)	Yes.	Yes but only to the extent (if any) the horse (or an interest in the horse) was used or installed ready for use other than for a taxable purpose.

[14] Note: a horse (or an interest in it) is used or installed ready for use when it is acquired or when it is born. See paragraph 95 of this Ruling.

	Horse (or an interest in the horse) of a taxpayer is not used in carrying on a business	**Horse (or an interest in the horse) of a taxpayer is used in carrying on a business otherwise than as trading stock**
Is each horse (or an interest in it) a personal use asset under section 108-20 such that capital losses are disregarded under section 108-20 and capital gains are disregarded if the horse (or interest in it) cost $10,000 or less?	Yes. An asset that is not used for business or profit-making purposes is regarded as used or kept mainly for personal use and enjoyment.	No.

Note 1: A capital gain or capital loss made from a CGT event **other than CGT event K7** is disregarded – see section 118-24.

Note 2: A capital gain or capital loss that is made from a CGT event is disregarded if the horse is trading stock at the time of the CGT event – see section 118-25.

Note 3: CGT event K7 happens if a balancing adjustment event occurs for a depreciating asset held by the taxpayer and, at some time the asset was held, it was used or installed ready for use for a purpose other than a taxable purpose.

Note 4: A capital gain or capital loss under CGT event K7 is calculated using the concepts of **cost** and **termination value** under Division 40 and not those found in the CGT provisions (cost base and capital proceeds).[15] The cost of a depreciating asset consists of two elements and is worked out under Subdivision 40-C. Termination value of a depreciating asset has the meaning given under section 40-300.

Non-commercial losses

26. Division 35[16] applies to an individual who is carrying on a 'non-commercial' business activity either as an individual or through a general law partnership and the deductions attributable to that business activity exceed the assessable income in that income year from that business activity. The Division could apply to a business involving horse-related activities.

[15] See section 104-240 as to how to work out a capital gain or loss under CGT event K7.
[16] Division 35 prevents losses of individuals from non-commercial business activities being offset against other assessable income in the income year that the loss is incurred unless one of paragraphs 35-10(1)(a) to (c) applies.

Part B: the racing of horses

Can the racing of horses as a stand-alone activity constitute the carrying on of a business?

27. As previously discussed, whether a taxpayer's activities of racing horses may, of themselves, amount to the carrying on of a business is a question of fact, having regard to all the relevant indicators as discussed at paragraphs 7 to 11 of this Ruling.

28. In the Commissioner's view, the racing of horses as a stand-alone activity would not amount to the carrying on of a business if either one of the following significant non-business features were present:

- a significant element of chance – meaning that whether or not a profit is made will depend very largely on considerations other than system and organisation of the taxpayer; and
- the activities are no more than the mere pursuit (albeit vigorous in many cases) of a hobby, recreational pursuit or pastime.

29. To overcome the non-business features described above, the Commissioner considers that the taxpayer would need to demonstrate that:

- there is system and organisation, rather than chance, driving the prospect of profit, which is consistent with a business; and
- there is a reasonable expectation that the activity will be commercially viable within a timeframe consistent with the industry standards.[17]

30. In assessing commercial viability, it is emphasised that a genuine intention to make a profit does not of itself establish a reasonable prospect of making one.

Horse racing activities that are carried on as an integral part of a horse training and/or horse breeding business

31. If a taxpayer conducts racing activities as an integral part of a horse training or breeding business, then the horse racing activities would constitute activities in the carrying on of that business.

32. To be considered an integral part of the other business, the racing activities must be inherently connected with it and be consistent with the furtherance of that business activity.

33. Again, it will be a question of fact whether there is a business in the first place, and whether the horse racing activities are an integral part of it (as opposed to a separate activity).

[17] Industry standards take into account the effect of unexpected events such as injury, death or floods – see paragraphs 114 and 115 of this Ruling.

34. Some of the key implications that follow from concluding that the racing of horses is not carried on as a business, or is carried on as a business or as an integral part of a horse training business, or as an integral part of a horse breeding business are set out in Table 4.

Table 4

	Racing of horses not carried on as a business	**Racing of horses carried on as a business or as an integral part of a horse training business**	**Racing of horses as an integral part of a horse breeding business**
Treatment of some common receipts and outlays			
Receipts from racing of horses	Not assessable income under section 6-5.	Assessable income under section 6-5.	Assessable income under section 6-5.
Non-capital outlays for racing of horses	Not deductible under section 8-1.	Deductible under section 8-1.[18]	Deductible under section 8-1.[19]
Rearing, maintenance and development costs	Not deductible under section 8-1.	Deductible under section 8-1.[20]	Deductible under section 8-1.[21]
Outlay for purchase of a horse	Not deductible under section 8-1 – cost of a depreciating asset.	Not deductible under section 8-1 – cost of a depreciating asset.	Deductible under section 8-1 – cost of trading stock.
Receipt for the sale of a horse	Not assessable under section 6-5. However, included in the termination value of a depreciating asset and CGT event K7 will apply.	Not assessable income under section 6-5. However, included in the termination value of a depreciating asset and CGT event K7 may apply if there has been use other than for a taxable purpose.	Assessable income under section 6-5.

[18] To the extent that both limbs of section 8-1 are satisfied.
[19] To the extent that both limbs of section 8-1 are satisfied.
[20] To the extent that both limbs of section 8-1 are satisfied.
[21] To the extent that both limbs of section 8-1 are satisfied.

Part C: the breeding of horses

35. The income tax consequences of the breeding of horses depend on whether or not the activity amounts to the carrying on of a business. This will be a question of fact in any particular case.

36. The general indicators as discussed at paragraphs 7 to 11 of this Ruling and summarised at paragraph 18 of TR 97/11 will be relevant, as will certain specific industry factors.

37. Specific industry factors may include:

- the quality and number of horses;
- whether the taxpayer is selling stock, for example at yearling sales, to generate a cash flow;
- whether the mares are being serviced;
- whether the taxpayer is using their stallion rights; and
- whether the taxpayer maintains geldings, barren female horses or other horses which are inappropriate for breeding – excluding horses that are being raced.

The breeding of horses not carried on as a business

38. If the breeding of horses is not carried on as a business by a taxpayer, the gross proceeds will not be assessable income under section 6-5, nor will the expenses be deductible under section 8-1. There can be no amount deducted for decline in value under Division 40.

39. A horse held by the taxpayer will be a depreciating asset. CGT event K7 may need to be considered if a balancing adjustment event occurs for the horse, such as a disposal, and the horse has been used for a purpose other than a taxable purpose.

The breeding of horses carried on as a business

40. If the breeding of horses is carried on as a business, the implications set out in Table 4 of this Ruling will also be relevant. The business will be a primary production business for the purposes of the ITAA 1997 as it involves 'maintaining animals for the purpose of selling them or their bodily produce (including natural increase)'.[22] The income from a horse breeding business will be assessable primary production income under subsection 392-80(2) for the purposes of the provisions for the long-term averaging of primary producers' tax liability in Division 392.

41. The horses are live stock and trading stock[23] for income tax purposes if they are used in such a business.

[22] See paragraph (b) of the definition of 'primary production business' in subsection 995-1(1).
[23] See paragraph (b) of the definition of 'trading stock' in section 70-10.

42. In cases where horses are co-owned and are used in such a business, the Commissioner adopts the view that an interest in the horse will come within the definition of trading stock.[24]

43. Expenditure incurred on stallion service fees for services that extend beyond the end of the income year will be subject to Subdivision H of Division 3 of Part III of the ITAA 1936.

Part D: the training of horses

44. The training of horses on its own does not raise any particular issues for consideration in this Ruling if the taxpayer only trains other people's horses. If that amounts to a business, the gross proceeds derived from the activities will be assessable under section 6-5 and the non-capital outlays and other expenses will be deductible under section 8-1 subject to the tests in that section.

45. If the training amounts only to a hobby or recreational pastime, the gross proceeds will not be assessable under section 6-5 and the non-capital outlays and other expenses will not be deductible under section 8-1.

46. Issues may arise where there is a training business and it is associated with racing or breeding activities. The question then may be whether those other activities can be regarded as an integral part of the training business. That will depend on the facts in any particular case.

47. If, in addition to training horses, a taxpayer has an ownership interest in those horses, those interests will be depreciating assets for the purposes of Division 40. Deductions may be available under that Division and there may be implications if a balancing adjustment event occurs for the horses. If there is a use of the horses other than for a taxable purpose, CGT event K7 may need to be considered.

Date of effect

48. The Ruling will apply to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
14 May 2008

[24] *Case J30* (1987) 9 NZTC 1,176.

Appendix 1 – Explanation

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

Part A: when are horse-related activities carried on as a business

49. The courts have identified a number of indicators that are relevant in determining whether a taxpayer's activities amount to the carrying on of a business. These indicators are outlined in TR 97/11.

50. In *Ferguson v. Federal Commissioner of Taxation*,[25] the Full Federal Court stated:

> There are many elements to be considered. The nature of the activities, particularly whether they have the purpose of profit-making, may be important. However, an immediate purpose of profit-making in a particular income year does not appear to be essential. Certainly it may be held a person is carrying on business notwithstanding his profit is small or even where he is making a loss. Repetition and regularity of the activities is also important. However, every business has to begin, and even isolated activities may in the circumstances be held to be the commencement of carrying on business. Again, organisation of activities in a businesslike manner, the keeping of books, records and the use of system may all serve to indicate that a business is being carried on. The fact that concurrently with the activities in question, the taxpayer carries on the practice of a profession or another business, does not preclude a finding that his additional activities constitute the carrying on of a business. The volume of his operations and the amount of capital employed by him may be significant. However, if what he is doing is more properly described as the pursuit of a hobby or recreation or an addition to a sport, he will not be held to be carrying on a business, even though his operations are fairly substantial.[26]

51. Further, in *Stone v. Federal Commissioner of Taxation,*[27] the Full Federal Court stated:

> Whether a person is carrying on a business will depend upon a number of factors and no single factor will be determinative in a particular case. Thus, it will be relevant to determine whether a relevant activity is carried on in a businesslike way and in accordance with commercial principles. If there is a system in the activity, coupled with repetition and continuity, that will be indicative of a business. An important fact is whether the relevant activity has a purpose of profit making. However, the fact that the activity does not actually produce a profit is not decisive. Indeed, even where it is not expected to derive a profit, an activity may nevertheless be properly characterised as the carrying on of a business.[28]

[25] (1979) 26 ALR 307; (1979) 37 FLR 310; 79 ATC 4261; (1979) 9 ATR 873.
[26] 79 ATC 4261 as per Bowen CJ and Franki J at 4264 – 4265.
[27] (2003) 130 FCR 299; [2003] FCAFC 145; 2003 ATC 4584; (2003) 53 ATR 214.
[28] 2003 ATC 4584 as per Heerey, Emmett and Hely JJ at 4594 – 4595.

52. Since the question of whether a taxpayer's activities amount to the carrying on of a business depends on a number of indicators with no single indicator being determinative, all of these indicators need to be considered in determining if the racing, training or breeding of horses (or a combination of one or more of them) by a taxpayer amounts to the carrying on of a business.

53. In *MR & SL Block v. Federal Commission of Taxation*,[29] (*Block*) a number of indicators were considered by the Tribunal before deciding that the taxpayer was carrying on a business of horse and sheep breeding.

Consequences if taxpayer's horse-related activities do not amount to the carrying on of a business

Amounts not assessable under section 6-5

54. A taxpayer's assessable income includes income according to ordinary concepts and such income is called ordinary income.[30] A substantial body of case law[31] has outlined the view of the courts on the type of income that is income according to ordinary concepts. This view is that income according to ordinary concepts generally arises from three sources, namely personal services, property or business activities.

55. The amounts derived by a taxpayer from the racing, training or breeding of horses, that is not carried on as a business by a taxpayer, is not derived from personal services,[32] property or business activities. Consequently, these amounts are not income according to ordinary concepts and are not included in the taxpayer's assessable income under section 6-5.

Amounts not deductible under section 8-1

56. A loss or outgoing is not deductible under section 8-1 if it is not incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for that purpose.[33]

57. Consequently, the losses or outgoings incurred by a taxpayer in a horse-related activity that are not incurred in gaining or producing assessable income or necessarily incurred in carrying on a business for that purpose (including as an integral part of another business) are not deductible under section 8-1.

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[29] [2007] AATA 1897; 2007 ATC 2735.
[30] See subsection 6-5(1).
[31] See for example *Scott v. Commissioner of Taxation* (1935) 35 SR (NSW) 215; (1935) 52 WN (NSW) 44; (1935) 3 ATD 142, *Richardson v. Commissioner of Taxation* (1997) 80 FCR 58; 97 ATC 5098; (1997) 37 ATR 452, *Federal Commissioner of Taxation v. Myer Emporium* (1987) 163 CLR 199; 87 ATC 4363; (1987) 18 ATR 693, *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1.
[32] It is possible that certain horse training activities (for example, advice) might in some circumstances give rise to personal services income.
[33] See subsection 8-1(1).

Not trading stock under Division 70

58. Where the horse-related activities are not carried on as a business by a taxpayer, the horses are not held for sale or exchange in the ordinary course of a business nor are they live stock. Consequently, these horses are not trading stock.[34] [35]

No amounts deductible or assessable under Division 40

59. A horse is a depreciating asset because it is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used.[36] This is so notwithstanding a horse may hold its value or even appreciate in value for a certain period of time. This is also so notwithstanding a horse may not be used for a taxable purpose.

60. A taxpayer can deduct an amount equal to the decline in value for an income year of a depreciating asset that they held[37] for any time during the year.[38] Subsection 40-25(2), with the exception of low-value pools and certain cars, reduces the deduction for the decline in value of a depreciating asset to the extent that the asset is used, or installed ready for use, for a purpose other than a taxable purpose.[39]

61. Where the horse-related activities are not carried on as a business by a taxpayer or otherwise for the purpose of producing the taxpayer's assessable income, the use of the horse will be for a purpose other than a taxable purpose. Consequently, the amount the taxpayer can deduct for the decline in value of the horse under subsection 40-25(1) will be reduced to nil.

62. A balancing adjustment amount arises under section 40-285 if a balancing adjustment event,[40] such as the disposal of a horse, occurs for a depreciating asset the taxpayer held and:

- whose decline in value the taxpayer worked out under Subdivision 40-B; or
- whose decline in value the taxpayer would have worked out under that Subdivision if the taxpayer had used the asset.

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[34] See section 70-10.
[35] See paragraphs 122 to 134 of this Ruling for further discussion of when a horse may be trading stock.
[36] See subsection 40-30(1).
[37] See paragraphs 97 to 99 of this Ruling for further discussion about holding and jointly holding depreciating assets.
[38] See subsection 40-25(1).
[39] As defined in subsection 40-25(7).
[40] See section 40-295 as to when a balancing adjustment event occurs for a depreciating asset.

63. A balancing adjustment amount is included in the taxpayer's assessable income to the extent that the asset's termination value[41] is more than its adjustable value[42] just before the balancing adjustment event occurred.[43] A balancing adjustment amount is allowed as a deduction to the extent that the asset's termination value is less than its adjustable value just before the balancing adjustment event occurred.[44] This amount is included in assessable income or is deductible for the income year in which the balancing adjustment event occurred.

64. Subsection 40-290(1) reduces the balancing adjustment amount worked out under section 40-285 if the taxpayer's deductions for the decline in value of the depreciating asset have been reduced under section 40-25. Where the horse-related activities are not carried on as a business by a taxpayer or otherwise for the purpose of producing the taxpayer's assessable income, the taxpayer's deductions for the decline in value of the depreciating asset under subsection 40-25(1) will be reduced under subsection 40-25(2) to nil.

65. Consequently, subsection 40-290(1) will reduce the balancing adjustment amount worked out under section 40-285 to nil. As a result, there is no balancing adjustment amount to be included in the taxpayer's assessable income or no amount that can be deducted by the taxpayer under section 40-285.

Application of the CGT provisions

66. Subsection 108-5(1) defines a CGT asset as any kind of property or a legal or equitable right that is not property. Consequently, a horse is a CGT asset.

67. Subsection 118-24(1) disregards a capital gain or loss a taxpayer makes from a CGT event that is also a balancing adjustment event that happens to a depreciating asset whose decline in value was worked out under Division 40. However, under subsection 118-24(2), such a gain or loss is not disregarded if it is from CGT event J2 or CGT event K7 or the depreciating asset is one for which the taxpayer or another taxpayer has deducted or can deduct amounts under Subdivision 40-F[45] or under Subdivision 40-G.[46]

68. CGT event J2 happens in certain circumstances if you have chosen a CGT asset as a replacement asset for a small business roll-over under Subdivision 152-E.

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[41] See sections 40-300 to 40-325 as to how to work out an asset's termination value.
[42] See subsection 40-85(1) as to how to work out an asset's adjustable value.
[43] Subsection 40-285(1).
[44] Subsection 40-285(2).
[45] Subdivision 40-F is about deductions for depreciating assets that are water facilities or horticultural plants.
[46] Subdivision 40-G is about deductions for capital expenditure incurred on landcare operations, electricity connections or telephone lines.

69. CGT event K7 happens if a balancing adjustment event occurs for a depreciating asset held by the taxpayer, and at some time the asset was held, it was used or installed ready for use for a purpose other than a taxable purpose.[47]

70. Where the horse-related activities are not carried on as a business by a taxpayer or otherwise for the purpose of producing the taxpayer's assessable income, the use of those horses is for a purpose other than a taxable purpose. Consequently, CGT event K7[48] happens if a balancing adjustment event occurs for the horse.

71. Where CGT event K7 happens, a taxpayer makes a capital gain to the extent that the asset's termination value[49] is more than its cost.[50] [51] Similarly, a taxpayer makes a capital loss to the extent that the asset's cost is more than its termination value.[52]

72. However, a capital gain made from a CGT event happening to a personal use asset[53] is disregarded if it is also a depreciating asset with its first element of cost[54] being $10,000 or less.[55]

73. A horse, that is not used in a business or not otherwise used for the purpose of producing the taxpayer's assessable income, is used or kept mainly for personal use or enjoyment. Consequently, it will be a personal use asset.[56] As a horse is also a depreciating asset, any capital gain made from CGT event K7 happening to a horse will be disregarded if the first element of the cost of that horse is $10,000 or less.

74. Further, a capital loss made from a personal use asset is disregarded in working out a taxpayer's net capital gain or net capital loss for an income year.[57] Consequently, where the racing of horses is not carried on as a business by a taxpayer, is not an integral part of another of their businesses or is not otherwise used for the purpose of producing the taxpayer's assessable income, any capital loss from a CGT event happening to each horse will be disregarded in working out a taxpayer's net capital gain or net capital loss for an income year.

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[47] See subsection 104-235(1).
[48] It is important to note that, where CGT event K7 happens, the CGT concepts of 'cost base' and 'capital proceeds' are not relevant. Rather, the Division 40 concepts of 'cost' and 'termination value' are relevant.
[49] See sections 40-300 to 40-325 as to how to work out an asset's termination value.
[50] See Subdivision 40-C as to how to work out the asset's cost.
[51] Subsection 104-240(1).
[52] Subsection 104-240(2).
[53] As defined in subsection 108-20(2).
[54] See section 40-180 as to how to work out the asset's first element of cost.
[55] Subsection 118-10(3).
[56] See paragraph 108-20(2)(a).
[57] Subsection 108-20(1).

Part B: the racing of horses as a business activity

The racing of horses as a stand-alone business

75. Whether the racing of horses as a stand-alone activity may amount to the carrying on of a business is a question of fact, having regard to all the relevant indicators discussed at paragraphs 7 to 11 of this Ruling.

76. In *Martin v. Federal Commissioner of Taxation,*[58] the Full High Court stated:

> The definition of income from personal exertion includes the proceeds of a business carried on by the taxpayer, but the pursuit of a pastime, however vigorous the pursuit may be, does not usually amount to carrying on a business. The onus, if the case is one in which onus assumes any importance, is on the appellant to satisfy the Court that the extent to which he indulged in betting and racing and breeding racehorses was not so considerable and systematic and organised that it could be said to exceed the activities of a keen follower of the turf and amount to the carrying on of a business.[59]

77. Consequently, to be a stand-alone business, the racing of horses must be planned and carried on in a businesslike manner and be so considerable, systematic and organised as to exceed the activities of a keen follower of horse racing.

78. In *Case E22,*[60] the Taxation Board of Review No. 2 stated:

> From observation and general knowledge, racing of horses is usually indulged in by owners as a hobby or pastime or for the sake of interest in spite of the fact that owners are anxious for their horses to win and want the money which the winning stakes provide.[61]

79. Further, in *Case M72*,[62] Member Harrowell said:

> Horseracing fits more easily, in my opinion, into the recreational category as it possesses what I would term 'anti business' characteristics.[63]

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[58] (1953) 90 CLR 470.
[59] (1953) 90 CLR 470 as per Williams ACJ, Kitto and Taylor JJ at 477.
[60] 73 ATC 168.
[61] 73 ATC 168 at 172.
[62] 80 ATC 497.
[63] 80 ATC 497 at 507.

80. Further, in observing that the activity of the racing of horses fits more easily into the recreational category because of its 'anti-business' characteristics Member Harrowell said:

> Its income is based on casual profits in the form of winnings, a fast horse is given extra weight to slow it down, in a race it may be subject to interference at the start and during the race and can be mishandled by its jockey, and but for the occasional dead heat, there is only one winner. The horse itself is subject to ills, strains and injuries as are all living things. None of these 'anti business' characteristics preclude horseracing from being a business activity but their inevitable presence would hardly create an enthusiastic reception by the investing public to a prospectus of a company formed for the purpose of racing horses.[64]

81. In *Shepherd v. Federal Commissioner of Taxation,*[65] the Court stated:

> The common reason why betting winnings were not regarded as 'profit or gain' in *Graham v. Green* [1925] 2 K.B. 37, or 'income' in *Martin's case* is that in that case there was no organisation of the activity towards the end of making a profit. In that sense, such gains as arose in the course of the activity had a significant element of chance, and there was no system, or not sufficient system, in relation to the chances involved as to lead to the conclusion that a system for profit making had been devised. There is a similar element of chance in relation to winning prize money from the racing of horses. Owner competes against owner, and the chance of one owner's horse winning is dependent to an extent on considerations as to which no system or organisation would usually apply, for example the form of the various horses and the weather conditions. Skill is involved, in bringing a horse to its peak and in the selection of riders; but skill which is displayed in a pastime, as the passage quoted from the judgement of *Rowlatt J* [in *Graham v Green*] shows, is not decisive of the question as to whether a business is being carried on, and may not in many cases be even relevant to that question.[66]

82. The decisions of the Board of Review, the Tribunal and the Courts demonstrate the difficulties a taxpayer will have in establishing that the racing of horses conducted as a separate activity by a taxpayer would amount to the carrying on of a business.

83. Based on existing authorities, the Commissioner considers that the racing of horses as a stand-alone activity would not amount to the carrying on of a business if either one of the following significant non-business features were present:

- a significant element of chance – meaning that whether or not a profit is made will depend very largely on considerations other than system and organisation of the taxpayer; and

[64] 80 ATC 497 at 507.
[65] (1975) 26 FLR 385; (1975) 75 ATC 4244; (1975) 5 ATR 646.
[66] (1975) 75 ATC 4244 as per Rath J at 4252.

- the activities are no more than the mere pursuit (albeit vigorous in many cases) of a hobby, recreational pursuit or pastime.

84. To overcome the non-business features described above, the Commissioner considers that the taxpayer would need to demonstrate that:

- there is system and organisation, rather than chance, driving the prospect of profit, which is consistent with a business; and
- there is a reasonable expectation that the activity will be commercially viable within a timeframe consistent with the industry standards.[67]

85. In assessing commercial viability, it is emphasised that a genuine intention to make a profit does not of itself establish a reasonable prospect of making one.

The racing of horses carried on by the taxpayer as an integral part of a horse training and/or horse breeding business

86. The racing of horses may not amount to the carrying on of a stand-alone business, but it may be an integral part of, say, a horse training and/or horse breeding business carried on by the taxpayer.[68]

87. To be considered an integral part of the other business, the racing activities must be inherently connected to the other business activity and be consistent with the furtherance of it. This will be a question of fact in each case.

88. In *Case 54/96,*[69] the Tribunal found that the taxpayer was carrying on a business of horse racing and breeding. Evidence was given in that case that the taxpayer raced their horses to be able to prove the quality of their breeding stock. Another example would be where a horse training business was being carried on and horses were raced in the conduct of that business to demonstrate the quality of the training programmes used and to encourage others racing horses to have them trained at the taxpayer's facilities.

89. In *Block*, the Tribunal stated that the taxpayers' primary activity and purpose was the carrying on of a business of horse and sheep breeding and not the racing of horses[70]. The Tribunal, in noting that the racing of the horses was done to improve the value of those horses for sale, implicitly accepted that the racing activity was an integral part of the horse breeding business in that case.

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[67] Industry standards take into account the effect of unexpected events such as injury, death or floods – see paragraphs 114 and 115 of this Ruling.
[68] *Case X28* 90 ATC 276; (1990) 21 ATR 3268.
[69] 96 ATC 521; (1996) 33 ATR 1243.
[70] 2007 ATC 2735 at 2742.

90. The consequences if a taxpayer's racing of horses is a stand-alone business, or one carried on as an integral part of a horse training business, are discussed below. The consequences if the horse racing activities are an integral part of a horse breeding business are covered briefly in Part C of this explanation.

Consequences if taxpayer's racing of horses is a stand-alone business activity, or is an integral part of a horse training (non-breeding) business

Amounts assessable under section 6-5

91. If the racing of horses is a business activity as described above, any amounts derived from it are ordinary income and assessable to the taxpayer under section 6-5.

Amounts deductible under section 8-1

92. The costs of maintaining those horses, which are non-capital outlays, are deductible under section 8-1 where all requirements of that section are met.

Not trading stock under Division 70

93. Live stock does not include animals used as beasts of burden or working beasts in a business other than primary production.[71] The horses are not live stock because they are working beasts and the business is not a primary production business.[72] Consequently, these horses are not trading stock.[73] [74]

Amounts deductible under section 40-25 for decline in value

94. A taxpayer can deduct an amount equal to the decline in value for an income year of a depreciating asset that they held for any time during the year.[75] Subsection 40-25(2), with the exception of low-value pools and certain cars, reduces the deduction for the decline in value of a depreciating asset to the extent that the asset is used, or installed ready for use, for a purpose other than a taxable purpose.[76]

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[71] See definition of 'live stock' in subsection 995-1(1).
[72] See *Riddle v. Federal Commissioner of Taxation* (1952) 5 AITR 225; (1952) 9 ATD 391.
[73] See section 70-10.
[74] See paragraphs 122 to 134 of this Ruling for further discussion of when a horse may be trading stock.
[75] See subsection 40-25(1).
[76] As defined in subsection 40-25(7).

95. A depreciating asset starts to decline in value from when its start time occurs.[77] The start time is when the taxpayer first uses it or has it installed ready for use for any purpose.[78] The start time for a horse will be when it is acquired or when it is born.

96. The cost of a depreciating asset is worked out under Subdivision 40-C. The acquisition cost of a horse is taken into account in working out the amounts that the taxpayer can deduct for the decline in value of that horse under Division 40.

Amounts for decline in value are only deductible to holder of the asset

97. The taxpayer can deduct an amount for the decline in value of their horses. However, it is only the taxpayer who holds[79] a depreciating asset who can deduct an amount for the decline in value of the depreciating asset. Where the taxpayer is the owner (or the legal owner if there is both a legal and equitable owner) of the horse, they will be the holder of the horse under item 10 of the table in section 40-40. Where the horse is a partnership asset, the partnership will hold the horse under item 7 of the table in section 40-40 rather than any particular partner. In this context, the term 'partnership asset' takes its common law meaning. That is, it refers to an asset of a partnership that is used for the purpose of the business carried on by the partnership.

Jointly held assets

98. The term 'partnership asset' is not defined under taxation legislation. The common law meaning of 'partnership asset' does not extend to assets that are merely co-owned[80] even if their co-ownership and their employment for the purpose of receiving income jointly may be enough to satisfy the expanded definition of a partnership for income tax purposes.[81]

99. For depreciating assets that are co-owned but are not partnership assets, section 40-35 applies to the asset as if the taxpayer's interest in the asset is the relevant asset for the purposes of Division 40. This means that each co-owner must treat their depreciating asset (their interest in the underlying asset) in accordance with their own tax profile.

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[77] Subsection 40-60(1).
[78] Subsection 40-60(2). However, there is a different start time under subsection 40-60(3) in certain circumstances.
[79] See the table in section 40-40 to work out who holds a depreciating asset.
[80] The Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001 states at paragraph 1.46 that whether a particular depreciating asset is a 'partnership asset' is determined in accordance with partnership law. As such, the term 'partnership asset' carries its common law meaning. That is, they refer to assets of a partnership that are used for the purpose of the business carried on by the partnership and not to assets that are merely co-owned.
[81] See the definition of 'partnership' in subsection 995-1(1).

Amounts assessable and deductible under section 40-285

100. A balancing adjustment amount arises under section 40-285 if a balancing adjustment event[82] occurs for a depreciating asset the taxpayer held and:

- whose decline in value the taxpayer worked out under Subdivision 40-B; or
- whose decline in value the taxpayer would have worked out under that Subdivision if the taxpayer had used the asset.

101. The decline in value of a horse is worked out under Subdivision 40-B. Consequently, a balancing adjustment amount arises under section 40-285.

102. A balancing adjustment amount is included in the taxpayer's assessable income to the extent that the asset's termination value[83] is more than its adjustable value[84] just before the balancing adjustment event occurred.[85] A balancing adjustment amount is allowed as a deduction to the extent that the asset's termination value is less than its adjustable value just before the balancing adjustment event occurred.[86] The amount is included in assessable income or deducted for the income year in which the balancing adjustment event occurred.

103. Subsection 40-290(1) reduces the balancing adjustment amount worked out under section 40-285 if the taxpayer's deductions for the decline in value of the depreciating asset have been reduced under section 40-25. Where the horses are used solely as an integral part of a business carried on by the taxpayer, the use of those horses is wholly for a taxable purpose.

104. Consequently, the taxpayer's deductions for the decline in value of the horses under subsection 40-25(1) will not be reduced under subsection 40-25(2). Furthermore, subsection 40-290(1) will not reduce the balancing adjustment amount worked out under section 40-285. As a result, a balancing adjustment amount will either be included in the taxpayer's assessable income or allowed as a deduction under section 40-285 providing that there is a difference between the termination value and the adjustable value.

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[82] See section 40-295 as to when a balancing adjustment event occurs for a depreciating asset.
[83] See sections 40-300 to 40-325 as to how to work out an asset's termination value.
[84] See subsection 40-85(1) as to how to work out an asset's adjustable value.
[85] Subsection 40-285(1).
[86] Subsection 40-285(2).

Application of the CGT provisions

105. Subsection 118-24(1) disregards a capital gain or loss a taxpayer makes from a CGT event that is also a balancing adjustment event that happens to a depreciating asset whose decline in value was worked out under Division 40. However, such a gain or loss is not disregarded if it is from CGT event J2 or CGT event K7 or the depreciating asset is one for which the taxpayer or another taxpayer has deducted or can deduct amounts under Subdivision 40-F or 40-G.[87]

106. CGT event K7 happens if a balancing adjustment event occurs for a depreciating asset held by the taxpayer and, at some time the asset was held, it was used or installed ready for use for a purpose other than a taxable purpose.[88]

107. Where the horse is used solely in a business activity carried on by the taxpayer, the use of the horse is wholly for a taxable purpose. Consequently, CGT event K7 does not happen if a balancing adjustment event occurs for the horse. Therefore, subsection 118-24(1) applies.

108. Consequently, any capital gain or loss made on the happening of a CGT event is disregarded.

Application of Division 35

109. Where a taxpayer is an individual or an individual carrying on a business in a general law partnership, Division 35, which deals with the deferral of losses for non-commercial business activities, will apply to every income year in which that individual taxpayer carries on a relevant 'business activity'.[89] The business activity in this case is the racing of horses, or the training of the horses with racing an integral part of that activity.

110. The general rule in section 35-10 is that a loss from the business activity is not incurred in a particular income year unless:

- in each income year the individual's business activity meets one of four tests;[90]
- the individual comes within the exception in subsection 35-10(4);[91] or
- the individual is covered by an exercise of the Commissioner's discretion in relation to that business activity.[92]

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[87] See subsection 118-24(2).
[88] See subsection 104-235(1).
[89] See paragraph 34 of Taxation Ruling TR 2001/14 for the meaning of *business activity*.
[90] The assessable income test in section 35-30; the profits test in section 35-35; the real property test in section 35-40 and the other assets test in section 35-45.
[91] See paragraph 111 of this Ruling.
[92] See section 35-55.

111. Where an individual has a loss from a primary production business that they are carrying on, there is an exception in subsection 35-10(4) which means that the deferral of the loss will not apply in relation to that business activity where the total of their assessable income from sources unrelated to that business activity (excluding any net capital gain) is less than $40,000.[93]

Part C: the breeding of horses

When is the breeding of horses carried on as a business by a taxpayer?

112. The question of whether the breeding of horses is carried on as a business is a question of fact.

113. In addition, having regard to industry specific factors, the general indicators, summarised at paragraph 18 of TR 97/11, are used to determine whether the breeding of horses is being carried on as a business.[94] As previously noted in paragraphs 31 to 33 of this Ruling and implicitly accepted in *Block*, horse racing activities may be carried on as an integral part of a horse breeding business.

114. In *Block*, the Tribunal had regard to a wide range of matters in deciding whether or not a business of horse breeding was being carried on. The Tribunal found that the relevant persons had, at all material times, conducted the activities in a businesslike and commercial manner and had maintained full and proper accounts in relation to the business. Regard was had to the extensive business and industry experience of the partners. Although the partnership activities had incurred significant losses, it was important to consider why that had been the case.

115. A series of unforeseeable set-backs had led to the need to restructure the business. Significant investment in infrastructure had increased losses, but was done with the intention of turning the business to profit in the future. There was evidence of systematic implementation of a business plan with the purpose of placing the horse breeding business on a path to sustainable profit. The capital, time and effort contributed to the activities were found to be far more than would occur in a recreational pursuit or hobby.

116. Although every case must be decided on its own particular facts, the decision in *Block* shows that proper regard must always be had to the reasons for start-up losses, and due allowance must be given to unforeseen events and the need for appropriate business restructuring in assessing whether there is, consistent with a business plan, a reasonable prospect of sustainable profits in the future.

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[93] See TR 2001/14 for an explanation of the operation of Division 35.

[94] For a summary of these indicators see paragraph 18 of TR 97/11 and for a more comprehensive explanation and case citations see paragraphs 23 to 103 of TR 97/11.

Consequences if the breeding of horses is carried on as a business by a taxpayer

A business of horse breeding is a primary production business

117. As carrying on a business of breeding of horses involves maintaining animals for the purpose of selling them or their bodily produce (including natural increase), it is carrying on a primary production business.[95]

Proceeds from horses in a breeding business are assessable income under section 6-5

118. Where the breeding of horses is carried on as a business by a taxpayer, the income from that business is considered to be ordinary income and therefore assessable under section 6-5. This ordinary income will include any proceeds from the use of a horse as trading stock. Such proceeds will include the sale of that horse and any prize money from the racing of that horse where the racing takes place as an integral part of the horse breeding business.

119. The income from a horse breeding business is also considered to be assessable primary production income under subsection 392-80(2) for the purposes of the long-term averaging of primary producers' tax liability provisions in Division 392. This is because the income will be derived from or will result from the carrying on of a primary production business. Therefore, the income will be subject to the long-term averaging of primary producers' tax liability in Division 392.

Deductibility of costs associated with horses in a breeding business

120. A loss or outgoing, that is not of a capital, private or domestic nature, is deductible under section 8-1 if it is incurred in gaining or producing assessable income or is necessarily incurred in carrying on a business for the purposes of gaining or producing assessable income. This would include costs associated with racing activities where they were integral to the breeding business.

121. Where the breeding of horses is carried on as a business by a taxpayer, the costs of the maintenance and the development of the horses that are non-capital outlays[96] are deductible under section 8-1. This is because these costs are necessarily incurred in carrying on the breeding business for the purposes of gaining or producing assessable income and are not of a capital, private or domestic nature.

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[95] See paragraph (b) of the definition of 'primary production business' in subsection 995-1(1).

[96] Examples of such costs include the costs of feeding, agistment and transport to agistment.

Trading stock and horses in a breeding business

122. The definition of 'trading stock' in section 70-10 includes:

(a) anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business; and

(b) live stock.

Horses in a breeding business are live stock

123. 'Live stock' is defined in subsection 995-1(1). The definition of 'live stock' does not expand on what is included within its bounds but rather specifies that beasts of burden or working beasts will only be considered live stock if used in a business of primary production. By inference, the definition includes all animals used in a business of primary production.

124. In *Federal Commissioner of Taxation v. Wade*[97] (*Wade*), the High Court stated:

> There is a definition of live stock which, by inference, makes it clear that all animals are to be included in the case of a business of primary production.[98]

125. Consequently, as horses used in a breeding business are used in a business of primary production, they are live stock.

Horses in a breeding business are trading stock

126. As horses in a breeding business are live stock, they are trading stock.[99] As a result, the purchase and sale of live stock will always be on revenue account regardless of how the live stock are actually used in the business. This was made clear in *Wade* where dairy cattle were considered trading stock, even though it was the milk rather than the cattle that the taxpayer actually traded in.

127. An outgoing that the taxpayer incurs in connection with acquiring an item of trading stock is not an outgoing of capital or capital in nature.[100] This means that paragraph 8-1(2)(a) does not prevent the outgoing of acquiring the trading stock from being deducted under section 8-1.[101] Section 70-15 determines the income year in which the taxpayer can deduct, under section 8-1, an outgoing incurred in connection with acquiring the trading stock.

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[97] (1951) 84 CLR 105; [1951] ALR 962; (1951) 25 ALJR 626; (1951) 5 AITR 214; (1951) 9 ATD 337.
[98] (1951) 84 CLR 105 as per Dixon and Fullagar JJ at 110.
[99] See paragraph (b) of the definition of 'trading stock' in section 70-10.
[100] Section 70-25.
[101] See the note to section 70-25.

128. Therefore, where the breeding of horses is carried on as a business by a taxpayer, the purchase price of horses that are trading stock of that business is deductible under section 8-1 and the income year in which that purchase price is deductible is determined by section 70-15.

129. The assessable income of a taxpayer includes any excess of the value of trading stock at the end of the income year[102] over the value at the start of the income year.[103] [104] A taxpayer can deduct an amount that is the excess of the value of trading stock at the start of the income year over the value at the end of the income year.[105]

130. However, instead of valuing trading stock at the end of the income year under the general rules set out in section 70-45, an election can be made to determine the value of that trading stock under section 70-60 where the horse is:

- held for breeding;
- acquired under a contract;[106] and
- at least three years old.[107]

131. The natural increase of the taxpayer's live stock cannot be valued under section 70-60 because they are not acquired under a contract.

132. The value under section 70-60 for female horses 12 years or over is $1.[108] The value under section 70-60 for any other horse is the excess of the horse opening value[109] over the horse reduction amount.[110] [111]

133. Where a taxpayer stops holding a horse as trading stock but still owns the horse:

- the horse stops being trading stock;
- the horse becomes a depreciating asset;
- the taxpayer is treated as selling the horse at its cost;
- that cost represents the proceeds of sale of trading stock and therefore is assessable income;[112] and

[102] See section 70-45 as to what is the value of trading stock at the end of the income year.
[103] See section 70-40 as to what is the value of trading stock at the start of the income year.
[104] Subsection 70-35(2).
[105] Subsection 70-35(3).
[106] The horse need not be acquired as breeding stock.
[107] See subsection 70-60(4) as to how to work out the horse's age.
[108] Subsection 70-60(2).
[109] See subsection 70-65(1) as to how to work out the horse opening value.
[110] See subsection 70-65(2) as to how to work out the horse reduction amount.
[111] Subsection 70-60(2).
[112] Section 70-110.

- the taxpayer is treated as having bought the horse for the same amount which is relevant in working out the horse's cost for capital allowances purposes[113] and capital gains tax purposes.[114]

134. An example of a situation in paragraph 133 of this Ruling is when a taxpayer stops using a horse that was used for breeding purposes and starts to use it solely for private purposes.

Interest in trading stock

135. The definition of 'live stock' in subsection 995-1(1) is silent as to whether a fractional interest in a horse is live stock. However, it does not specifically exclude a fractional interest in a horse from being live stock. Likewise, there are no other legislative provisions in the ITAA 1997 that point toward the exclusion of a fractional interest in a horse being live stock. Australian case law is silent on this issue. However, a New Zealand case, *Case J30*,[115] provides guidance on this issue. In *Case J30*, the New Zealand Taxation Review Authority stated that interests or shares in stallions were trading stock. Moore DJ in judgment stated:

> unless shares or interests in an animal are treated on the same basis as is ownership of an animal by one person, some very incongruous results would flow.[116]

136. In the context of horse breeding, the definition of 'trading stock' in New Zealand is analogous to that in the ITAA 1997.[117] As such, it is considered that a fractional interest in a horse that is held by an entity carrying on a horse breeding business does come within the definition of 'live stock' and 'trading stock' and will be treated on the same basis as is ownership of the horse by a single entity.

Horses in a breeding business are not depreciating assets

137. As horses used in a breeding business are trading stock, they are not depreciating assets.[118]

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[113] Worked out under Subdivision 40-C and see also the note to subsection 40-185(1).
[114] See Division 110.
[115] (1987) 9 NZTC 1,176.
[116] (1987) 9 NZTC 1,176 at 1,183.
[117] The definition of 'trading stock' for the purposes of section LIT98 of the *Land and Income Tax Act 1954* (NZ) includes 'anything produced or manufactured, and anything acquired or purchased for the purposes of manufacture, sale or exchange; and also includes live stock; but does not include land'.
[118] See paragraph 40-30(1)(b).

Application of the CGT provisions

138. Where the breeding of horses is carried on as a business by a taxpayer, the horses used in the business are trading stock. As horses used in a breeding business are trading stock, any capital gain or loss made from a CGT event happening to a horse, which at the time of the event was being used in such a business, is disregarded.[119]

Stallion service fees

139. Stallion service fees generally fall due on a 45 day (thoroughbred) or 42 day (standard bred) positive pregnancy test. If stallion service fees are paid, any allowable deductions will be subject to the provisions of Subdivision H of Division 3 of Part III of the ITAA 1936 which deals with the period of deductibility of certain advance expenditure, unless the rules relating to a 'small business entity' apply.[120]

140. Prepayments of service fees by any taxpayer to an associate are subject to section 82KK of the ITAA 1936. This means that a deduction may not be allowed if the associate does not return the assessable income in the income year in which the income was received, unless the rules relating to a 'small business entity' apply.

Application of Division 35

141. Where a taxpayer is an individual or an individual carrying on a business in a general law partnership, Division 35 will apply to every income year in which that individual taxpayer carries on a relevant 'business activity'.[121] The business activity in this case is the breeding or the breeding and racing of the horses.

142. The general rule in section 35-10 is that a loss from the business activity is not incurred in a particular income year unless:

- in each income year the individual's business activity meets one of four tests;[122]
- the individual comes within the exception in subsection 35-10(4);[123] or
- the individual is covered by an exercise of the Commissioner's discretion in relation to that business activity.[124]

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[119] See section 118-25.
[120] The rules in sections 82KZM and 82KZMD of the ITAA 1936 relate to a 'small business entity' as defined in Subdivision 328-C.
[121] See paragraph 34 of TR 2001/14 for the meaning of *business activity.*
[122] The assessable income test in section 35-30; the profits test in section 35-35; the real property test in section 35-40 and the other assets test in section 35-45.
[123] See paragraph 143 of this Ruling.
[124] See section 35-55.

143. Where an individual has a loss from a primary production business that they are carrying on, there is an exception in subsection 35-10(4) which means that the deferral of the loss will not apply in relation to that business activity where the total of their assessable income from sources unrelated to that business activity (excluding any net capital gain) is less than $40,000.[125]

Part D: the training of horses

144. Where the training of horses amounts to a business, the gross proceeds derived from the activities will be assessable under section 6-5 and the non-capital outlays and other expenses will be deductible under section 8-1, subject to the tests in that section.

145. Where the training amounts only to a hobby or recreational pastime, the gross proceeds will not be assessable under section 6-5 and the non-capital outlays and other expenses will not be deductible under section 8-1.

Application of Division 35

146. Where a taxpayer is an individual or an individual carrying on a business in a general law partnership, Division 35 will apply to every income year in which that individual taxpayer carries on a relevant 'business activity'.[126] The business activity in this case is the training of the horses.

147. The general rule in section 35-10 is that a loss from the business activity is not incurred in a particular income year unless:

- in each income year the individual's business activity meets one of four tests;[127]
- the individual comes within the exception in subsection 35-10(4);[128] or
- the individual is covered by an exercise of the Commissioner's discretion in relation to that business activity.[129]

148. Where an individual has a loss from a primary production business that they are carrying on, there is an exception in subsection 35-10(4) which means that the deferral of the loss will not apply in relation to that business activity where the total of their assessable income from sources unrelated to that business activity (excluding any net capital gain) is less than $40,000.[130]

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[125] See TR 2001/14 for an explanation of the operation of Division 35.
[126] See paragraph 34 of TR 2001/14 for the meaning of *business activity*.
[127] The assessable income test in section 35-30; the profits test in section 35-35; the real property test in section 35-40 and the other assets test in section 35-45.
[128] See paragraph 148 of this Ruling.
[129] See section 35-55.
[130] See TR 2001/14 for an explanation of the operation of Division 35.

Appendix 2 – Examples

This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.

149. Whether a business is carried on depends heavily on the facts of each case. The Examples which follow rely on simplified fact settings. They are not intended to prescribe the level of information required to conclude categorically whether or not a business is carried on. In practice, a higher level of detail would need to be examined to reach such a conclusion. However, the Examples are useful because they provide some indicative guidance of an approach that is likely to be adopted in factual scenarios such as these. For this reason, the Examples are included but they do not form part of the binding public ruling.

Example 1: the racing of horses – not carrying on a business

150. Joe runs a successful primary production business called Grow-N-Grow. Over the last few years, Joe has acquired several race horses. Although he is a keen follower of horse racing, Joe does not have any particular expertise in the buying, racing or training of horses. Joe's horses are in work with a trainer who is also a good friend and who advised him on the purchase of the horses. Joe incurs expenditure on agistment, training fees and veterinary fees. Joe's horses have achieved a few minor places in local country race meetings.

151. Joe does not have any clear objectives in regard to his horse racing activities other than to enjoy watching them race and hopefully sometimes win. He relies on his friend to manage the training of the horses. However, there are no plans to improve the performance or profitability of his current horses. In addition, Joe has no plans to buy additional horses or sell any of his current horses to improve the profitability of his activities.

152. The racing of the horses by Joe does not amount to the carrying on of a business of the racing of horses. The size and scale of the activity and the lack of system or organisation directed towards the making of a profit points towards his activities being no more than those of a keen follower of horse racing.

153. Therefore, Joe cannot deduct the expenses relating to his horses from his business income from Grow-N-Grow. The gross proceeds from the racing of the horses will also not be included in Joe's assessable income.

Example 2: the sale of a horse – not carrying on a business

154. Continuing with Joe's situation from Example 1, Joe decides to sell one of his fillies. He acquired the horse for $6,500 and someone has offered him $7,000. He sells the horse for $7,000.

155. Notwithstanding that the filly is not used in the carrying on of a business, it is still a depreciating asset under subsection 40-30(1) that Joe stops holding when it is sold. Under paragraph 40-295(1)(a), a balancing adjustment event occurs for the filly when Joe stops holding the horse as an asset.

156. The filly is also a CGT asset. CGT event K7 happens when a balancing adjustment event occurs for a depreciating asset that Joe held and at some time when he held the asset, he used it for a purpose other than a taxable purpose. In Joe's case, he held the filly for a purpose other than a taxable purpose.

157. Joe will work out his capital gain or loss under section 104-240. The capital gain or capital loss under CGT event K7 is calculated using the concepts of cost and termination value under Division 40 and not those found in the CGT provisions (cost base and capital proceeds). Joe will make a capital gain if the termination value of the filly is more than its cost.

158. The termination value of the filly, as worked out under section 40-300, is $7,000. This is the amount he is taken to have received under section 40-305 under a balancing adjustment event for the filly.

159. The cost of a depreciating asset consists of two elements – the first and second elements of cost. The first element of cost is worked out as at the time when Joe began to hold the filly. In Joe's case, it will be the amount he is taken to have paid to hold the asset under section 40-185. This will be $6,500. Joe does not have any second element of cost under section 40-190 because his costs of agistment, training and maintenance of the filly over the last year are not capital.

160. Joe's capital gain will be $500. However, under subsection 118-10(3), any capital gain Joe makes from a personal use asset is disregarded if the first element of the asset's cost base, or the first element of its cost, if it is a depreciating asset, is $10,000 or less. In this case, Joe's filly is a depreciating asset and the first element of cost under section 40-185 is $10,000 or less.

161. As Joe is not carrying on a business, the racing of his horses is considered to be a pastime. Therefore, his filly has been used for his own personal use and enjoyment and it is a personal use asset. In Joe's circumstances, the $500 capital gain that is made is disregarded.

Example 3: racing activities integrally related – carrying on a business of training horses

162. Rob runs a race horse training business and has a substantial amount of land that he uses in the business. The land is situated in an environmentally suitable area for horse raising and is close to major breeding studs. On this land, he has established a racetrack, spelling paddocks and stables for the horses he trains. He has 26 horses in work on his property and permanently employs two apprentice jockeys in his business, along with other contractors (farriers and handlers), as required. Rob enters into contracts with horse owners to provide training services in return for a daily fee, which covers training expenses. Other costs, such as veterinary and farrier fees, are on-charged. Rob sets his fee and invoices it on a monthly basis. Rob owns a 20% interest in 17 of the racehorses that he trains in his business. Rob believes it is important to hold a share in the horses he selects for his client groups as a sign of good faith.

163. The racing of the horses in which he has an interest would be seen as an integral part of the horse training business carried on by Rob. It is not a separate activity and its object is in the furtherance of the objectives of the horse training business.

164. Therefore, any amounts he receives as winnings from his interests in the horses raced are assessable as ordinary income and associated expenses are deductible. Rob's interests in the horses are depreciating assets of his business and Rob is using his interest in the horses for a taxable purpose (to earn assessable income). Rob can deduct an amount for the decline in value of his interest in the horses that he owns as a joint holder.

165. When these interests are disposed of by Rob, he will usually either have an amount included in his assessable income or an amount that is deductible under section 40-285 as a balancing adjustment amount. Rob's use of the horses means that they are not trading stock for the purposes of Division 70. The interests in the horses are also CGT assets. However, as Rob is using his interest in the horses entirely to earn assessable income as part of his business, CGT event K7 will not happen.

Example 4: racing activities integrally related – carrying on a business of training horses

166. Assume the same facts as in Example 3 except that Rob also owns three horses in his own right that he races. These horses are from quality bloodstock and Rob's extensive knowledge of horse conformation and potential leads him to believe that they are a good proposition to train successfully and will enhance his reputation as a trainer.

167. The racing of such horses by Rob does not amount to the carrying on of a separate business of the racing of horses. However, his knowledge and reputation in the industry, his intention to race horses to improve the reputation of his training business, the fact that the horses are from quality bloodstock and show appropriate potential are all factors that weigh in favour of a conclusion that the racing of these horses is integrally related to Rob's business of horse training.

168. Therefore, any amounts he receives as winnings from his horses raced are assessable as ordinary income and associated expenses are deductible. Rob's horses are depreciating assets and Rob is using his horses for a taxable purpose (to earn assessable income). Rob can deduct an amount for the decline in value of his horses that he owns.

169. When these horses are disposed of by Rob, he will either have an amount included in his assessable income or an amount that is deductible under section 40-285 as a balancing adjustment amount. Rob's use of the horses means that they are not trading stock for the purposes of Division 70. Each horse is also a CGT asset. However, as Rob is using the horses entirely to earn assessable income as part of his business, CGT event K7 will not happen.

Example 5: the breeding of horses – not carrying on a business

170. Harry currently has 25 horses on hand. Most of these horses are not from quality bloodstock and have so far showed limited potential on the racetrack. Four potential broodmares have been identified for later breeding. There are two broodmares on hand, each with a foal-at-foot (one is a colt and one is a filly). Harry intends to race the foals from these broodmares.

171. The horses that Harry offers for sale are those horses that he has raced that are nearing the end of their effective life on the racetrack or are found to be unsuccessful and of limited ability on the racetrack. His most successful horse on the racetrack has never been offered for sale. No progeny bred from his own horses have been sold.

172. Harry is not carrying on a business of racing because he does not satisfy the general indicators. Harry is also not carrying on a business of the breeding of horses as the general indicators in relation to the carrying on of a business do not apply either. Harry only has two broodmares that are active in breeding activities. Both of these horses are not from quality bloodstock. None of their progeny has been sold. It is Harry's intention to race the foals he has bred, including the colt. Commercial studs have a practice of retaining some fillies on the basis that mares which have had a successful racing career are likely to produce valuable progeny, so the fillies are retained and raced and later taken into the broodmare stocks as a valuable breeding asset. In these circumstances, the racing of the filly may be regarded as part of the activities of the stud. However, in Harry's case, although large in quantity, his horses are of an average standard and have shown limited promise on the racetrack. It is a high risk strategy to retain and race the filly. As the colt bred is also of average quality, the fact that he is keeping it and racing it is persuasive that Harry is not carrying on a business of racing.

173. Harry has experienced six years of losses from his activities. Harry does not carry out his breeding activities in the same manner as that of the ordinary trade of a stud; he has no sales from his own broodmares; he does not intend to sell his colt; his broodmares are of average quality and are mated to average quality stallions. There is little commercial purpose or character, nor any prospect of profit from the activity. The breeding activities are not carried on in a businesslike manner such that they are directed at making a profit. Considered objectively, Harry's activities, taken as a whole, do not indicate that he is carrying on a business.

174. Harry's racing activities are no more than can be expected from a person vigorously pursuing a hobby or pastime. Whatever attempts were made by Harry to breed racehorses are ancillary to his racing hobby or pastime and bear the same character. The sale of rejected animals, although great in number, is no more than an incident of Harry's racing of them. It does not amount to a breeding business.

Example 6: the breeding of horses – carrying on a business

175. Max-Win Stud breeds horses. They offer yearlings, mares and weanlings for sale to the general public. Each season they sell the majority of these horses through the major sales yards. Last year, they sold 12 foals through the public sales yards and a further two in private sales before the major sales. Occasionally, they may keep a filly for future breeding purposes.

176. The stud does not maintain any geldings or barren mares which are inappropriate for breeding. If the stud purchases a race filly, it must have proven itself on the racetrack before it will be used as a broodmare at the stud. Max-Win currently has three proven sires standing at the stud and has recently added a further unproven black type champion stallion to its roster.

177. There are currently 50 mares in residence at the stud. 17 of these are broodmares that belong to the stud and the remainder are mares owned by individual breeders. Max-Win Stud prides itself on their bloodlines and their 17 broodmares have produced 30 group winners. Because of this, they experience extremely strong, high value sales at the sales yards.

178. Max-Win Stud employs a stud manager to manage their breeding portfolio. They also employ a pedigree manager to assist with stallion selection, stallion nominations and the marketing of their bloodstock. Another manager is employed to oversee the preparation of the yearlings for sale. The stud also employs veterinary staff, stable hands, grooms and administration staff.

179. Max-Win Stud is carrying on a business of the breeding of horses. This is because the general indicators in relation to the carrying on of a business are evident and the specific industry guidelines in relation to the carrying on of the breeding of horses are also evident.

180. Their level of activity has a significant commercial purpose. There is a purpose of profit as well as a prospect of profit from their activities because of the care they take in planning, managing and marketing the quality and number of their bloodstock. The activity is carried out in a systematic and organised manner with the regular selling of their stock to the general public. It relies more on efficient business planning, rather than chance, to be successful. The size, scale and permanency of the activity indicate a business is being carried on.

181. Therefore, the horses used by Max-Win Stud are not depreciating assets. They are trading stock of the business. As the horses are trading stock, any capital gain or loss Max-Win Stud makes from a CGT event that happens to a horse is disregarded. Any proceeds from the use of the horses by Max-Win Stud, including any winnings from any of their horses raced, are assessable as ordinary income. The costs of the maintenance and the development of the horses are deductible as a revenue expense. The stud will account for any changes in trading stock using their live stock accounts under Division 70.

Example 7: racing activities not integrally related – carrying on a business of horse breeding

182. Imogen is carrying on the family tradition of breeding thoroughbred horses. She currently has a number of very well-bred broodmares. All of the mares have strong pedigrees and are always mated to successful commercial stallions.

183. Imogen has her own property in a geographic location well suited to horse breeding. It is accepted Imogen is carrying on a business of horse breeding.

184. A close friend approaches Imogen to share in the purchase of a three year old gelding which they will race together. The gelding has no relation to any of Imogen's broodmares.

185. The racing of the gelding lacks the integral relationship with Imogen's breeding activities. Consequently, the racing of the horse is a mere hobby and is not associated with her business of breeding. The amounts derived from the racing of the gelding are not assessable income under section 6-5 and the losses and outgoings incurred in the purchase of the gelding and in the maintenance and the development of the gelding are not deductible under section 8-1.

Appendix 3 – Detailed contents list

186. The following is a detailed contents list for this Ruling:

References

Previous draft:

TR 2007/D9

Related Rulings/Determinations:

TR 97/11; TR 2001/14;
TR 2006/10

Previous Rulings/Determinations:

TR 93/26

Subject references:

- capital gains tax
- carrying on a business
- deductions and expenses
- producing assessable income
- trading stock
- uniform capital allowances system

Legislative references:

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- Case E22 73 ATC 168
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- Ferguson v. Federal Commissioner of Taxation (1979) 26 ALR 307; (1979) 37 FLR 310; 79 ATC 4261; (1979) 9 ATR 873;
- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1
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- Martin v. Federal Commission of Taxation 90 CLR 470
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- Richardson v. Federal Commissioner of Taxation (1997) 80 FCR 58; 97 ATC 5098; (1997) 37 ATR 452
- Riddle v. Federal Commissioner of Taxation (1952) 5 AITR 225; (1952) 9 ATD 391
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- Shepherd v. Federal Commissioner of Taxation (1975) 26 FLR 385; 75 ATC 4244; (1975) 5 ATR 646
- Stone v. Federal Commissioner of Taxation (2003) 130 FCR 299; [2003] FCAFC 145; 2003 ATC 4584; (2003) 53 ATR 214

Other references:

- Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001

ATO references

NO: 2006/12059
ISSN: 1039-0731

ATOlaw topic: Income Tax ~~ Assessable income ~~ carrying on a business
Income Tax ~~ Assessable income ~~ derivation of income
Income Tax ~~ Assessable income ~~ primary production income
Income Tax ~~ Capital allowances ~~ balancing adjustments - balancing adjustment amount
Income Tax ~~ Capital allowances ~~ balancing adjustments - balancing adjustment event
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